

Pipelines,  
88(1)(d) bumps,  
and Post-mortem  
Tax Planning:  
Where are we  
now?



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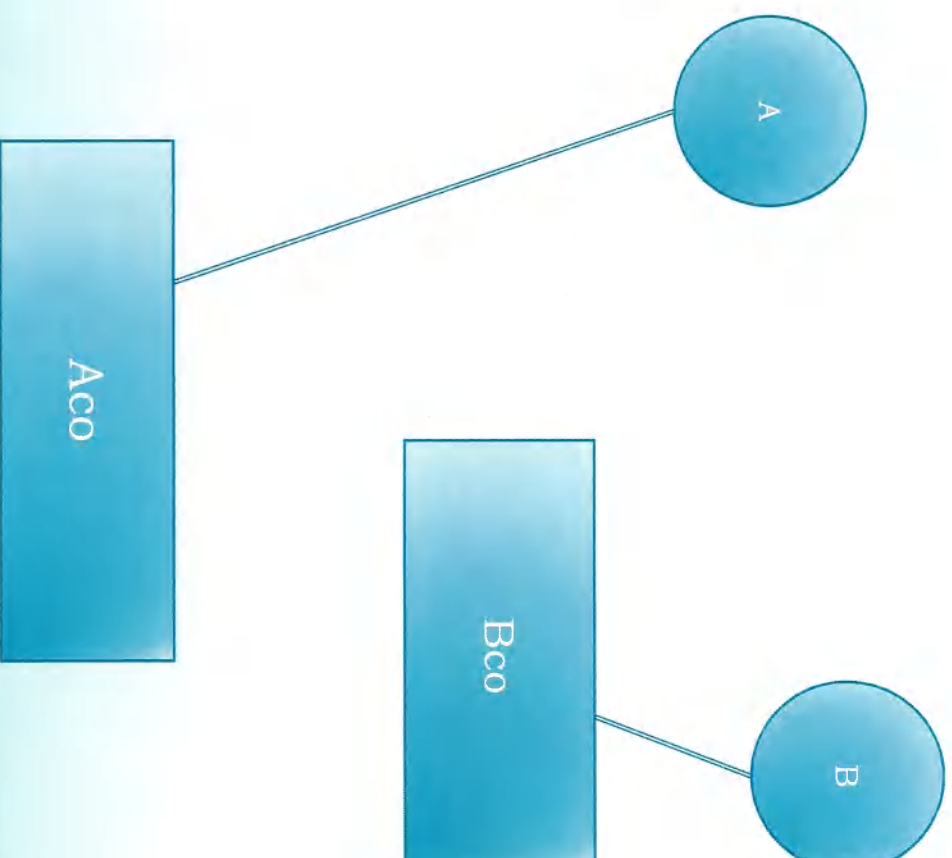
# MacDonald v. R.

Transaction was a “pipeline”

Shareholder “A” sold shares of corporation to individual “B” for a note.

