



ONTARIO
BAR ASSOCIATION
A Branch of the CANADIAN BAR ASSOCIATION

Taxation Issues in Acquisition Transactions – A Practical Review

**Additional Issues With Respect To an Asset Acquisition:
Election Documents in a Closing - Precedent Materials
and Advice**



James A. Hutchinson
Miller Thomson LLP

Thursday, March 27, 2008

Ontario Bar Association
Continuing Legal Education





Additional Issues With Respect To an Asset Acquisition:
Election Documents in a Closing – Precedent Materials and Advice
James A. Hutchinson

Introduction

The purpose of this paper is to set out the requirements and implications of certain elections under both the *Income Tax Act*¹ (the “ITA”) and the *Excise Tax Act*² (the “ETA”) that are relevant to transactions involving the acquisition of assets. Discussion and analysis focuses on the following:

1. Elections under section 167 of the ETA;
2. Elections under section 156 of the ETA;
3. Elections under section 22 of the ITA;
4. Sale of Inventory;
5. Elections under subsection 20(24) of the ITA; and
6. Allocations and elections under proposed section 56.4 of the ITA.

In addition, sample clauses and forms corresponding to the elections listed above are provided in the appendices.

1. Section 167 Election

The section 167 election of the ETA eliminates the need to pay GST on the sale of all or substantially all of the assets of a business when certain conditions are met. The election can be used when parties are either selling an established business, a distinct or discrete part of the business, or a newly established business. The vendor and purchaser must jointly elect to use the section 167 election which deems the purchaser to have acquired the assets for nil consideration. Subsection 167(2) of the ETA treats the disposition of assets on death in a similar manner.

¹ *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.)

² *Excise Tax Act*, R.S.C. 1985, c. E-15

Qualifying for the Election

The following conditions are necessary to qualify for the section 167 election:

1. The vendor makes a supply of a business or part of a business.
2. One of the following must apply:
 - (a) Business was carried on or established by vendor; or
 - (b) Business was carried on or established by another and acquired by vendor
3. The purchaser is acquiring ownership, possession, or use of all or substantially all of the property reasonably regarded as necessary for the operation of a business or part of a business.
4. One of the following must apply:
 - (a) The vendor is not a registrant and the purchaser is a registrant
 - (b) The vendor and the purchaser are registrants
 - (c) The vendor and the purchaser are not registrants

“Business” is defined broadly in section 123 of the ETA and includes, “a profession, calling, trade, manufacture of any kind whatever,” whether for profit or not. Assets usually include inventory, equipment, real property and intangibles and will vary depending on the nature of the business. The election applies when a vendor is selling a business or a part of a business. Generally, it will be clear when the vendor is selling the entire business. Difficulties will arise when the vendor is selling only a “part of a business.” CRA has interpreted “part” to mean a functionally and physically discrete and separate operating unit from the rest of the business. As such, the sale of a single asset will usually not qualify for the sale of part of a business. Nevertheless, CRA’s interpretation may not be supported in law.

CRA has also taken the position that “all or substantially all of the property” means at least 90% of the business. CRA has excluded accounts receivable, cash, debt, and capital stock from calculating this 90% minimum as these are either not considered to be needed to carry on business or property. Legally, though, this is a qualitative test and CRA’s position may instead

be used as a guideline. In *547391 Alberta Ltd. V. The Queen*³, the court held that it was Parliament's intent to have a flexible test and therefore did not include a set percentage in the provision. Although it was discussing a similar type of provision, the same argument can apply to the section 167 provision. Moreover, CRA does not indicate what to use to calculate this 90% requirement and, hence, it is questionable whether to use the book value, fair market value, acquisition cost or another measure. Finally, the purchaser can use all the property acquired, whether it be by ownership, possession or use, to determine if all or substantially all of the property was transferred, but may still have to pay tax on some of that property. For example, if the property was transferred by way of lease, the leased property would be used to determine what was acquired but the subsequent lease payments would be taxed.

Exclusions

The section 167 election has certain exclusions enumerated in subsection 167(1.1)(a) of the ETA. Generally, taxable supplies of an ongoing nature which will continue after the transaction is completed do not qualify for the election. Also, a taxable sale of real property to a non-registered purchaser and taxable supplies of property using leases, licenses, or other arrangements, e.g. franchises or royalties, are also excluded. Finally, the election contemplates property acquired under "the agreement for the supply of the business or part." As multiple purchasers or multiple agreements will preclude the election from applying, transactions should be structured to transfer all assets in one agreement.

Advantages and Disadvantages

The vendor has little incentive to use this election as there are no advantages and many disadvantages. One such disadvantage is the loss of the cash flow benefit of collecting the GST and offsetting any GST already paid out. More importantly, though, is that the vendor is liable for tax, interest and penalty for non-collection of GST if the election is not-applicable, not filed, or not filed on time. Therefore, it is always prudent for the vendor to obtain an indemnity from the purchaser for any tax, interest, and penalty that may have to be paid and to obtain an undertaking that the form will be filed by the purchaser in a timely manner.

³ *547391 Alberta Ltd. V. The Queen*, 2003 GTC 713

The purchaser's main incentive to use this election is the cash flow benefit as GST paid on the sale if the election was not used would be returned in input tax credits. A disadvantage of using the election is that the change-of-use rules may apply if a purchaser will not be using the assets in a commercial activity. If this is the case, the purchaser may have to self-assess and pay GST, or deal with a GST assessment. In this scenario, the GST should be paid up front by the purchaser to the vendor. Also, the election should not be used if the purchaser is entitled to less than 100% ITCs as there is no benefit.

As the vendor and purchaser have conflicting interests, the election may be a point of contention in the negotiation of a transaction. An advanced ruling can be requested from CRA which may help the parties come to a resolution. A difficulty with this, however, is that the response may not be delivered in a timely manner.

Election Form

GST Form 44, "*Election Concerning the Acquisition of a Business or Part of a Business*" must be filed by the purchaser with the first GST return following the completion of the transaction. The purchaser must ensure that all property is listed correctly and described fully in the form. The vendor should ask for a copy of the form from the purchaser to keep with their records. If both the vendor and the purchaser are not registrants, the form does not need to be filed but must be kept in the books and records of the parties.

NOTE:

- See Appendix I for sample Form 44
- See Appendix II for sample clause in respect of Section 167 Election

2. Section 156 Election

The election under subsection 156(2) of the *Excise Tax Act* is intended to cover ongoing supplies between closely related persons, contrary to the section 167 election which is intended to cover transfers of assets between arm's length parties. Specified members of a qualifying group must jointly elect to use the section 156 election, which deems sales of taxable supplies used in commercial activities as being made for nil consideration. Normally, corporations are not taxed on transfers of supplies within its separate divisions. This election treats comparable transfers

between related corporations or partnerships in a similar manner to obtain the same cash flow benefits.

Qualifying for the Election

The following definitions establish some of the criteria to qualify for the section 156 election. A "qualifying group" is a group of corporations, a group of Canadian partnerships, or partnerships and resident Canadian corporations each of which is related to the other⁴. As prescribed in the section 128 definition of "closely related," corporations will be considered to be in a related group if they are resident and registered in Canada and have 90% common ownership^{5,6}.

Pursuant to a recent change in the ETA, two sister corporations are considered to be related even if the parent is a non-resident of Canada⁷. Previously, all three corporations needed to be GST registrants and residents of Canada. Furthermore, the section 156 definition of "specified member" states that the parties of the group must use all or substantially all of the property to make taxable supplies. If the corporation does not have property the test is whether all or substantially all of the supplies are taxable supplies, or, in other words, made in the course of commercial activities. Finally, the election is not available to those parties who make a section 150 election.

Exceptions

There are two exceptions to the section 156 election. Firstly, the election will not apply to the sale of real property between related groups^{8,9}. Secondly, the election will not apply to the supplies of property or service not acquired for the consumption, use or supply in commercial activities. For example, the election will not be available to financial institutions.

