Business Matters

APRIL 2020

VOLUME 34 | ISSUE 2

MANAGEMENT

# Buying a Business: A Little Planning Goes a Long Way

**Last week, I met a businessperson who was thinking about buying a new business. Fortunately, they are very experienced and understood many of the issues they would face. Despite that, they took the step of discussing the purchase with their lawyer and their accountant before signing any documents. Read on to learn about some key matters you should take into account before making this substantial acquisition.**

It's amazing how many calls I receive from clients who don't have that foresight. Instead of getting advice when they first consider buying a business, they wait. Often, they have already signed a letter of intent or an agreement of purchase and sale by the time they contact me. Some are entirely new to business structures and operations, while others have worked in the corporate world for many years. Either way, there is often some information missing.

## Letter of intent or agreement of purchase and sale?

Often, parties negotiating for the purchase and sale of a business enter into a letter of intent before signing a long form agreement of purchase and sale. Letters of intent are also referred to as "LOIs" or "memoranda of understanding."

A letter of intent is usually just that – an expression of intention rather than a binding contract. As a result, people often think there is no harm in signing one before consulting their advisors. The challenge is that once terms have been reduced to writing, it's very difficult to get people to modify them. Even though the LOI may specifically say that it is not legally binding and is subject to the negotiation and signing of a long form agreement of purchase and sale, people will return to its terms time and time again. The negotiations will be much easier if the LOI reflects the basic outline of the deal.

## Consider these things first

If you're thinking of buying a business, you should first consider what structure your business should take. Will you complete the purchase personally, so that you directly own the business you are buying? Or, will you buy through an incorporated company? There are legal and tax considerations to both.

If you decide to buy through a company, you need to consider who its shareholders will be. It is very easy to issue shares in a newly incorporated company; it has no value at the time of incorporation, and as a result, you can give shares to others without any tax implications. After the company completes the purchase, though, Canada Revenue Agency will take the position that the company has value and, therefore, issuing shares after the purchase will have tax consequences.

If there will be more than one shareholder, I strongly encourage you to enter into a shareholders' agreement. Many clients want to delay taking this step, to avoid either the time it takes to get its terms right or the expense associated with it. However, it's too late to enter into one if the relationship between the shareholders has deteriorated to the point where they no longer want to be in business together. Shareholders' agreements are like marriage contracts – if you can't agree going into the relationship, you'll be hard-pressed to agree when the relationship ends.

## What should you buy: shares or assets?

One of the first questions I ask a client who is buying a business is whether they are buying shares or assets. This influences the nature of the agreement that must be drafted. Not knowing the answer to that question may put you at a disadvantage when you start negotiations.

If you are purchasing shares, you are acquiring the company that operates the existing business. That includes all of that company's assets and liabilities. Sellers often prefer a share deal because it may allow them to access the federal capital gains tax exemption. If they are eligible, that exemption allows the seller to receive upwards of $866,912[1] free of capital gains tax (this amount changes slightly each year).

A share transaction means that the assets stay inside the company. You become the owner of the shares in the company, and the company remains the owner of the assets. This may mean that there is no tax payable on the transfer of the asset. For example, if you were purchasing land in Nova Scotia you would have to pay deed transfer tax. If, however, you buy a company which owns land, you do not have to pay this tax. The company remains the owner of the property, and the purchaser becomes the owner of the shares in that company. However, the tax value of the assets inside the company would remain unchanged. That could mean increased capital gains if you later decide that the company's assets should be sold, rather than its shares.

In addition, because you are acquiring the company, you must consider any liabilities it may have. Not all liabilities may show on the financial statements. For example, consider what happens if a lawsuit is brought against the company after you have bought its shares. Usually, the lawsuit will not name you personally, but you will probably become involved in the litigation in order to protect your investment. Determining all liabilities that may exist is next to impossible. As a result, you will have to rely on a well-drafted agreement to protect your interests.

## Should you worry about competition?

Another thing to consider is whether the seller might set up to compete with your business after the closing. You may wish to include a non-competition agreement as part of your transaction. Sometimes purchasers arrange for the seller to stay on as a consultant or an employee after the sale. That allows the buyer to take advantage of the seller's knowledge, and it can give the seller certain tax advantages as well.

[1] as of January 1, 2019

## Get advice before you proceed

Buying a business can be a great strategic move, but only if the transaction is well-structured. Businesspeople with advisors to turn to have an advantage in this regard. Good tax and legal advice can help you with all of these considerations and ensure that you get what you originally intended.