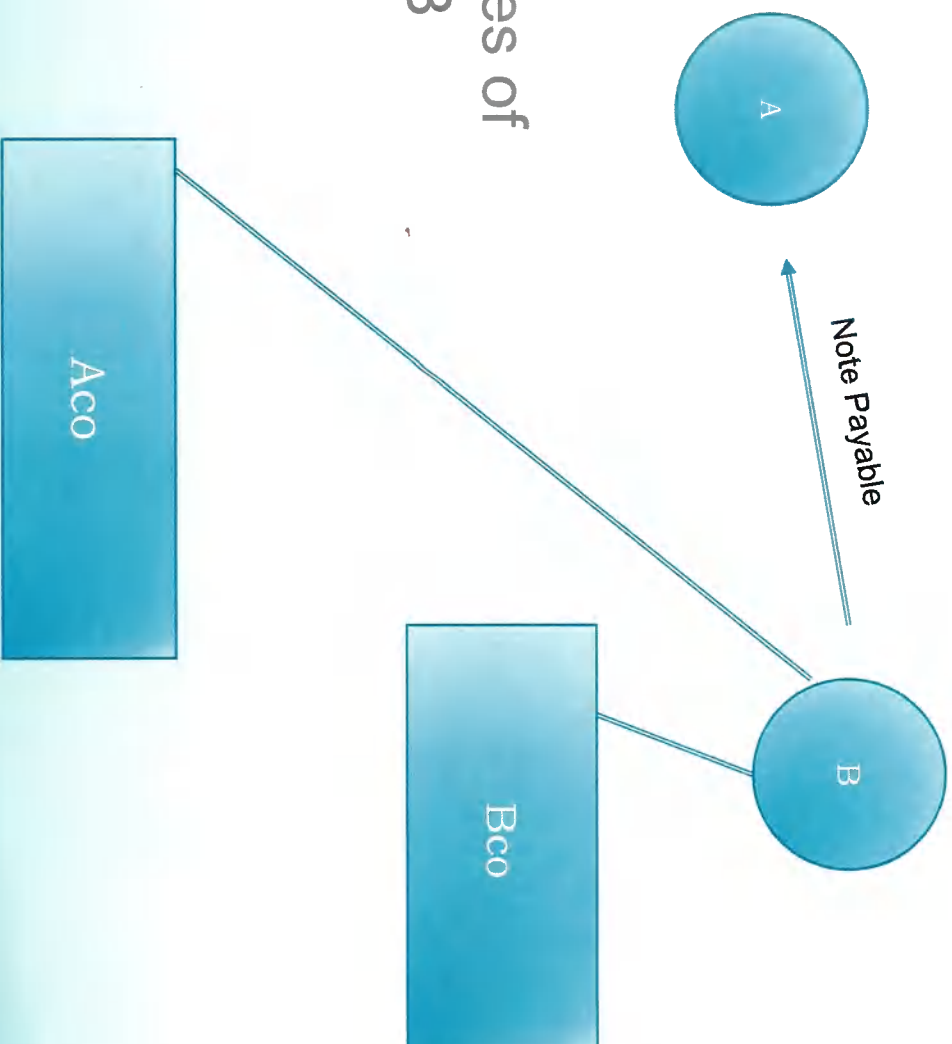
“B” sold shares to “Bco” for a note (no capital gains exemption claimed; therefore “hard” ACB to B