⁴ S. 156(1), "qualifying group" and s. 156(1.1), "closely related persons"

⁵ Corporations must be related via corporations or partnerships, not individuals

⁶ S.128(1)(a) prescribes that will take into account value and number of issued and outstanding shares of capital stock of other corporation, having full voting rights, to determine if the parties have 90% common ownership

⁷ S. 128(2). Note: The similar provision when dealing with related partnerships and corporations is s. 156(1.2)

⁸ When dealing with real property, the section 156 election may only apply to commercial real property rentals.

⁹ Supplies of real property between registrants are subject to subsection 221(2) which states the vendor does not need to collect tax.

Reorganization of a Corporation

Generally, the section 156 election cannot be used in a start-up business other than in a situation of an income tax "butterfly" transaction. Also, caution must be used if the election is being used in a partial asset sale between closely related groups. For instance, the election cannot be used in a reorganization where a Newco is created to facilitate the transaction but does not carry on business and is amalgamated or wound up as part of the transaction.

If a new purchaser corporation created to facilitate a reorganization wants to use the election, technically it will still have to comply with the section 156 requirements. Therefore, it is advisable that the new corporation register, acquire property to meet the "all or substantially all" test described above (commonly satisfied by purchasing office supplies) and that sufficient effort is made to make taxable supplies prior to the transfer.

Election Form

The election form, GST 25, "*Closely Related Corporations and Canadian Partnerships - Election or Revocation of the Election to Treat Certain Taxable Supplies as having been made for Nil Consideration*" does not need to be filed but must to be kept in the books and records of the parties. The form must be kept as long as the election is in effect and for six years after the election ceases to be in effect. The election remains in effect unless one of the parties ceases to qualify or the parties themselves jointly elect to have it revoked¹⁰. Finally, even though the election will usually be used by only two parties, the form allows for more than two specified members to make the election. If two or more members make the election, each member is considered to have elected with every other member and the election applies to supplies made between each and every member¹¹.

NOTE:

- See Appendix III for sample Form 25
- See Appendix IV for sample clause in respect of Section 156 Election

¹⁰ S. 156(3) ETA

¹¹ For example, if three members are listed, the election applies to supplies between 1 and 2, 1 and 3, and 2 and 3.

3. Section 22 Election

On the sale of a business, accounts receivable are often included among the assets involved in the transaction. In the normal course of business, specific receivables create income or deductible losses; however, when a business is sold, accounts receivable may be considered capital, which could result in either a capital gain or loss in an amount equal to the difference between the purchase price and the face value of the receivables. Section 22 of the Act provides for a joint election by the vendor and purchaser to avoid these tax consequences (the "Section 22 Election"). The Section 22 Election benefits both the vendor and purchaser.

Vendor

The Section 22 Election allows the vendor to claim a deduction equal to the difference between the face value of the accounts receivable and the allocated portion of the purchase price. Any loss is not affected by any reserve for doubtful debts, regardless of whether such reserve has been previously allowed as a deduction under section 20(1)(l) of the Act.

Purchaser

For the purchaser, the accounts receivable are treated as having been included in computing the purchaser's income for the taxation year of the transaction (or a previous taxation year) enabling the purchaser to claim either an allowance for doubtful debts (pursuant to section 20(1)(l)) or a bad debt write-off (pursuant to section 20(1)(p)). Basically, the Section 22 Election allows the purchaser, for tax purposes, to deal with the accounts receivable as though they had arisen while the purchase was the owner of the business.¹²

Qualifying for the Election

In order to be able to make the Section 22 Election, the following conditions must be satisfied:

¹² It should be noted that a receivable that the vendor previously deducted under section 20(1)(p) cannot be deducted by the purchaser. Conversely, if the purchaser collects a receivable that was previously deducted by the vendor under section 20(1)(p), it must be included in income.

- (a) The transaction must provide for the sale of all or substantially all of the property used for carrying on the business being sold.¹³
- (b) All the outstanding accounts receivable of the vendor at the time of the sale must be among the assets being sold.
- (c) The accounts must relate to a business carried on in Canada by the vendor or subject to tax in Canada on income generated by the accounts receivable.
- (d) The purchaser must propose to continue the business carried on by the vendor.
- (e) Both the vendor and the purchaser must jointly file the Section 22 Election in prescribed form (i.e. Form T2022) with their tax return for the year of the sale.¹⁴

When filing the Section 22 Election, Form T2022, submitted by the vendor and purchaser, must set out the portion of the purchase price of the business allocated to accounts receivable; however, if the agreement of purchase and sale for the business does not specifically allocate a portion of the purchase price, a reasonable allocation should be made between accounts receivable and other assets included in the sale. This amount is considered final for tax purposes and cannot be amended after being filed.

NOTE:

- See Appendix V for sample Form T2022
- See Appendix VI for sample clause in respect of Section 22 Election

4. Sale of Inventory

Subsection 23(1) of the ITA deems that sale of inventory as part of the purchase and sale of a business as having been sold by the taxpayer in the course of carrying on the business. There is no election that needs to be filed. This does not require the sale of all of the inventory. The effect of this subsection is that any gain realized on the sale will be included in the vendor's income as regular income.

¹³ According to IT-188R – *Sale of accounts receivable*, “[w]here 90% of the assets of the business carried on in Canada are sold, all or substantially all of the assets of such business will be considered sold.”

¹⁴ References to “year” and “taxation year” in subsection 22(1) refer to the fiscal period of a business.

5. Subsection 20(24) Election – Future Obligations

In the normal course of business, the situation may arise where a vendor has included an amount in its income for payment received for goods or services to be provided at some later time.¹⁵

Subsection 20(24) of the ITA provides that if the vendor provides reasonable consideration (i.e., pays a reasonable amount) to the purchaser for the assumption of the future obligation, then the vendor may deduct such payment from its income, with the purchase required to include the payment in its income for the year (the “Subsection 20(24) Election”).

Subsection 20(24) relates to income inclusions pursuant to section 12(1)(a) of the Act, which contemplates amounts received in the year in the course of business for future income or the prospective obligation to deliver goods or services. Subsection 12(1)(a) also requires taxpayers to include in income amounts received throughout the year in the course of business any amounts to be repaid by customers as a result of the return or resale to the taxpayer of goods previously delivered. This means that subsection 20(24) applies to more than just amounts paid to a purchaser for assuming future obligations to deliver goods or services. If an income inclusion is made pursuant to subsection 12(1)(a) in a particular year, the taxpayer is entitled to a reserve under subsections 20(1)(m) or 20(1)(m.1) of the ITA for that year.

Vendor

From the vendor’s perspective, the Subsection 20(24) Election presents the obvious and immediate advantage of an income deduction, otherwise the vendor is barred from deducting any amount from income. However, if the Subsection 20(24) Election is made, the vendor cannot claim any further reserves under paragraph 20(1)(m) or 20(1)(m.1).

Purchaser

Basically, for assuming the vendor’s contractual obligation to deliver goods or services some time in the future, the purchaser receives an adjustment to the purchase price that reflects the

¹⁵ The vendor would have included the full price of the goods or services under subsection 12(1) of the Act and claimed a reserve for the goods or services to be provided after the year end under subsection 20(1)(m) of the Act; although, a deduction under subsection 20(24) can be claimed in any subsequent taxation year in respect of an amount previously included in income under paragraph 12(1)(a) even when no reserve was claimed under paragraph 20(1)(m) or 20(1)(m.1) in respect of the amount.

assumption of liability. As this does not usually involve express consideration, the amount for the purposes of subsection 20(24) should be an amount allocated from the total purchase price for the cost to the purchaser for assuming the vendor's obligations.