TAXATION

# Voluntary Disclosures Program

**The Canada Revenue Agency (CRA) refers to the Voluntary Disclosures Program (VDP) as a second chance to correct your taxes. The program has both income tax and GST/HST streams.**

## Income tax stream

VDP applications in the income tax stream may cover:

- omitted or underreported income
- expenses claimed in error
- failure to remit source deductions
- failure to file an information return

For an application to be accepted, one condition is that it must be *voluntary.* In other words, you must have disclosed the error before the CRA has taken any enforcement action or been informed – for example, through a leak of offshore financial information – that you did not comply with its regulations.

Other guidelines to note are that the application must:

- be complete
- involve a penalty that may be applied
- include information that is at least one year past due
- include the payment of the estimated tax due

The VDP was changed after March 1, 2018 to create two separate programs: a General Program and a Limited Program.

**General Program**

The General Program is for unintentional errors. If the CRA accepts your application, you will not be charged penalties or face criminal prosecution. You will be required to pay full interest on amounts due for the three most recent years, but you may be granted partial relief of interest for the years before then.

**Limited Program**

The Limited Program applies to those who intentionally avoided their tax obligations. If the CRA accepts your application, you will not be charged gross negligence penalties or be referred for criminal prosecution. However, you will have to pay other penalties and all interest as required.

The other factors that affect which of the two programs your application will be considered for include whether you made efforts to avoid detection (such as through offshore vehicles, recalling our earlier example), the number of years you did not comply and amounts involved, and how sophisticated the CRA perceives you to be – to what degree do you appear to have made efforts to "work the system" to your benefit? For example, you may be denied acceptance into the Limited Program if you only disclosed the error after the CRA announced that it would be focusing its compliance efforts on an area that applied to your situation.

Generally, taxpayers are allowed to avail themselves of the VDP only once.

## GST/HST stream

The GST/HST stream includes three programs: Wash Transactions, General and Limited.

**Wash Transactions Program**

The Wash Transactions Program applies when the supplier failed to charge and collect the GST/HST from a registrant who is entitled to a full input tax credit. This program may provide full relief from interest and penalties.

**General Program**

As with the income tax stream, the General Program applies to those who want to correct unintentional errors. If the CRA accepts your application, you will not be referred for criminal prosecution or charged penalties and may be eligible for relief of 50 per cent of the applicable interest.

**Limited Program**

The Limited Program provides limited relief for those who intentionally avoided their tax obligations. If the CRA accepts your application, you will not be referred for criminal prosecution or charged gross negligence penalties, but there is no relief from other penalties or interest.

In considering whether there was an intention to avoid tax obligations, the CRA asks these questions about a case:

- Was the GST/HST collected, but just not remitted?
- Did the taxpayer make efforts to avoid detection?
- Was there deliberate or wilful default or carelessness that amounted to gross negligence?

Similar to the income tax stream, the CRA also decides on which program applies to you based on the number of years you did not comply and amounts involved, how sophisticated they perceive you to be and how quickly you acted to correct their non-compliance.

And again, you may be denied acceptance into the Limited Program if you only disclosed an error after the CRA has announced that it will be focusing its compliance efforts on an area that applied to your situation.

Typically, this program will automatically apply to applications by large corporations with more than $250 million in revenue in two of their last five taxation years.

## Recent court cases

Under section 220(3.1) of the *Income Tax Act,* the CRA can waive or cancel any part of the penalties or interest otherwise payable within a ten-year limit from the relevant taxation year. It had been the CRA's common practice not to reach beyond the period covered by the VDP to reassess any prior years' tax returns, but there seems to be a shift to a more aggressive approach, as noted in the *Gaultier v. Canada (National Revenue)* (2017 FC 1173) case.

The taxpayer in this case had transferred $300,000 to a Bahamian bank in 1978. Many years later, he wanted to set his affairs in order so as not to pass on his tax problems to his heirs, and made an application to the VDP for 2005 – 2014, within the normal ten-year period for which interest and penalties could be waived.

The CRA accepted the application and provided relief from penalties and interest for those taxation years, but they also used the information from the VDP application to reassess taxation years going back to 1980, since they considered that the taxpayer's inability to provide support for the initial transfer of the funds was a misrepresentation attributable to neglect, carelessness, wilful default or fraud.