# MacDonald Pipeline



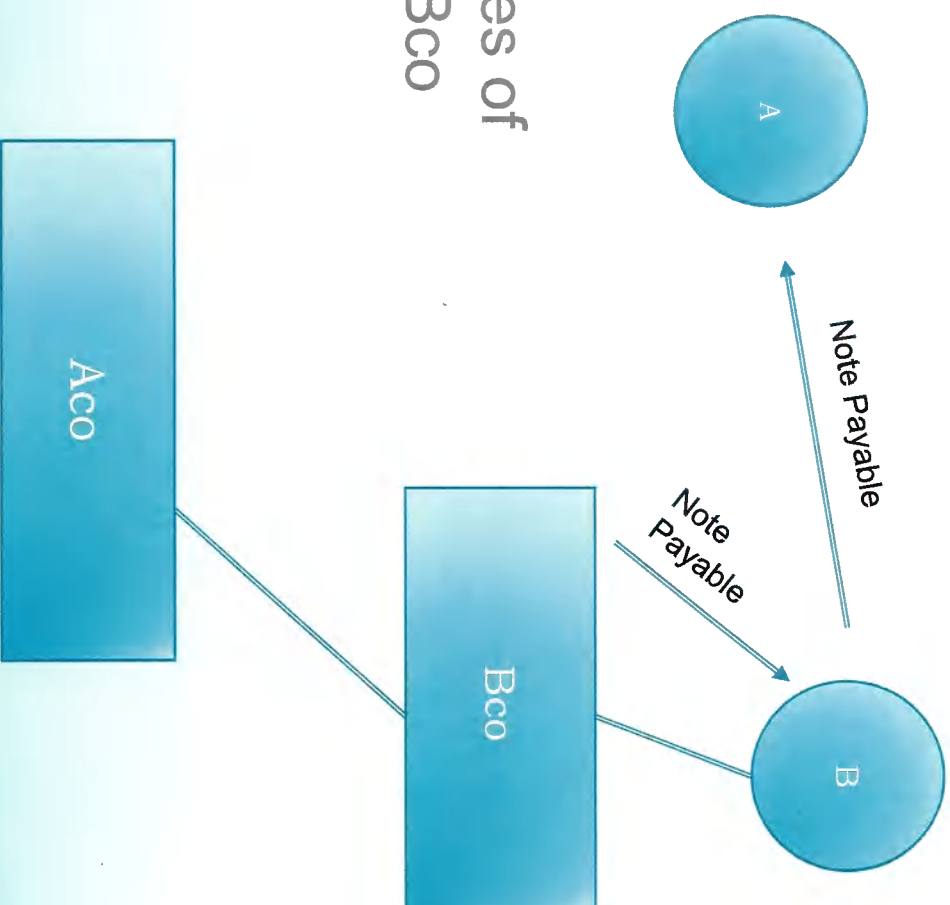
# MacDonald Pipeline

- Sale of Shares of Aco by A to B



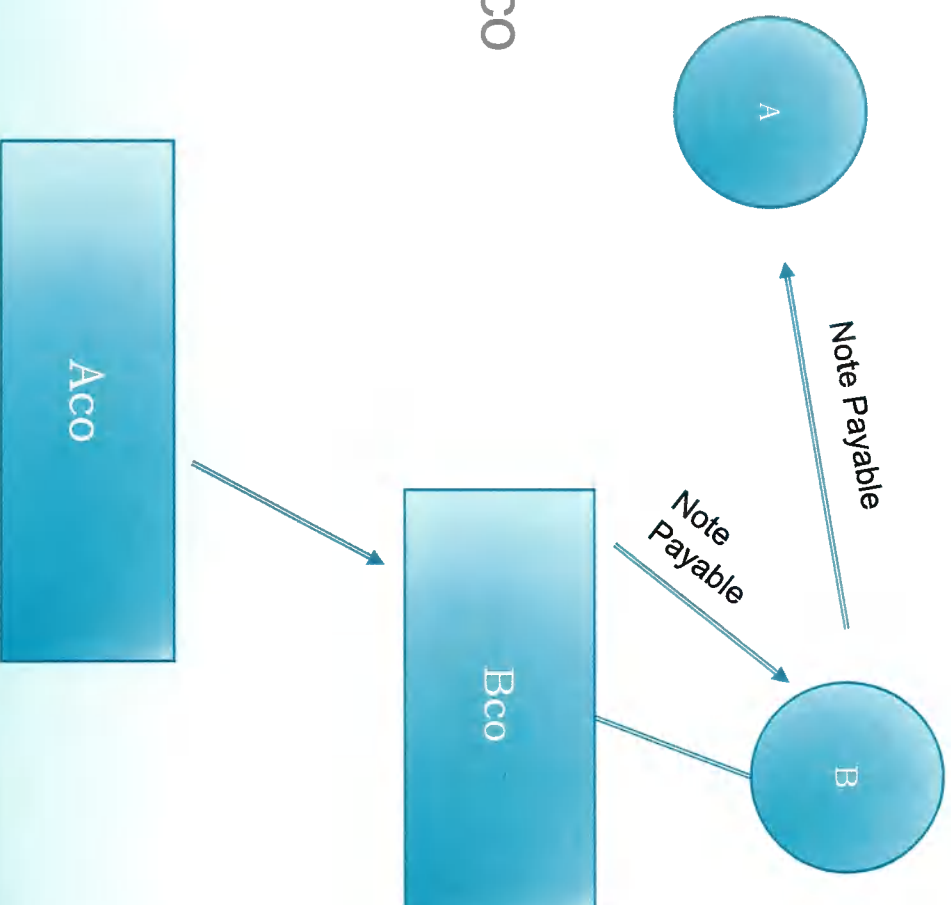
# MacDonald Pipeline

- Sale of Shares of Aco by B to Bco

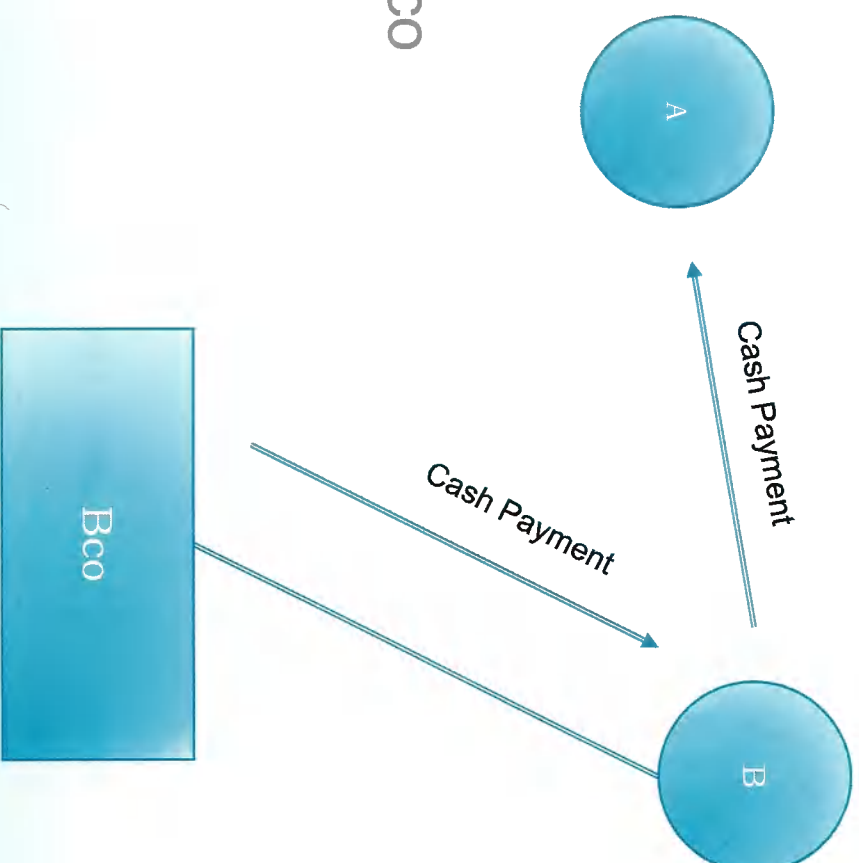


# MacDonald Pipeline

- Windup of Aco into Bco



# MacDonald Pipeline



- Windup of Aco into Bco



## S. 84(2)

- **84(2)** Where funds or property of a corporation resident in Canada have at any time after March 31, 1977 been distributed or otherwise appropriated in any manner whatever to or for the benefit of the shareholders of any class of shares in its capital stock, on the winding-up, discontinuance or reorganization of its business, the corporation shall be deemed to have paid at that time a dividend on the shares of that class equal to the amount, if any, by which
- (a) the amount or value of the funds or property distributed or appropriated, as the case may be,
- exceeds
- (b) the amount, if any, by which the paid-up capital in respect of the shares of that class is reduced on the distribution or appropriation, as the case may be,