If the Subsection 20(24) Election is not made, the purchaser forgoes the opportunity to deduct from income any expenses incurred to perform the vendor's obligations, since they would likely be considered a capital outlay related to the purchase of the business and not costs incurred for the purpose of earning income (as such the vendor has already earned such income). Rather than there being an income inclusion to the purchaser, the assumption of any future obligation by the purchaser to provide goods or service would form part of the consideration for the purchased assets.¹⁶

When faced with the choice to make the Subsection 20(24) Election, the purchaser is left with a more difficult decision because the disadvantages of the immediate income inclusion are only offset by the ability to deduct expenses related to delivering the future goods or services and to claim reserves¹⁷ – the income inclusion and corresponding tax burden may outweigh any benefits of the deduction. Purchasers need to be particularly aware in circumstances where the income inclusion is high as compared to the projected deductible costs, which is typically the case where the costs of the future delivery of the goods or services are relatively low, but the customer's costs are high, and all or most of the income from the future obligation has been transferred to the purchaser. With that said, purchasers should be alert to situations where costs match or exceed the income inclusion as the excess deduction made available by the Subsection 20(24) Election may provide advantageous tax planning opportunities. While the Subsection 20(24) Election will tend to always benefit vendors, the decision to elect by purchasers should be considered carefully in consultation with legal and accounting advisors to ensure optimal results.

To avail themselves of the Subsection 20(24) Election, the vendor and purchaser must jointly file an election that is due by the earlier of the two parties' deadlines for filing of income tax returns

¹⁶ However, by filing a Subsection 20(24) Election, the purchaser becomes entitled to deduct from income any costs incurred in undertaking and performing the vendor's future obligations.

¹⁷ If the Subsection 20(24) Election is made, while the purchaser acquires the ability to claim the corresponding reserves (under paragraph 20(1)(m) or 20(1)(m.1)) related the income inclusion from the election.

for the year in which sale of the business took place. As there is no prescribed form for the Subsection 20(24) Election, the vendor and purchaser should agree on the manner in which the election will be made. This typically involves a letter being attached to the appropriate tax return.

NOTE:

- See Appendix VII for sample clause in respect of Subsection 20(24) Election

6. Sections 56.4 and 68 – Non-competition Agreements

In the wake of the decisions of the Federal Court of Appeal in *Fortino* and *Manrell*,¹⁸ the Federal Department of Finance (“Finance”) has proposed amendments to the ITA (“New Section 56.4”) so that payments received or receivable by a taxpayer after October 7, 2003 in respect of non-competition agreements (and other restrictive covenants) will be taxable as ordinary income, with certain exceptions provided.¹⁹

Non-competition agreements fall within the broad definition of “restrictive covenant” contained in proposed subsection 56.4(1). In turn, consideration for such agreements will be subject to the new default income inclusion rule proposed in subsection 56.4(2) (the “Income Inclusion Rule”). Subsection 56.4(2) provides that amounts received or receivable in a year in respect of a non-competition agreement are to be included in the grantor’s income. In the context of a purchase and sale of a business, the vendor (or a related individual) may covenant to not compete with the purchasers of a business, which typically involves agreeing not to provide property or services in competition with the business being bought for a specified time period within defined geographical boundaries.

¹⁸ *Fortino v. The Queen*, 2000 DTC 6060 (FCA); *Manrell v. The Queen*, DTC 5225 (FCA): In these decisions, the Federal Court of Appeal held that payments received by a taxpayer for entering into a non-competition agreement were not income from a source and therefore were not taxable.

¹⁹ It is important to note that, still after nearly five and a half years, legislation to implement the proposed amendments has yet to be enacted. However, Bill C-10 (which contains the current version of the amendments) was passed in the House of Commons on October 29, 2007, has received second reading in the Senate, and is currently under review by the Committee on Banking, Trade and Commerce. A date for Royal Assent is uncertain.

Finance also proposed an amendment to section 68 of the ITA ("Subsection 68(c)") to provide for the allocation of consideration where a portion received or receivable can reasonably be regarded as an amount in respect of a restrictive covenant granted by a taxpayer. Under Subsection 68(c), the portion of the consideration attributable to the restrictive covenant is deemed to be received or receivable by the grantor and paid or payable by the person to whom the restrictive covenant was granted.²⁰ Thus, it is not possible to avoid the rules provided in subsection 56.4(2) by simply failing to allocate an amount to a restrictive covenant that is otherwise part of a transaction.

While Subsection 68(c) reinforces subsection 56.4(2), exceptions to the Income Inclusion Rule are provided. There are several exceptions contained in proposed subsection 56.4(3) with respect to consideration for restrictive covenants in the context of an arm's length transaction²¹, including:

1. Amounts included in computing the grantor's employment income for the year (or would otherwise be included if received in the year).
2. Dispositions of eligible capital property (e.g., goodwill) where the vendor and purchaser jointly elect to treat any payment in respect of a restrictive covenant as forming part of the proceeds for the eligible capital property.
3. In the case of amount, which satisfy the following conditions:
 - (a) the amount directly relates to the vendor's disposition of a capital property that is an "eligible interest"²² in the partnership or corporation that carries on the business to which the covenant relates (or of a holding company that owns shares of the corporation that carries on the business)²³,

²⁰ Subsection 68(c) can apply even in situations where the parties have not allocated any consideration for the restrictive covenant. It should be expected that CRA will assume that a portion of the proceeds from the sale of a business should always be regarded as consideration for a non-competition agreement, if one is provided.

²¹ It should be noted that the exceptions in proposed subsection 56.4(3) only apply to amounts received or receivable by the grantor of the restrictive covenant and not by a non-arm's-length person.

²² Pursuant to subsection 56.4(1), "eligible interest", of a taxpayer, means a capital property of a taxpayer that is: (1) a partnership interest in a partnership that carries on a business; (2) a share of the capital stock of a corporation that carries on a business; or (3) a share in the capital stock of a corporation 90% or more of the fair market value of which is attributable to eligible interest in one other corporation.

²³ It should be noted that proposed subsection 56.4(3)(c) applies to the sale of holding company shares by the grantor of the restrictive covenant. However, since 90% or more of the FMV of the holding company's assets must be attributable to the shares of the operating company, it may be necessary to distribute redundant assets

- (b) the covenant is a non-competition covenant,
- (c) it is granted to the purchaser of the eligible interest (or a related person), and
- (d) subsection 84(3) does not apply to the disposition

the vendor and purchaser may jointly elect to treat the amount as additional proceeds of disposition of the eligible interest, with the maximum claimable amount as additional proceeds being the incremental increase in the FMV of the eligible interest attributable to the granting of the restrictive covenant.

By virtue of proposed subsection 56.4(4), the applicability of any of the above exceptions will result in tax treatment to the purchaser that will essentially mirror that of the vendor.

Exceptions to section 68 are found in proposed subsections 56.4(6) and (7), which also extend the Income Inclusion Rule. According to proposed subsection 56.4(6), section 68 will not apply to a restrictive covenant granted by an individual if:

1. the restrictive covenant is granted to a person at arm's length to the individual;
2. the restrictive covenant directly relates to the acquisition, by a purchaser from a vendor or vendor(s), of an interest in the individual's employer, in a corporation related to that employer, or in a business carried on by that employer;
3. the individual deals at arm's length with the employer and the vendor(s);
4. the restrictive covenant is a non-competition covenant;
5. the individual does not receive (or will not receive) any proceeds for granting the restrictive covenant; and
6. any consideration for the restrictive covenant (reasonably regarded as such) is only received or receivable by the vendor(s).

This exception provides relief for certain employees who grant non-competition covenants as part of sale transactions.

prior to a sale to ensure the 90% test is satisfied. Moreover, this exception only applies to the sale of first-tier holding companies - multiple tiers of holding companies would need to be merged prior to a sale in order to have the exception apply.