This gave them the authority to assess taxation years beyond the normal limitation period. Penalties and interest were assessed on the unreported income and failure to file information returns for the relevant years. Gaultier's request for judicial review of CRA's application of a discretionary policy to reassess years prior to those covered by the VDP was denied.

**Even good intentions may have consequences – so be diligent**

Given the proliferation of tax information exchange agreements with countries that are considered to be tax havens in recent years, this tightening of the VDP program may become increasingly common.

Another recent court case dealt with the requirement for individuals to file a T1135 information return if they have specified foreign property worth more than $100,000. The penalties for failing to file this return are $50 per day to a maximum of $2,500 for each property, with additional gross negligence penalties possible.

In the case of *Moore v. The Queen* (2019 TCC 141) the taxpayer received shares in the U.S. parent company of his employer through an employer-sponsored share purchase plan. In 2016, the taxpayer realized that the cost of these shares had passed the $100,000 limit during 2015, and that he should have filed the T1135 for 2015. Unaware of the VDP, he completed the T1135 for both 2015 and 2016 and sent a letter to the CRA to inform them of his mistake. The CRA charged him the $2,500 penalty for late-filing the 2015 return.

In ruling on this case, the judge noted that the taxpayer had been diligent in reporting the employment benefit and the income from these shares in his tax return for both years in question, and thereafter. The judge further noted that the guidance contained in the 2015 *Income Tax Guide* was not clear about what was included in specified foreign property, or about the VDP application being the only way one could seek relief from penalties. In this case, the taxpayer was able to use a due diligence defence and the judge noted the unclear administrative guidance from the CRA. However, if you discover inadvertent mistakes on your prior tax returns, be sure to file the RC199 VDP Application Form without delay.

In conclusion, the VDP provides many benefits for those who need to "correct their taxes" – relief from prosecution and penalties, and potential reduction in interest. It can also provide peace of mind. Mistakes in the application process can be costly though. If in doubt, consult with legal and accounting professionals.

To learn more about the VDP, see: **www.canada.ca/en/revenue-agency/programs/about-canada-revenue-agency-cra/voluntary-disclosures-program-overview.html**

TECHNOLOGY

# What Is Blockchain, and Why Do You Need to Know What It Is?

**When Bitcoin first came onto the scene in 2008, it came with a new underlying technology called "blockchain." As interest in cryptocurrencies grew, so did special recognition for the technology that made them work. Since then, blockchain has grown to be used in many different industries – making it possibly the next big revolution in the digitization of business.**

## Blockchain defined

Blockchain represents not just a new technology, but also an important new construct for recording data. And it's gaining momentum as a transparent, immutable and secure method of recording business transactions.

At its rudimentary core, blockchain is the finite organization of digital data into a series of *blocks*. These blocks are then digitally and chronologically connected together into a chain. Each block contains a unique set of data, and is comprised of three components:

- First, it contains specific, and usually transactional, details such as dates, quantities and dollar amounts.
- Second, it contains information, in the form of digital signatures, about who is involved in the transaction.
- Finally, a unique identifier (called a "hash") is assigned to reference the specific block.

These hashes are actually cryptographic codes generated via algorithms. They are dependant on the data in the block and make reference to the block before them. These elements make each hash unique to each block. As data is added or changed, new blocks are added to the chain. It is important to note that the data in a particular block is never changed; erroneous or new data simply adds a new block to the chain. As a result, there is always a complete record of the data, right from its origins.

Blockchain also differs from traditional data recording methods in terms of how the data is stored. The chains are essentially digital ledger systems that are then stored across a wide range of networks (making them often referred to as a "distributed ledger"). Anyone can view the contents of a blockchain and, if they so desire, can have their computer added as a node to the chain. From that point on, their computer will receive a copy of the entire chain every time the blockchain is updated.

This is the main reason why blockchains are considered so secure: In order to modify the data in a particular block, that block would have to be changed on every system where the ledger existed – which creates a significant barrier to malicious intent. Imagine a particular block that is the target of malicious intent. That block would have to be manipulated on literally thousands of nodes (individual computers) for the threat to take affect.

## Uses of blockchain

Blockchain was initially developed as a ledger system for Bitcoin. To this day, many people still incorrectly refer to blockchain and Bitcoin interchangeably. Given the inherent features of transparency and security, blockchain has easily lent itself to many other uses. It has been employed in healthcare centres for patient medical records; by food manufacturers as a means of keeping lot, batch and ingredient data; and even in the finance industry to track fraud. The list continues to grow.