- and a dividend shall be deemed to have been received at that time by each person who held any of the issued shares at that time equal to that proportion of the amount of the excess that the number of the shares of that class held by the person immediately before that time is of the number of the issued shares of that class outstanding immediately before that time.

# Federal court of Appeal

- “in any manner whatever” includes the pipeline transaction
- The words “distributed or otherwise appropriated *in any manner whatever* on the winding-up, discontinuance or reorganization of its business” are words of the widest import, and cover a large variety of ways in which corporate funds can end up in a shareholder’s hands.

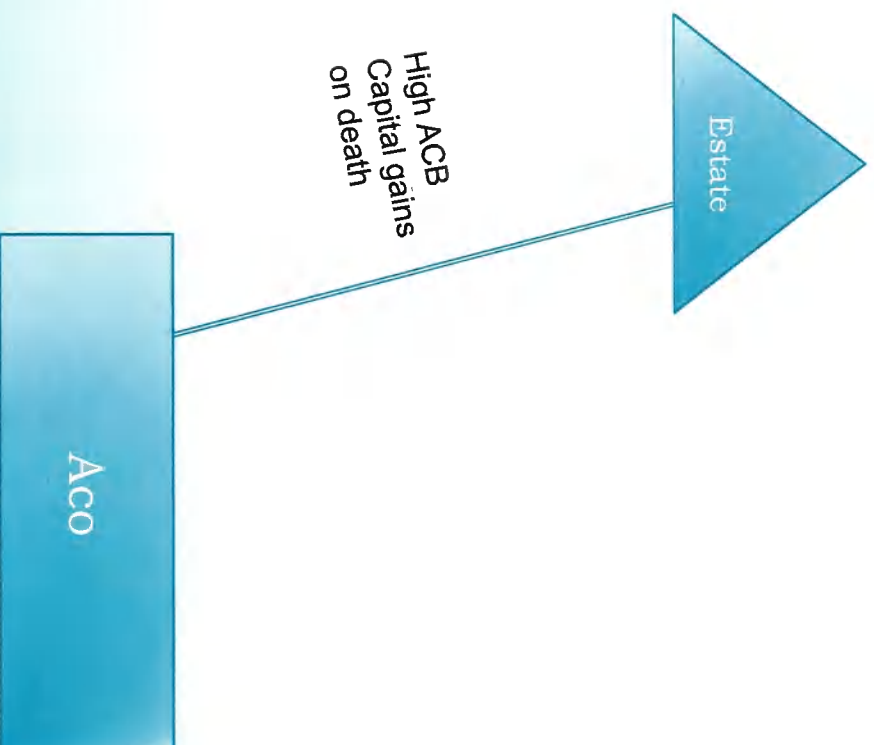
# Result

- Dividend in the hands of the original shareholder, even though said person was not a shareholder “at the time” of the distribution.
- *MacDonald* was *inter vivos* but had large implications for *post-mortem* planning

