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94 Cumberland Street, Suite 200, Toronto, Ontario M5R 1A3
Telephone: (416) 961-5612 Fax: (416) 961-6158
e-mail: valuators@marmerpenner.com

Marmer Penner Newsletter

Edited by Michael S. Penner, BBA, CA, CBV, ASA, CFE and Steve Z. Ranot, CA, CBV, CFE

More than the price was right at Loblaws

Family law practitioners are generally familiar with the concept of contingent disposition costs with respect to business interests. It is generally accepted that owning an asset whose fair market value exceeds its cost will trigger an accrued gain which is subject to tax. An exception exists where the business interest meets the definition of a qualified small business corporation ("QSBC") and thus a $500,000 capital gains exemption may apply to reduce or eliminate the tax liability. Another exception may now exist as a result of a recent Tax Court of Canada decision in *Fortino et al v. the Queen* (97 DTC 55).

Fortino's was a chain of supermarkets owned and operated by eight shareholders ("the husbands"). In 1988, Loblaws purchased the chain for proceeds of approximately $13 million consisting of approximately $8,500,000 for the shares and $4,500,000 as consideration for executing a non-competition agreement ("NCA").

The husbands sold half of their shares to their wives for consideration in the form of a promissory note. Subsequently, the husbands and their wives sold all of their shares to Loblaws, so that all sixteen individuals were able to utilize all or a portion of their $500,000 lifetime capital gains exemption with respect to shares of a QSBC. None of the proceeds received with respect to the NCA was reported by either the husbands or their wives on their 1988 personal income tax returns. The Minister of National Revenue reassessed their personal income tax returns for that year and added 75% of the amount received as consideration for the NCA to their incomes on the basis that such amounts were properly taxable as eligible capital property, the recapture of goodwill. Furthermore, the Minister ascribed all of the capital gain from the sale of the shares to the husbands, thereby denying the wives their ability to utilize any of their capital gains exemption.

With respect to the income splitting, the Tax Court agreed with the Minister of Revenue and assessed all of the capital gain as the husbands'. However with respect to the proceeds received for executing the NCA, the Tax Court did not agree with the Minister of National Revenue.

In the course of the trial, testimony was provided by a chartered business valuator with respect to the value of goodwill in the business and personal goodwill. The difference between the two is that personal goodwill is non-transferable and is generally not reflected in the price received for shares of a business. In this case, the taxpayers attempted to draw a distinction between the taxable proceeds received on the disposition of their corporation's transferable goodwill and the con-sideration they received in exchange for forfeiting their right to utilize their personal goodwill. The Tax Court judge, in her opinion, concluded that the NCA payments were in fact consideration paid to the husbands for forfeiting their ability to earn income in the grocery business for a prescribed period of time, and that there was no provision in the *Income Tax Act* that taxed such profits as they were "windfalls" unexpected and unlikely to recur.

With regard to the argument that the NCA payment was "eligible capital property" the judge rejected this argument on a technical basis as in order to apply, the taxpayer must have been carrying on a business. Since each of the husbands was a shareholder in a corporation which carried on the business, the provision did not apply.

The Minister of National Revenue may choose to appeal this decision. However if this decision is not overturned on appeal, this decision provides tax planning opportunities for those wishing to dispose of a business with transferable goodwill.

For family law practitioners, it adds another wrinkle in the calculation and determination of the existence of contingent disposition costs.

This newsletter is intended to highlight areas where professional assistance may be required. It is not intended to substitute for proper tax planning. The professionals at Marmer Penner will be pleased to assist you with any matters that arise.