One of the recent important modifications is how the blockchain is accessed. While one of the defining aspects of the technology is that it is public and fully accessible, more private chains have gained popularity. These new *permissioned* blockchains work just like their predecessors, except that the access to the network where they reside is controlled. Organizations can then grant access only to the individuals or entities they want to include. These forms of blockchain are expected to grow significantly as organizations test this new technology's effectiveness.

## What does this mean to you?

As noted, blockchain represents a new way of recording the interactions (transactions) between individuals and organizations. As this new technology becomes more popular and utilized, questions have emerged as to what the future holds for this new way of transacting.

While the inherent benefits of a system that is transparent, secure and immutable are exciting, conversion to it will still take some time. Unlike many other technological enhancements, blockchain represents not a disruptive technology, but rather a foundational shift. Its advantages will take time to become part of the economic infrastructure. In large part, this evolution will depend on how blockchain is taken up by enterprise.

Key questions for finance and accounting professionals relate to how this technology can withstand audit and assurance challenges. It will be some time before blockchain replaces audited financial statements, but it will increasingly be used to record transactions. As such, it is imperative that these professionals gain an understanding of the system. And while it does record transactions in a new way, auditors will still need to

assess whether those transactions were correctly categorized on the financial statements and whether they were authorized, fraudulent, or even illegal.

As technology continues to advance, and business processes continue to be digitized, it is increasingly important to monitor these advances and continually assess their impact on your industry. Blockchain is a key player in this trend that won't be disappearing anytime soon. Whether your business is a technology giant, an accounting firm or a professional organization, it is increasingly important to monitor these advances and continue to assess their impact on your industry.

WEALTH MANAGEMENT

# Babies: The Cost and How to Plan for It

**A reality of the economic and demographic trends occurring in Canada is that everything costs more, especially in urban centres. Take real estate costs, for instance, which for new parents might be eight to ten multiples of their combined income to acquire a detached home. For new or expecting parents, this is increasingly a key question in family planning.**

As a result, the cost of bringing a new child into a family is a very important consideration. Parents may wonder about the ability of their children to succeed with a middle-class upbringing or the fact that they could jeopardize their own finances if they are not careful. It's imperative for families to discuss the financial aspects of raising children because, in reality, children are cost centres – and finances are typically cited as a leading driver of divorce in Canada.

To maintain your family's long-term stability, it is recommended to review your family finances and the cost of raising children ahead of time. This will help new parents avoid a scenario where they are worrying about their mortgage payment while their child is screaming at 3 a.m.

## Cost to raise a child in Canada

The author of a 2011 article in MoneySense magazine estimated that from birth to age 19 the average annual cost per child is $12,285 – or $243,660 cumulatively over that period. These costs did not include post-secondary tuition, which can add another $137,000 in inflation-adjusted dollars.

These costs also did not include the many opportunity costs that parents must sacrifice based on their parental responsibilities. Consider the parent who has to be home in time for their child's bath time and misses out on time networking with management after work hours.

It's a tall task for anyone – let alone new parents – to figure out how to create an extra $12,285 per year, per child, in after-tax spending power. With the added opportunity costs, they will likely have to find that extra money on a reduced combined income to boot.

## Parental leave options

Ideally, when parents make the decision to have a baby, it's also prudent to review how the family will be able to live off a reduced income while one of the parents is on maternity or paternity leave.

The prospect of losing one income will be partially replaced by government benefits through Employment Insurance (EI) and the Canada Child Benefit (CCB).

- EI is 55% of your average insurable weekly earnings up to a maximum of $54,200 (2020).

  - Covid-19 Update: In regards to individuals who are scheduled to take maternity or paternity leave, essentially the EI process is unaffected when you apply for EI benefits. In the interim, if your EI benefits are not set to start for a few months and you are not working due to Covid-19, then you would follow the Federal government's Canada Emergency Response Benefits (CERB), which provide $2,000 per month when eligible conditions are met.
- The CCB varies by adjusted family net income, however the maximum that a family can receive per child is $6,765 (2020) under age six. For most working families, this benefit would likely be reduced when adjusted family net income exceeds $31,120 and fully eliminated when income exceeds about $188,000 (for a one-child family where the child is under age six).
  - Covid-19 Update: The Federal Government recently increase the CCB for eligible families by a single lump sum of $300 per child, which will be payable in May 2020. Eligible families are families who already receive the CCB.

