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CHARTERED PROFESSIONAL ACCOUNTANTS

Selling Shares of a Private Corporation

By Kamille Stead, CPA, CA, Taxation **February, 2018**

As a shareholder of a private corporation, it is important to be aware of your options and any tax planning opportunities should you ever be in a position to sell your shares. Planning for the structure of the sale now can result in considerable tax savings when you eventually sell your shares. Generally, the departing shareholder will either have their shares repurchased by the corporation or will sell them to either the existing shareholders or a third party. A summary of the tax consequences of each option follows:

The Share Repurchase

If the corporation were to repurchase your shares, this will result in a taxable dividend to the extent the proceeds received exceeds the paid-up capital of the shares which is generally the amount shown on the financial statements for the shares. Depending on whether the company is able to make an eligible dividend designation or a capital dividend election, the dividend will be taxed as an eligible dividend at 2018 tax rates of 30- 40% (based on the top personal tax bracket), as an ineligible dividend at rates 8-10% higher, as a tax-free capital dividend or some combination of the three. The specific tax rates depend on the province where you reside.

It is possible that you may be able to restructure your affairs prior to the share repurchase by transferring your shares on a tax-deferred basis to a new company in order to defer some or all of the tax that would otherwise result. When the repurchase of shares occurs, a portion of the deemed dividend will generally be received by the new corporation on a tax -free basis; the proportion received tax-free will vary based on the tax attributes of the corporation sold. If you plan to subsequently start your own business, the cash now held in your corporation could assist in funding your new business operations. If you do not plan to start any new business activities, the funds could be held in your corporation until a time when your personal tax rates are lower, at which time the funds may be taken personally. This option will require additional professional fees to set up and will involve ongoing compliance costs so this will need to be factored in to the overall decision.

Sale to Existing Shareholders/Third Party Purchaser

A sale of your shares to the existing shareholders or a third party purchaser normally carries a more favorable tax treatment. The proceeds received less the amount paid for the shares gives rise to a capital gain*. The top personal tax rates on capital gains are between 23% and 27% in most provinces for 2018 as opposed to the dividend rates mentioned previously. Furthermore, if the shares meet certain criteria making them "qualified small business corporation shares," and you have lifetime capital gains exemption available (maximum available of $848,252 in 2018), you may be able to claim a capital gains deduction to offset a portion of the taxable capital gain and reduce your taxable income to end up with an even lower effective tax rate. Note that only individuals are eligible to claim a capital gains deduction; corporations cannot.

*There are exceptions to this for certain non-arms length sales but these exceptions are outside the scope of this article.

Review Your Unanimous Shareholder Agreement

To ensure that both of these options are available to you when you choose to sell your shares, you should review your Unanimous Shareholder Agreement. Ensure the appropriate clauses are included which allow you to either sell your shares to existing shareholders or have the company repurchase your shares.

The Unanimous Shareholder Agreement should also include how the value of the shares will be determined on such a sale to avoid disagreements on the value or potentially costly professional fees. Failing to ensure these items are in your Unanimous Shareholder Agreement today can restrict your tax planning opportunities when you decide to sell your shares in the future.

As a current shareholder there is a lot to consider with respect to the sale of your shares and this is only a brief overview. A detailed review of your and your corporation's specific circumstances is essential to achieving the best possible tax results.

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