Proposed subsection 56.4(7) also provides an exception to the application of section 68 to a restrictive covenant granted by a vendor, provided:

1. the restrictive covenant is granted to a person at arm's length to the vendor;
2. the restrictive covenant is a non-competition covenant;
3. the vendor does not receive (or will not receive) any proceeds for granting the restrictive covenant;
4. any consideration for the restrictive covenant (reasonably considered as such) is included by the vendor in computing a "goodwill amount"²⁴ or is received or receivable by a corporation that was an "eligible corporation"²⁵ of the vendor and included in the eligible corporation's goodwill amount for the business to which the restrictive covenant relates;
5. it is reasonable to consider that the restrictive covenant was granted to maintain or preserve the goodwill of the business; and
6. the vendor and purchaser jointly elect to have this exception apply.

This exception ensures that proposed subsection 56.4(2) will not apply on an asset sale where a 90% shareholder of the vendor corporation grants a restrictive covenant to the purchaser.

NOTE:

- See Appendix VIII for sample Election for Restrictive Covenants
- See Appendix IX for sample clause in respect of section 56.4

²⁴ See Definitions in proposed subsection 56.4(1): "Goodwill amount", of a taxpayer, is an amount that is received or receivable by the taxpayer as consideration for the disposition by the taxpayer of goodwill, and that is required by the description of E in the definition "cumulative eligible capital" in subsection 14(5) to be included in computing the cumulative eligible capital of a business carried on through a permanent establishment located in Canada. This definition is relevant for the purpose of determining whether new subsections 56.4(5) and (7) apply to provide an exception from the rule in section 68 that may deem a person who grants a restrictive covenant to receive an amount for the restrictive covenant.

²⁵ See Definitions in proposed subsection 56.4(1): "Eligible corporation" of a taxpayer means a taxable Canadian corporation of which, (1) the taxpayer holds, directly or indirectly, shares of the capital stock; and (2) taxpayers with whom the taxpayer does not deal at arm's length (determined without reference to paragraph 251(5)(b)) hold in aggregate, directly or indirectly, less than 10% of the issued share capital (votes and value). This definition is relevant for the purpose of determining whether new subsections 56.4(5) and (7) apply to provide an exception (for goodwill amounts) from the rule in section 68 that may deem a person who grants a restrictive covenant to receive an amount for the restrictive covenant.

Conclusion

Before any of the elections discussed above are undertaken, it is important that all of the parties involved in the transaction are aware of the availability of such elections and alert to the corresponding tax implications. Consideration must be paid to both the benefits and disadvantages of electing to ensure that the optimal planning results are achieved. To this end, agreements must be drafted accordingly and deadlines for filings must be observed. The availability of elections provides a number of opportunities to maximize the benefits of the intended results in asset acquisitions; however, the particularities and objects of a given transaction must always be considered to ensure that the available elections are optimized.

APPENDIX I

See next page for sample GST Form 44 for s. 167 election.



ELECTION CONCERNING THE ACQUISITION OF A BUSINESS OR PART OF A BUSINESS

A supplier and a recipient should use this form to jointly elect so that GST/HST does not apply to the supply of a business or part of a business.

For information on eligibility, see the back of the form or contact us at 1-800-959-5525.

If the supplier is a GST/HST registrant and the recipient is not a registrant, this election cannot be used.

| Part A - Identification (recipient) | | | |
|---|----------|------------------|-------------------------|
| Legal name | | Business Number | |
| Trading name (if different from legal name) | | | |
| Mailing address | | | |
| City | Province | Postal code | Telephone number () |
| Contact person | Title | Type of business | |

| Part B - Identification (supplier) | | | |
|---|----------|------------------|-------------------------|
| Legal name | | Business Number | |
| Trading name (if different from legal name) | | | |
| Mailing address | | | |
| City | Province | Postal code | Telephone number () |
| Contact person | Title | Type of business | |

| Part C - Eligibility | |
|--|--|
| 1. Does the property supplied by the supplier and described in part D below constitute a business or part of a business? | <input type="checkbox"/> Yes <input type="checkbox"/> No |
| 2. Does the recipient, under the agreement with the supplier, acquire the ownership, possession, or use of all or substantially all of the property required to carry on the business or part of the business? | <input type="checkbox"/> Yes <input type="checkbox"/> No |
| If the supplier answered Yes to question 1 and the recipient answered Yes to question 2 above, they can jointly elect to have the supply of the business or part of a business described in part D below not subject to GST/HST. | |

| Part D - Election | |
|---|--|
| Description of property acquired (if necessary, add on a separate sheet of paper) | |
| Enter the recipient's GST/HST reporting period in which the acquisition occurred: | From: Year Month Day To: Year Month Day |
| Enter the date the property was acquired by the recipient: | Year Month Day |
| <input type="checkbox"/> | We, the recipient and the supplier, jointly elect to have the supply of the business or part of the business described above not subject to GST/HST. |
| Note: This election is subject to the exclusions specified on the back of this form. | |

| Certification (recipient) | |
|--|--------------------------|
| I, _____, certify that the information given on this form and in any attached documents with respect to the person identified in Part A is, to the best of my knowledge, true, correct, and complete in every respect, and that I am the recipient or that I am authorized to sign on behalf of the recipient. | |
| Position | Signature Year Month Day |

| Certification (supplier) | |
|--|--------------------------|
| B is, to the best of my knowledge, true, correct, and complete in every respect, and that I am the supplier or that I am authorized to sign on behalf of the supplier. | |
| Position | Signature Year Month Day |

General information

Definitions

all or substantially all generally means 90% or more.

business includes a profession, calling, trade, manufacture or undertaking of any kind whatever, whether the activity or undertaking is engaged in for profit, and any activity engaged in on a regular or continuous basis that involves the supply of property by way of lease, licence or similar arrangement, but does not include an office or employment.

property means any property, whether real or personal, movable or immovable, tangible or intangible, corporeal or incorporeal, and includes a right or interest of any kind, a share and a chose in action, but does not include money.

recipient of a supply of property or a service means

- (a) when an amount is payable for the supply, the person who pays or agrees to pay for the amount;
- (b) when no amount is payable for the supply, and
- i) the property is sold, the person to whom the property is delivered or made available;
 - ii) the property is not sold (e.g., leased, rented, etc.), the person using the property, or who could use it, or to whom it is made available; or
 - iii) a service is rendered, the person to whom the service is rendered.

As a general rule, the recipient is the person to whom a supply is made.

registrant means a person who is registered, or who is required to be registered for GST/HST.

supplier (e.g., vendor) means the person making the supply.

supply means the provision of property or a service in any manner, including sale, transfer, barter, exchange, licence, rental, lease, gift, or disposition.

Eligibility

The supplier and the recipient can jointly make this election, so that the supplier does not have to collect and the recipient does not have to pay GST/HST on the supply of a business or part of a business, when they meet the following conditions:

- The supplier makes a supply of a business or part of it that was established or carried on by the supplier, or that was established or carried on by another person and acquired by the supplier.
- The recipient acquires ownership, possession, or use of at least 90% of the supplier's property necessary for the recipient to carry on the business or part of it.
- The supplier and the recipient are both registrants, non-registrants, or the supplier is a non-registrant and the recipient is a registrant.

Exclusions

This election does not apply to the following supplies:

- a taxable supply of a service to be rendered by the supplier;
- a taxable supply by way of lease, licence or similar arrangement; and
- a taxable sale of real property, if the recipient is not a GST/HST registrant.

Filing the election

A recipient who is a GST/HST registrant has to file this election form together with the GST/HST return for the reporting period in which the acquisition was made to the address specified on the GST/HST return.

Otherwise, this election form has to be kept with the recipient's records.