*Further Resources: For an estimated calculation of the government benefits your family may be eligible for please visit* ***www.preetbanerjee.com/covid19-calculator*** *a free online calculator setup by financial columnist for the Globe & Mail and regular CBC guest Preet Banerjee. Information on CERB or the Enhanced CCB please visit* ***www.canada.ca/en/services/benefits/ei/cerb-application.html***

After analyzing your expected combined income, it is a good idea to put this adjusted spending and lifestyle into practice ahead of time. This will allow you to adjust to the reduced spending level and build a savings cushion – and be ready when the baby arrives and your focus changes to caring for your child.

## Care at home or at daycare?

Whether one of the two parents will remain at home with the child after maternity or paternity leave ends is another potential decision. Daycare services can be very expensive, so on an after-tax basis it might make financial sense for one of you to stay home, especially if you have multiple children in daycare at the same time.

For instance, in the Greater Toronto Area (GTA), even subsidized daycare services can cost $3,000 per month for two children. As a result, if one parent's salary is equal to or less than $43,000 per year, then the economics of staying home to care for the children makes more sense (excluding tax deductions for daycare expenses).

On the other hand, this decision to stay home may be a bit short-sighted, because when that parent decides to return to work after the children are in grade school, they may suffer professionally. Research suggests that this "child penalty" impacts new mothers by reducing their future expected earnings for the balance of their working years compared to women without children. Despite this, the tradeoff may be the peace of mind in knowing that one parent is looking after the child, something money can't buy.

A relatively recent option has been created for parents, which could bridge the difference between reducing daycare costs and ensuring that the parents are spending the early and critical development years with their child.

The 18-month maternity or paternity leave allows a parent to stay with their child for an extended maternity or paternity leave. They will not be entitled to additional EI benefits, however they would forgo paying for daycare those six months. As a result, this extended leave option may provide the best outcome for the child and the family's finances.

## Plan farther ahead for greater peace of mind

When new parents are swept up in the fun and chaos that surrounds the arrival of a new addition to the family, they can sometimes forget very important planning points to complete preferably before, and at latest shortly after, baby arrives. Although no one likes to ponder their mortality, new parents can achieve greater peace of mind by completing their will and power of attorney (POA) documents and securing a life insurance policy.

Many people think mainly about the financial aspects of a will and POA. While it's important to ensure that your estate and beneficiaries receive the deceased parents' assets in a timely and cost-effective manner, the more important element here is the ongoing guardianship of the children if both parents pass away.

Costs for a standard will and POA will vary based on the law firm, however $1,000 for completion of these documents for both parents, including storage of the documents at the law firm, is common.

Insurance is important for ensuring that your family has the necessary liquidity to cover final expenses and debts and replace lost income if a parent should pass away. Life insurance coverage and costs will vary based on a variety of factors; however, at a bare minimum, you can protect your family with low-cost term insurance for a specified time period (10, 20 or 30 years).

Insurance coverage for 20 to 30 years is typically appropriate for a family with children if they are likely to be independent at the maturity of the term and where most or all of the mortgage debts carried by the family will be paid down.

## Next steps … are you ready?

Parenting is a rewarding-but-challenging stage of life. Getting ahead of important financial details will reduce the risk of parents running into unpleasant financial surprises after baby arrives.

In addition, planning ahead will allow parents to focus their attention where it matters most: on their growing family.

---

**Disclaimer:**

*BUSINESS MATTERS* deals with a number of complex issues in a concise manner; it is recommended that accounting, legal or other appropriate professional advice should be sought before acting upon any of the information contained therein.

Although every reasonable effort has been made to ensure the accuracy of the information contained in this letter, no individual or organization involved in either the preparation or distribution of this letter accepts any contractual, tortious, or any other form of liability for its contents or for any consequences arising from its use.

*BUSINESS MATTERS* is prepared bimonthly by the Chartered Professional Accountants of Canada for the clients of its members.

**Authors:**

| | |
|---|---|
| Buying a Business: A Little Planning Goes a Long Way | Christene H. Hirschfeld, Q.C., ICD.D |
| What Is Blockchain, and Why Do You Need to Know What It Is? | Cory Bayly, MBA |
| Voluntary Disclosures Program | Susan Cox, CPA, CA |
| Babies: The Cost and How to Plan for It | Adam McHenry, CFA |