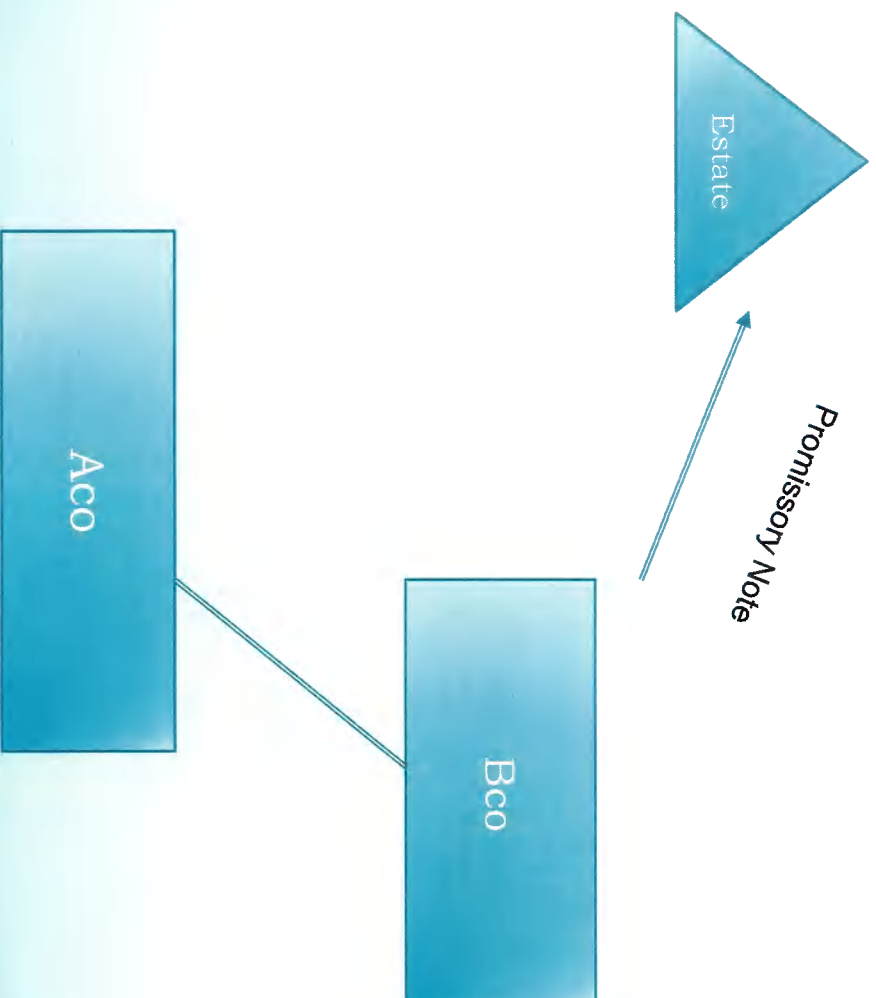
# Why Pipeliness?

- In 2000, the capital gains inclusion rate fell from 75% to  $66\frac{2}{3}\%$ , and then to 50%.
- Spread in taxation rates between dividends and capital gains continues to widen.
- Capital gains: 26.65%
- Non-eligible dividends: 47.14%