APPENDIX II**Sample clauses in respect of GST s. 167 Election**

- The Vendor and the Purchaser shall elect jointly pursuant to the provisions of subsection 167(1) of the *Excise Tax Act* by completing at or prior to Closing all prescribed forms and related documents in such manner as is prescribed, so that for purposes of the *Excise Tax Act*, no GST is payable in respect of the purchase and sale of the Purchased Assets. The Purchaser covenants that, at the time of Closing, it will file with Canada Revenue Agency, the joint election made under section 167 of the *Excise Tax Act* by registered mail, and will provide the Vendor with written confirmation of such filing.
- The Purchase Price does not include GST. The Vendor and the Purchaser will jointly execute in prescribed form (GST Form 44), and the Purchaser will file within the required time, elections as required under section 167(1) of the *Excise Tax Act* (Canada) so that no GST will be payable by the Purchaser with respect to the purchase and sale of the Purchased Business and the Purchased Assets. The Purchaser will be liable to the Vendor for and will indemnify the Vendor against any GST, interest or penalties assessed against the Vendor as a result of a determination that the said election was not available or because of the failure of the Purchaser to file the requisite election in a timely fashion.
- The Corporate Vendors and Newco shall file an election under Section 167 of the GST Legislation to exempt the purchase and sale of the Vendor's Assets from the GST Legislation. Newco shall indemnify the Corporate Vendors from any liability under GST Legislation as a result of the acquisition of the Assets.

APPENDIX III

See next page for sample GST Form 25 for the s. 156 Election



CLOSELY RELATED CORPORATIONS AND CANADIAN PARTNERSHIPS

Election or Revocation of the Election to Treat Certain Taxable Supplies as having been made for Nil Consideration

Corporations and Canadian partnerships that are specified members of a qualifying group can use this form to jointly elect to treat certain taxable supplies as having been made for no consideration. See the section "Description of the election" on page 4 for more information and the exceptions. Complete Parts A, B, and C of this form to make this election or Parts A and C to revoke it.

This form is based on proposed amendments to the Excise Tax Act that were announced on November 27, 2006.

For definitions and more information, see pages 3 and 4 of this form or call our Business Enquiries line at 1-800-959-5525.

Part A - Identification form with fields for legal name, business number, trading name, mailing address, city, province, postal code, contact person, title, telephone number, and signature.

Part A - Identification form with fields for legal name, business number, trading name, mailing address, city, province, postal code, contact person, title, telephone number, and signature.

Part A - Identification form with fields for legal name, business number, trading name, mailing address, city, province, postal code, contact person, title, telephone number, and signature.

Note: If more than three corporations or Canadian partnerships elect or revoke the election, use a photocopy of this form or additional forms to provide the information requested in Part A. This form is available on our Website at www.cra.gc.ca/forms.

Part B - Eligibility for the election

Each person must be a qualifying member or a temporary member to qualify as a specified member; only specified members in the same qualifying group are eligible to make this election. The definitions of these terms and others start on page 3.

Section 1. This section must be completed.

Check the boxes that apply:

- The registrant corporations resident in Canada and registrant Canadian partnerships identified as qualifying members in Part A and on any attached forms are members of the same qualifying group.
- None of the corporations identified as qualifying members in Part A and on any attached forms are party to an election to deem certain taxable supplies as supplies of financial services. (Check this box if all the members identified as qualifying members in Part A or on any attached forms are Canadian partnerships.)
- For each corporation or Canadian partnership, registrant and resident in Canada, identified as qualifying members in Part A and on any attached forms:
 - all or substantially all of the property of the corporation or Canadian partnership (other than financial instruments) was last manufactured, produced, acquired, or imported by the corporation or Canadian partnership for consumption, use, or supply exclusively in its commercial activities; or
 - if the corporation or partnership has no property (other than financial instruments), all or substantially all of the supplies it made were taxable.

If you checked all three boxes, the corporations and Canadian partnerships identified as qualifying members in Part A and on any attached forms are eligible to jointly make the election.

Section 2. This section has to be completed if there is at least one temporary member in the qualifying group.

Check the boxes that apply:

- The registrant corporations resident in Canada identified as temporary members in Part A and on any attached forms are members of a qualifying group but not qualifying members.
- None of the corporations identified as temporary members are party to an election to deem certain taxable supplies as supplies of financial services.
- The corporations identified as temporary members are to receive a supply of property in contemplation of a distribution made in the course of a reorganization from the distributing corporation that is a qualifying member in the same group.
- The corporations identified as temporary members do not carry on any business or have any property (other than financial instruments) before receiving the supply and the shares of the corporations are transferred on the distribution.

If you checked all four boxes, the corporations identified as temporary members in Part A and on any attached forms, that are to receive a supply of property in contemplation of a distribution made in the course of a reorganization, are eligible to jointly make the election with the qualifying members in the same qualifying group.

Complete Part C of this form.

Part C - Election or revocation of the election

Check one of the boxes below and enter the effective date of the election or revocation of the election:

- The corporations and Canadian partnerships identified in Part A of this form and on any attached forms jointly elect to treat taxable supplies made between them while the election is in effect as having been made for no consideration, with the following exceptions. The election does not apply to a supply of property or a service that is not acquired by the recipient of the supply for consumption, use, or supply exclusively in its commercial activities or to a sale of real property. If the recipient of the supply is a temporary member, the election also does not apply if a supply is not made in contemplation of a distribution in the course of a reorganization, as described in the *Income Tax Act*.

or

- The corporations and Canadian partnerships identified in Part A of this form and on any attached forms jointly revoke the election to treat certain taxable supplies made between them as having been made for no consideration.

Effective date of this election or revocation of the election:

| | | |
|------|-------|-----|
| Year | Month | Day |
| | | |

General information

Definitions

All or substantially all generally means 90% or more.

Canadian partnership means a partnership each member of which is a corporation or partnership and is resident in Canada.

Commercial activity means a business or an adventure or concern in the nature of trade carried on by a person, but does not include the making of exempt supplies. It also includes the supply of real property by a person, other than an exempt supply, and anything done in the course of making the supply or in connection with the supply.

A commercial activity does not include a business or an adventure or concern in the nature of trade carried on without a reasonable expectation of profit by an individual, a personal trust, or a partnership where all the members are individuals.

Distribution has the meaning assigned by subsection 55(1) of the *Income Tax Act*. A distribution for the purposes of section 55 of the *Income Tax Act* means the direct or indirect transfer of property of a corporation (referred to in section 55 as a "distributing corporation") to one or more of its corporate shareholders (referred to in section 55 as a "transferee corporation") such that each transferee corporation that receives property on the distribution receives its *pro rata* share of each type of property owned by the distributing corporation immediately before the distribution.

Exclusive in respect of the consumption, use, or supply of a property or service by a person (other than a financial institution) means all or substantially all of the consumption, use, or supply of the property or service. For a financial institution, **exclusive** in respect of the consumption, use, or supply of a property or service means 100% of the consumption, use, or supply.

Qualifying group means:

- a group of corporations, each member of which is closely related to each other member of the group; or
- a group of Canadian partnerships, or of Canadian partnerships and corporations, each member of which is closely related to each other member of the group.

To determine if corporations or Canadian partnerships are closely related, for the purposes of this election, to other corporations or Canadian partnerships, see the section "Meaning of closely related corporations and closely related Canadian partnerships."

Qualifying member of a qualifying group means a registrant corporation resident in Canada or a registrant Canadian partnership:

- that is a member of the qualifying group;
- that is not a party to an election to treat certain taxable supplies as supplies of financial services; and
- all or substantially all of the property of which (other than financial instruments) was last manufactured, produced, acquired, or imported by the corporation or partnership for consumption, use, or supply exclusively in its commercial activities, or if the corporation or partnership has no property (other than financial instruments), all or substantially all of its supplies are taxable.

Qualifying subsidiary of a particular corporation means another corporation not less than 90% of the value and number of the issued and outstanding shares of the capital stock of which, having full voting rights under all circumstances, are owned by the particular corporation, and includes:

- a corporation that is a qualifying subsidiary of a qualifying subsidiary of the particular corporation;
- where the particular corporation is a credit union, every other credit union; and
- where the particular corporation is a member of a mutual insurance group, every other member of that group.

Specified member of a qualifying group means:

- a qualifying member of the group; or
- a temporary member of the group. A temporary member of the group only qualifies as a specified member when it is to receive a supply of property in contemplation of a distribution made in the course of a reorganization described in subparagraph 55(3)(b)(i) of the *Income Tax Act* from the distributing corporation that is a qualifying member of the same group.

