

2 Bloor Street West, Suite 2603, Toronto, Ontario M4W 3E2
Telephone: (416) 961-5612 Fax: (416) 961-6158
E-mail: valuators@marmrpenner.com

Marmer Penner Inc. Newsletter

Written by Written by Steve Z. Ranot, CPA, CA•IFA, CBV
Edited by Pier Sperti, BBA, CPA, CA, CBV

Grimes and Ozerdinc, Trustees of the Ozerdinc Family Trust No. 2 v. The Queen

Chartered business valuers who practice in the area of family law often look at tax court decisions for guidance on the court's view of certain grey areas in valuation. This tax case involving a group of family-controlled businesses deals with a number of issues seen in family law valuation cases.

Ms. Grimes and Mr. Ozerdinc were married and the trustees of the Ozerdinc Family Trust No. 2 ("the trust"). The trust owned the common share of a holding corporation, Holdco, as well as \$2.7 million non-voting preferred shares of Holdco redeemable at \$1 each. Voting control of Holdco lay with twelve voting preferred shares redeemable at \$1 each. Ms. Grimes owned these voting preferred shares. The beneficiaries of the trust were Ms. Grimes and Mr. Ozerdinc's children so it is relevant to understand that, in a family law context, every shareholder, beneficial shareholder and decision-maker was related and likely acting in concert.

Holdco owned all of the shares of a construction company, Opco.

A valuation of Holdco was required as it had been held by the trust for 21 years and *The Income Tax Act* requires a trust to report deemed capital gains on capital property held on its 21st anniversary. Accordingly, the taxpayer has incentive to report a lower value while Canada Revenue Agency (“CRA”) would prefer to see a higher value.

The valuator for the taxpayer, MNP, differed with the valuator employed by CRA, Mr. Timothy Spencer (“Spencer”), on these issues, among others:

- a) Valuation date was February 1 and Holdco’s fiscal year-end was February 28. Management prepared internal financial statements at January 31. Spencer relied on these January 31, 2011 internal financial statements while MNP relied on the audited financial statements from one month later;
- b) Opco had made significant advances to Ms. Grimes and Mr. Ozerdinc, which the court was told were not expected to be repaid. Spencer argued it was still a bona fide loan receivable;
- c) Both valutors used an adjusted book value approach for Opco and Holdco. MNP arrived at a value for Holdco’s common shares and then deducted 12.5% as a discount for absence of control because the trust held the common shares and \$2.7 million of redeemable non-voting shares but voting control was held by Ms. Grimes’ personally-held voting preferred shares; and
- d) MNP determined that a 30% marketability discount on the common share was also appropriate as a result of the following reasons:
 - i) Limited market for the share;
 - ii) Absence of a redemption policy; and

- iii) Absence of a distribution history nor any assurance of future distributions.

The tax court's decision on these three issues was as follows:

- a) The court decided it was appropriate to rely on the year-end audited financial statements because they contained all of the year-end adjustments and MNP had adjusted the income for the year to exclude the portion earned after the valuation date;
- b) The court found Ms. Grimes' testimony credible that Opco's advances would not be repaid and were, effectively, advances on bonuses that had not yet been declared. Given that Opco had a history of making the advances in previous years and then declaring a retroactive bonus, the court did not consider the amounts to be a corporate asset nor that the subsequent bonus declaration was a use of hindsight;
- c) The last issue was the allocation of overall value among the three classes of shares. Both valuers agreed on the \$2.7 million for the non-voting preferred shares. However, MNP deducted about \$250,000 from the value of the common share and added it to Ms. Grimes' personally-held voting preferred shares as a control premium. Spencer did not reduce the value of the common shares on the basis that it was reasonable that no one would buy the common shares alone and that any sale of Holdco would involve all of the related shareholders acting in concert. Spencer bolstered this position by arguing that Ms. Grimes, as part of her responsibility as a trustee, would be required to sell her voting preferred shares as part of any sale of the common share in order to permit the trust to maximize its proceeds of disposition. To further strengthen its argument, CRA engaged Campbell Valuation Services to prepare a critique stating that "the application of a minority or marketability discount to common shares in a situation of family control is highly unusual and there appears to be no basis in Holdco's situation

for such a...discount". The judge rejected CRA's position and accepted that the valuation should assume that the common shares were being sold without a corresponding sale of the voting preferred shares. As a result, the court accepted the 12.5% discount for absence of control; and

- d) The court considered MNP's argument for the additional marketability discount and reduced it to 15% on the basis that some of the arguments were already considered in the absence of control discount.

CRA and its valuator took positions consistent with many taken in family law valuations especially in regard to related parties acting in concert. Try to imagine a similar fact situation where a shareholder of a \$1 million operating company rolls it into a holding company controlled by her father shortly before separation. Whatever shares the separating spouse received in exchange would be worth less than \$1 million because there would now be a discount for absence of control. This might be an area where valuations for family law and income tax differ but family law practitioners should be aware of this decision.