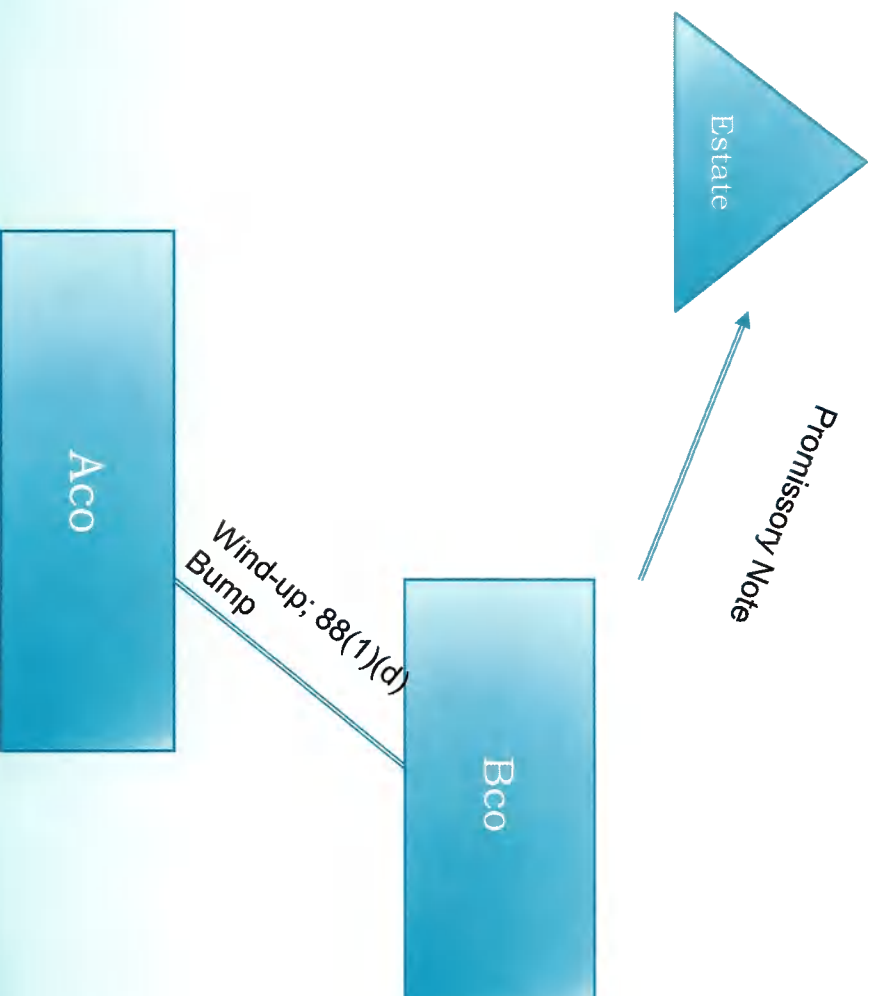
# Post-Mortem Pipeline



# Post-Mortem Pipeline



# Post-Mortem Pipeline



# Comparison

- \$1 million capital gain; tax \$266,500
- Redemption of shares 164(6): tax \$471,400
- Pipeline savings: \$204,900



# CDA & RDTOH

- FMV = \$1 million;
- CDA = \$250,000
- RDTOH = \$100,000
- Straight Pipeline; Tax = \$266,650
- After-tax yield = \$733,350

# CDA & RDTOH

- Redeem \$250,000 of shares with CDA
- Redeem \$261,100 of shares to recoup RDTOH
- Pipeline for \$588,900 (balance of \$488,900 plus RDTOH refund)
- CDA = \$250,000 (Tax = \$33,300)
- Dividend = \$261,100 (Tax = \$123,100)
- Pipeline = \$588,900 (Tax = \$157,000)
- Net after-tax yield = \$786,600

# Pre-death planning

- Clear out CDA (avoid  $\frac{1}{2}$  loss denial penalty)
- Clear out RDTOH (may allow some deemed dividends taxed at lower marginal rates)

# CRA Policies

- Leave corporation's legal existence and business alone for one (1) year
- Following one (1) year period, gradually pay off the note
- Numerous favourable rulings.

# Pipeline and Butterfly

- CRA confirms that 55(2) does not apply to redemptions of “high ACB” shares
- If a freeze was previously in place, it may be tax-efficient to butterfly the corporation
- Query: pipeline pre-butterfly or post-butterfly?
- One (1) year requirement.

# Shareholder agreements and Wills

- Need for flexibility
  - CDA,
  - RDTOH,
  - Life-insurance proceeds (grandfathered or not)
- Presence of Non-resident heirs

# Non-Resident issues

- 212.1 – ACB not recognized; therefore no pipeline possible
- Reduction of dividend withholding rates under treaty may make 164(6) more advantageous
- Transfer to “Newco”, then wind-up prior to 164(6) redemptions to access 88(1)(d) bump

# *Inter vivos Pipeline*

Sale to 3<sup>rd</sup> party

Section 85 rollover

Downstream pipelines