Note

Once the reorganization is complete, the temporary member must qualify as a qualifying member to be a specified member and eligible to make this election.

Temporary member of a qualifying group means a registrant corporation, resident in Canada:

- that is a member of the group but not a qualifying member;
- that is not a party to an election to treat certain taxable supplies as supplies of financial services;
- that receives a supply of property in contemplation of a distribution made in the course of a reorganization described in subparagraph 55(3)(b)(i) of the *Income Tax Act* from the distributing corporation that is a qualifying member of the same group;
- that does not carry on any business or have any property (other than financial instruments) before receiving the supply; and
- that transfers its shares on the distribution.

Meaning of closely related corporations and closely related Canadian partnerships

Closely related corporations

In general, two corporations are considered to be closely related if at least 90% of the value and number of the issued and outstanding shares of the capital stock of one of the corporations, having full voting rights under all circumstances, are owned by:

- the other corporation;
- a qualifying subsidiary of the other corporation;
- a corporation of which the other corporation is a qualifying subsidiary;
- a qualifying subsidiary of a corporation of which the other corporation is a qualifying subsidiary; or
- any combination of the corporations or subsidiaries referred to above.

Closely related Canadian partnerships

A particular Canadian partnership and another Canadian partnership are closely related if all or substantially all of the interest in the other Canadian partnership is held by:

- the particular Canadian partnership;
- a corporation or a Canadian partnership, that is a member of a qualifying group of which the particular partnership is a member; or
- any combination of corporations or partnerships referred to above.

Two Canadian partnerships are also closely related to each other if one:

- owns at least 90% of the value and number of the issued and outstanding shares, having full voting rights under all circumstances, of the capital stock of a corporation that is a member of a qualifying group of which the other partnership is a member; or
- holds all or substantially all of the interest in a Canadian partnership that is a member of a qualifying group of which the other partnership is a member.

Closely related Canadian partnerships and corporations

A Canadian partnership is considered to be closely related to a particular corporation if one of the following applies:

- at least 90% of the value and number of the issued and outstanding shares, having full voting rights under all circumstances, of the capital stock of the particular corporation are owned by:
 - the partnership;
 - a corporation or a Canadian partnership, that is a member of a qualifying group of which the partnership is a member; or
 - any combination of corporations or partnerships referred to above;
- at least 90% of the issued and outstanding shares of the capital stock of a corporation that is a member of a qualifying group of which the particular corporation is a member are owned by the Canadian partnership, having full voting rights under all circumstances;
- at least 90% of the issued and outstanding shares of the capital stock of a corporation that is a member of a qualifying group of which the partnership is a member are owned by the particular corporation, having full voting rights under all circumstances;
- all or substantially all of the interest in the partnership is held by
 - the particular corporation;
 - a corporation or a Canadian partnership that is a member of a qualifying group of which the particular corporation is a member; or
 - any combination of corporations or partnerships that includes the particular corporation or another member of a qualifying group of which the particular corporation is a member;
- all or substantially all of the interest in a Canadian partnership that is a member of a qualifying group of which the partnership is a member is held by the particular corporation; or
- all or substantially all of the interest in a Canadian partnership that is a member of a qualifying group of which the particular corporation is a member is held by the partnership.

Persons closely related (as defined above) to the same person

Two corporations are considered closely related to each other for the GST/HST if they are each closely related to a third corporation.

A corporation and a Canadian partnership or two Canadian partnerships are considered closely related to each other for this election if they are each closely related to a third corporation or Canadian partnership, or would be considered to be closely related to the Canadian partnership if each member of that partnership were resident in Canada.

Interest in a partnership

For the purposes of this election, a person (corporation or partnership), or a group of persons, holds, at any time, all or substantially all of the interest in a partnership if at that time the person, or every person in the group, is a member of the partnership and the person is, or the members of the group collectively are, all the following:

- entitled to receive at least 90% of the total of all amounts, each of which is the share of the partnership's income from all sources that each of its members is entitled to receive for the last fiscal period (within the meaning of the *Income Tax Act*) of the partnership that ended before that time (or if the partnership's first fiscal period includes that time, for that period), or if the partnership has no income, the total of all amounts each of which is the share of the income of the partnership that each member of the partnership would be entitled to receive if the income of the partnership from each source were one dollar;
- entitled to receive at least 90% of the total amount that would be paid to all members of the partnership (other than amounts that would be paid as a share of partnership income) if it were wound up; and
- able to direct the business and the affairs of the partnership, or would be able to do so if no secured creditor had any security interest in an interest in, or the property of, the partnership.

Description of the election

When a specified member of a qualifying group jointly elects with another specified member of the group, certain taxable supplies made between them are considered to have been made for no consideration. (A corporation that has filed an election (Form GST27) to deem certain taxable supplies as supplies of financial services cannot make this election).

Exceptions

The following supplies are excluded from this election:

- a taxable supply from the sale of real property;
- a taxable supply of property or service that is not acquired for consumption, use, or supply exclusively in the commercial activities of the recipient; and
- a supply of property that is not made in contemplation of a distribution made in the course of a reorganization described in subparagraph 55(3)(b)(i) of the *Income Tax Act*, if the recipient of the supply is a temporary member.

Eligibility

Complete Part B on Page 2 of this form to determine if you are eligible to make this election.

Parties to this election

Every combination of eligible corporations and eligible Canadian partnerships whose names appear on this form and on any attached forms is considered to have made this election. For example, for a group with three electing members, if we number them 1, 2, and 3, the combinations would be:

- a) 1 and 2;
- b) 1 and 3; and
- c) 2 and 3.

Duration of the election

The election made jointly by two specified members of the qualifying group ceases to have effect on the earliest of:

- the day one of those members ceases to be a specified member of the qualifying group; or
- the day those members jointly revoke the election.

Books and records

You do not have to file this form with the Canada Revenue Agency. However, you must complete it and keep it with the books and records of the specified members making the election while an election is in effect, and for six years from the end of the year to which an election relates.

Need more information?

Call our Business Enquiries line at 1-800-959-5525.

APPENDIX IV

Sample clauses in respect of GST s. 156 Election

The Vendor and the Purchaser shall execute jointly an election in prescribed form under the provisions of section 156 of the *Excise Tax Act* (Canada) in respect of the purchase and sale of the Purchased Assets.

APPENDIX V

See next page for sample Form T2022.

APPENDIX VI**Sample clauses in respect of Section 22 Election: (“Income Tax Election”)**

- The Purchaser and the Vendor agree to elect jointly in the prescribed form under Section 22 of the Tax Act as to the sale of the accounts receivable and other assets that are referred to in Section ● and described in Section 22 of the Tax Act and to designate in such election an amount equal to the portion of the Purchase Price allocated to such assets pursuant to Section ● as the consideration paid by the Purchaser therefor. The price payable by the Purchaser to the Vendor for the accounts receivable described in Section ● includes all amounts (“**Tax Amounts**”) payable by the customers on account of GST and all other Taxes which the Vendor is required to collect from the customers in conjunction with such accounts and which the Vendor has remitted or is obliged to remit to the relevant taxing authority. All amounts collected by the Purchaser in respect of Tax Amounts shall be retained by it, and the Purchaser shall not be required to remit any part of the Tax Amounts to any taxing authority. The Vendor agrees to indemnify the Purchaser for any Tax Amounts and any interest and penalties thereon that may be assessed against the Purchaser and all costs and expenses which the Purchaser may incur in respect of any such assessment.
- The Purchaser and the Vendor shall, on the Closing Date, elect jointly in the prescribed form under Section 22 of the ITA as to the sale of the accounts receivable and other assets that are referred to in Section ● and described in Section 22 of the ITA and to designate in such election an amount equal to the portion of the Purchase Price allocated in Schedule ● to such assets as the consideration paid by the Purchaser therefor. The Purchaser and the Vendor shall each file such election with the Canada Revenue Agency after the Closing Date.

