Paisley Pike™ Chartered Accountant

Leading edge solutions that build personal wealth for investors.

Issue 6 - Version 1 (September 2013)

Section 85 Elections - Reduce Taxes on Corporate Mergers

There is an increasing number of companies that are in a strong position to grow their business through acquisitions in the Canadian market. These transactions are often worth billions of dollars. You may already be familiar with the terms "merger", "take-over" or "acquisition", among other commonly used terms to refer to Corporate Actions. Transactions or deals of this nature can have significant financial impacts on the value of an individual investor's portfolio, as well as introduce tax-reducing opportunities that are not always apparent to an individual shareholder.

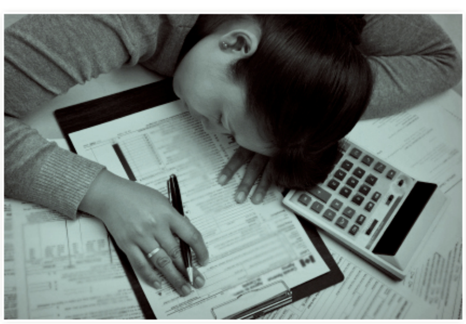
There is "Good News" and "Bad News"

Let's begin with the good news. Investors who hold shares of a company that is the target for a take-over will often see a sizeable increase in the value of those shares, as the acquiring company will offer a premium over the pre-announcement closing market price. This situation creates increased wealth for investors as they see the value of their holdings grow. The individual investor is also considered to have effectively participated in a "sale" of their target company shares when they receive shares of the acquiring company. This event, when transacted in the hands of the individual investor, frequently results in a large capital gain that must be reported on the shareholder's tax return. That's the less desirable part of the deal.

Only target company shares owned in taxable investment accounts are subject to taxation as a result of a take-over transaction. Target company shares owned in registered accounts such such as RRSPs, RRIFs, LIRAs, TFSAs and RESPs are not subject to tax on the take-over transaction.

Sometimes the Offer Provides "Relief"

Each corporate action is uniquely structured and will have different tax consequences and opportunities for each shareholder. Some acquisitions provide participating investors with a limited-time opportunity to defer the taxation of capital gains that resulted from the take-over. This provision, called a "Section 85 Election", may be specifically mentioned in the terms of the offer. The election process requires both the individual investor and the acquiring company to jointly apply for the tax deferral on the transaction.



Not All Options are Created Equal

Corporate actions that provide a Section 85 Election often provide the shareholder with several choices on how they would like to participate in the offer. These options can include a choice of receiving cash or cash and acquiring company shares, and may be subject to proration if there is a limit on the amount of cash and/or acquiring company shares available. Care must be taken in selecting an option as only certain choices will be eligible for the Section 85 Election.

Issue 6 - Version 1 (September 2013)

Make Wise Choices

The most important part of the election is the correct choice of an elected amount for the transaction, as the elected amount will determine the amount of the capital gain that can be deferred. Choosing the optimal elected amount for each shareholder is dependent on the unique combination of the proceeds received in the transaction and the attributes of the target company shares surrendered in the transaction. Selecting a less than optimal elected amount can result in a larger immediate tax liability, or worse it may invalidate the election entirely.

A Section 85 Election is a Limited Time Offer

The window of opportunity available to investors is at the discretion of the acquiring company, as the acquiring company must jointly authorize the prepared election. Investors planning to take advantage of a Section 85 Election may be given as little as 90 days from the close of the deal to do so. To be assured of successfully being granted the joint approval, it is recommended to submit the required forms well in advance of the deadline.

Correctness Counts

These deals are complex. A successful Section 85 Election requires that the terms of the offer are understood, the optimal election value is applied in completing the documentation and that the election forms are submitted on time. Errors on these submissions can result in your election request being rejected by the company or by the Canada Revenue Agency (CRA). These failures can have significant consequences for the taxpayer.

Make Cost Effective Decisions

A Section 85 Election is not always in the individual investor's best interest. If the cost of preparing the election outweighs the benefit from the amount of tax being deferred in the current year, then pursuing the election may end up not being beneficial.

You're Not Alone

As Section 85 Elections can offer a significant tax-deferral opportunity for investors, it is recommended that these forms are prepared by professionals with the expertise and experience in tax and corporate actions. At PAISLEY PIKE Chartered Accountant and PAISLEY PARACHUTES INC. we have the expertise and experience with complex investment transactions to ensure that your Section 85 Elections are properly prepared on a timely basis to help you effectively manage and minimize your taxes. See our website at www.canadiantaxelections.com for details.

JD Greenberg