APPENDIX VII

Sample clauses in respect of Subsection 20(24) Election: (“*Amounts Paid For Undertaking Future Obligations*”)

- The Vendor and the Purchaser shall jointly execute and file an election under subsections 20(24) and 20(25) of the ITA and under the equivalent provisions of any other applicable Law, in the prescribed forms and within the time period permitted under the ITA and under any other applicable Law, as to such amount paid by the Vendor to the Purchaser for undertaking future obligations. In this regard, the Vendor and the Purchaser acknowledge that part of the Assets was transferred to the Purchaser as a payment by the Vendor to the Purchaser for the undertaking by the Purchaser of such future obligations of the Vendor to the Purchaser.
- The parties shall elect jointly pursuant to Subsection 20(24) of the *Income Tax Act* (Canada) with respect to deferred revenue arising from the operation of the Business in Canada, by completing and filing all prescribed forms and related documents in such manner and at such time as is prescribed.

Appendix VIII

See next page for sample Election for Restrictive Covenants.

Election for Restrictive Covenants

Grantor

Full name of grantor (print): _____

Social Insurance Number or Business Number: _____

Address:

Mailing Address, if different from above: _____

Grantor's taxation year in which the covenant is agreed to: _____

Purchaser

Full name of the purchaser (print): _____

Social Insurance Number or Business Number: _____

Address:

Mailing Address, if different from above:

Purchaser's taxation year in which the covenant is agreed to: _____

Information concerning the covenant

Provide a brief description of the transaction/covenant -- must be clear that the grantor is the grantor of the restrictive covenant, that the grantor is the recipient of the consideration and that the grantor deals at arm's length with the purchaser. Attach a separate sheet if necessary.

- day on which the restrictive covenant was agreed to: _____
- When the parties elect under paragraph 56.4(3)(b), the amount must be taken into consideration when computing the grantor's "cumulative eligible capital" in respect of the business. The amount paid or payable for the covenant is considered an outlay on account of capital by the purchaser for purposes of applying the definition of "eligible capital expenditure."
- When the parties elect under paragraph 56.4(3)(c), indicate that each of the five requirements in that paragraph are met:
 - (i) the amount directly relates to the grantor's disposition of an eligible interest: Yes _____ No _____
 - (ii) the disposition of the eligible interest is to the purchaser of the restrictive covenant or a person related that purchaser:
Yes _____ No _____
 - (iii) the amount is for an undertaking by the grantor not to provide property or services in competition with the purchaser or a person related to the purchaser:
Yes _____ No _____
 - (iv) the amount elected upon is the lesser of (A-B) and the consideration received by the grantor for the restrictive covenant, where
A is what the fair market value of the grantor's eligible interest would have been had all restrictive covenants been provided for no consideration and
B is what the fair market value of the grantor's eligible interest would have been had no covenants been granted by any taxpayer (including a partnership) that held an interest in the business
(A-B) = _____
Consideration received by grantor for covenant: _____

(v) the amount is included in the amount reported by the grantor as proceeds of disposition of the eligible interest:

Yes _____ No _____

Amount included in grantor's proceeds of disposition _____

Amount, if any, included in grantor's ordinary income _____

Statement and signatures confirming that the grantor and purchaser agree to make the election referred in paragraph _____ of the *Income Tax Act*, and that the elections will be filed in their respective tax returns for the taxation year in which they agree to the covenant.

Name and title of authorized person of the grantor (print):

Signature of grantor or authorized person:

Date: _____ Telephone: _____

Name and title of authorized person of the purchaser (print):

Signature of purchaser or authorized person:

Date: _____ Telephone: _____

APPENDIX IX

Sample clauses in respect of section 56.4: ("*Section 56.4 Election*")

- The Purchaser and the Vendor shall execute and file, on a timely basis and in the form prescribed (if available), a joint election to have proposed paragraph 56.4(3)(b) and paragraph 56.4(7)(f) (or such similar provision as finally enacted), as applicable, of the ITA apply to the amount of the Purchase Price attributable to the non-competition covenant provided with respect to the Business and shall prepare their respective tax returns consistent with such joint election. For the purposes of such joint election, the amount of the Purchase Price attributable to such non-competition covenant will be consistent with the Purchase Price allocation determined in accordance with this Agreement. The parties agree, on behalf of themselves and their Affiliates, to file all Canadian tax returns consistent with the portion of the Purchase Price allocated to the non-competition covenant.
- The Purchaser and Vendor agree to jointly execute and file on a timely basis and in the form prescribed (if available), a joint election pursuant to proposed section 56.4 (or such similar provision as finally enacted), as applicable, of the *Income Tax Act* (Canada) and shall prepare their respective tax returns consistent with such joint election.



Additional Issues with respect to an Asset Acquisition: Election Documents in a Closing

March 27th, 2008

James A. Hutchinson
Miller Thomson LLP
www.millerthomson.com

**MILLER
THOMSON** LLP
Barristers & Solicitors
Patent & Trade-Mark Agents

1



Elections

Excise Tax Act (ETA):

1. S. 167 Election – sale of assets
2. S. 156 Election – non-arm's length transactions

Income Tax Act (ITA):

3. S. 22 Election – accounts/receivable
4. Inventory
5. S. 20(24) Election – future obligations
6. Allocation of portions of a purchase price to Non-Competition Agreements


**MILLER
THOMSON** LLP
Barristers & Solicitors
Patent & Trade-Mark Agents

2



1. Section 167 Election

- No GST on sale of all or substantially all of the assets of a business
- Joint election by purchaser and vendor
- Deems purchaser to have acquired assets for exclusive use in commercial activity for nil consideration
- **S. 167(2):** similar treatment for disposition of assets on death



Conditions for s. 167 election to apply

1. vendor makes supply of business or part of a business
2. One of the following:
 1. Business was carried on or established by vendor; or
 2. Business was carried on or established by another and acquired by vendor.
3. purchaser acquiring ownership, possession, or use of all or substantially all of property reasonably regarded as necessary for operation of business or part of business.
4. all combinations of vendor/purchaser registration status except where vendor is registrant and purchaser is not.

= NO TAX



Definitions

"Business"

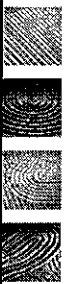
- Broad definition
- **S. 123 ETA:** "includes profession, calling, trade, manufacture of any kind whatever," whether for profit or not.

"Assets"

- Includes inventory, equipment, real property and intangibles
- Varies depending on nature of business

**MILLER
THOMSON** LLP
Barristers & Solicitors
Patent & Trade-Mark Agents

5



Definitions cont.

"All or Substantially all of the property"

- CRA: quantitative 90% or more test
- Courts: legally, it is a qualitative test
 - *547391 Alberta Ltd. V. The Queen*, – not binding but influential re Parliamentary intent to have a flexible test
- CRA: exclude accounts receivable, cash, debt and capital stock as not needed to carry on business or not property
- 90% of what?

**MILLER
THOMSON** LLP
Barristers & Solicitors
Patent & Trade-Mark Agents

6



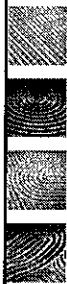
Vendor

- No advantages
- Disadvantages:
 - Loss of cash flow
 - Liable for tax, interest and penalty for non-collection if election not-applicable, not filed, or not filed on time
- Advised to obtain indemnity from purchaser for tax, interest, and penalty, and undertaking that purchaser will file on time



Purchaser

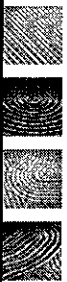
- Advantages:
 - Cash flow (will claim ITCs anyway)
- Disadvantages:
 - Change-of-Use Rules
 - If rule applies, i.e. purchaser will not use assets in commercial activity, then may have to self-assess or may be inviting GST assessment



Exclusions

S. 167(1.1)(a)(i)-(iii) ETA

- Leases or licenses of property
- Services rendered by vendor
- Franchises, for the most part
- Real property to unregistered purchaser
- Multiple purchasers or multiple agreements



Election Form 44

- Form 44: *"Election Concerning the Acquisition of a Business or Part of a Business"*
- Filed by the purchaser
 - No filing requirement when both vendor and purchaser are not registrants
- Due with first GST return following the completion of the transaction
- Ensure all property is listed and described correctly
- Vendor should ask for copy



2. Section 156 Election

- For non-arm's length transactions
- S. 156(2) ETA deems taxable supplies between specified members of closely related groups as being made for nil consideration
 - **S. 156(1):** "specified members"
 - Related corporations
 - Use all or substantially all of property to make taxable supplies
 - **S. 128:** "closely related"
 - 90% common ownership
 - Canadian residents and registered



Section 156 Election

- Intended to cover ongoing supplies between closely related persons
- Joint election between two members of a group exclusively engaged in commercial activities
 - Form 25 – "*Closely Related Corporations and Canadian Partnerships - Election or Revocation of the Election to Treat Certain Taxable Supplies as having been made for Nil Consideration*"
 - Do not need to file form but required to keep in books and records.



3. Section 22 Election

- On sale of business, accounts receivable may be considered capital
 - Capital gain or loss equal to difference between purchase price and face value of receivables
- Section 22 Election benefits both vendor and purchaser
 - Avoids capital tax consequences



Section 22 Election (cont'd)

- Vendor
 - Allows vendor to claim deduction equal to difference between purchase price and face value of accounts receivable and the allocated portion of the purchase price
 - Any loss is not affected by any reserve for doubtful debts, regardless of whether such reserve previously allowed under s.20(1)(l)



Section 22 Election (cont'd)

- Purchaser

- Allows accounts receivable to be treated as though they had arisen under purchaser's ownership of business
- Includes accounts receivable in purchaser's income for the taxation year of the transaction (or a previous taxation year)
- Enables purchaser to claim allowance for doubtful debts (s. 20(1)(l)) or a bad debt write-off (s. 20(1)(p))



Section 22 Election (cont'd)

- Availability of Section 22 Election requires:

- Sale of all or substantially all of the property used for carrying on the business
- All outstanding accounts receivable must be sold
- Accounts must relate to business carried on in Canada or subject to tax in Canada on income generated by the accounts receivable
- Purchaser must propose to continue the business
- Vendor and purchaser must jointly file the Section 22 Election in prescribed form (i.e. Form T2022) with their tax return for the year of the sale



4. Inventory

- Subsection 23(1) of ITA deems sale of inventory as part of purchase and sale of business to be in course of carrying on the business
 - No election required
 - Regular income



5. Subsection 20(24) Election

- Subsection 20(24) relates to income inclusions under s. 12(1)(a) and reserves under ss. 20(1)(m) or 20(1)(m.1)
 - Amounts received in the year for future income or obligation to deliver goods or services
- If the vendor provides reasonable consideration to purchaser for assumption of future obligation, then vendor may deduct such payment from its income, with purchaser required to include payment in its income for the year



Subsection 20(24) Election (cont'd)

- If Subsection 20(24) Election is made:
 - Vendor cannot claim any further reserves under ss. 20(1)(m) or 20(1)(m.1)
 - Purchaser can claim reserves related to income inclusion
- Basically, for assuming vendor's contractual obligation, purchaser receives adjustment to purchase price that reflects assumption of liability.
- Amount for purposes of Subsection 20(24) Election should be allocated from total purchase price for cost to purchaser for assuming the future obligations
- Subsection 20(24) Election requires vendor and purchaser to file joint election, due by earlier of the parties' filing deadlines
- No prescribed form for Subsection 20(24) Election
 - Letter typically attached to appropriate tax return




Subsection 20(24) Election (cont'd)

- Vendor
 - Subsection 20(24) Election presents obvious, immediate advantage of income deduction
- Purchaser
 - More difficult decision
 - Disadvantages of the immediate income inclusion only offset by ability to deduct expenses related to delivering the future goods or services and to claim reserves



Subsection 20(24) Election (cont'd)

- Purchaser
 - Income inclusion and corresponding tax burden may outweigh benefits of the deduction
 - Should be particularly aware where income inclusion is high relative to projected deductible costs
 - Typically the case where costs of the future delivery relatively low, but customer's costs are high, and all or most of income has been transferred to purchaser
 - Conversely, may be planning opportunities where costs match or exceed the income inclusion



6. Allocations to Non-Competes: Sections 56.4 & 68

- Non-competition agreements fall within broad definition of “restrictive covenant” in proposed s. 56.4(1)
- Consideration for such agreements will be subject to new default income inclusion rule in s. 56.4(2) (the “Income Inclusion Rule”)
 - Amounts received or receivable for non-competition agreements to be included in grantor's income
 - With the sale of a business, the vendor (or employees) may covenant to not compete with purchaser's business for specified time within certain regions




Allocations to Non-Competes (cont'd)

- Proposed Subsection 68(c) provides for allocation of consideration where a portion can reasonably be regarded as in respect of restrictive covenant
 - Portion of consideration attributable to restrictive covenant deemed received or receivable by grantor and paid or payable by person to whom restrictive covenant was granted
- Thus, not possible to avoid the Income Inclusion Rule by simply failing to allocate amount for restrictive covenant otherwise part of a transaction.



Allocations to Non-Competes (cont'd): Exceptions to Income Inclusion Rule – 56.4(3)

1. Amounts included in grantor's employment income for the year
2. Dispositions of eligible capital property (e.g., goodwill) where vendor and purchaser jointly elect to treat any consideration for restrictive covenant as proceeds for eligible capital property
3. In the case of amounts, which satisfy the following conditions:
 - a) Directly relates to vendor's disposition of capital property that is an "eligible interest" in partnership or corporation (carrying on business related covenant) or holding company with shares of corporation carrying on business,
 - b) Covenant is a non-competition covenant,
 - c) Covenant granted to purchaser of eligible interest (or a related person), and
 - d) subsection 84(3) does not apply to the dispositionthe vendor and purchaser may jointly elect to treat amount as additional proceeds of disposition of eligible interest, with maximum claimable amount being incremental increase in FMV of eligible interest attributable to restrictive covenant



Allocations to Non-Competes (cont'd):
Exceptions to s. 68 & Income Inclusion Rule – 56.4(6)


S. 56.4(6): Restrictive covenant granted by individual

1. Granted to person at arm's length;
2. Directly relates to acquisition of an interest in individual's employer, related corporation or business carried on by employer;
3. Individual deals at arm's length with the employer/vendor;
4. Non-competition covenant;
5. Individual does not receive (or will not receive) any proceeds for granting the restrictive covenant; and
6. Any consideration for the restrictive covenant (reasonably regarded as such) only received or receivable by the vendor

- Provides relief for certain employees who grant non-competition covenants as part of sale transactions

MILLER THOMSON LLP
Barristers & Solicitors
Patent & Trade-Mark Agents

25



Allocations to Non-Competes (cont'd):
Exceptions to s. 68 & Income Inclusion Rule – 56.4(7)

S. 56.4(6): Restrictive covenant granted by vendor

1. Granted to person at arm's length;
2. Non-competition covenant;
3. Vendor does not receive (or will not receive) any proceeds for granting restrictive covenant;
4. Any consideration for restrictive covenant included by the vendor in computing a "goodwill amount" or included in "eligible corporation's" goodwill amount for business relate to restrictive covenant;
5. Reasonable that restrictive covenant granted to maintain/preserve goodwill of business; and
6. Vendor and purchaser jointly elect to have exception apply

- Ensures Income Inclusion Rule will not apply on asset sale where 90% shareholder of vendor corporation grants restrictive covenant to purchaser

MILLER THOMSON LLP
Barristers & Solicitors
Patent & Trade-Mark Agents

26



James A. Hutchinson
Miller Thomson LLP
jhutchinson@millerthomson.com
416.597.4381

**MILLER
THOMSON** LLP
Barristers & Solicitors
Patent & Trade-Mark Agents

27