

Case Studies

Note: Given the complexities of income tax in any situation, the case studies have been created for illustrative purposes only. Owners are strongly encouraged to meet with their accountants and tax advisors early in the process to assess their specific tax consequences.



CRA CAUTION

Should CRA choose to object to the valuation, Jen and Paul should have a valuation of the business completed by a Chartered Business Valuator (CBV) so they are able to justify the valuation should CRA reassess the transaction. CBV fees vary depending on the complexities of the business. Jen and Paul should budget at least \$7,500 for a CBV. Challenges tend to occur in the context of family transactions or tax-free rollovers. When independent 3rd parties are involved, there are fewer CRA challenges.

Abattoir

Jen and Paul live in a small town (less than 2,500 residents). The economy in the area is agriculture – primarily the production of crops, beef, and hogs. Jen and Paul established the abattoir in 1995. It now has 14 people employed in production, shipping/receiving, retail and support roles. Jen and Paul continue to work as general managers, are responsible for new business development, and are actively involved in industry events and local organizations. The abattoir has been profitable. In addition to taking small salaries, dividends from the business have provided cash to invest outside the business. This is available to them to partly fund their retirement. The business has been valued at \$425,000 - \$500,000 with much of the value related to the business's long-standing reputation and ongoing customer contracts. None of Jen and Paul's three children are interested in taking over the family business. They have permanently moved to the city.

Utilizing the Exit Option Checklist (Appendix 3), the business owners and their advisors decide the most likely exit options are:

1. **Sale to workforce**
2. **Sale to a worker co-operative**
3. **Sale to a 3rd party**

As an abattoir, it has been challenging to hire the talent needed to grow the business, however, the team has gelled and turnover is relatively low. Two of the production floor employees have been with the company for 6 and 10 years, respectively. Establishing team leaders and supervisors has lessened the day-to-day operational demands on Jen and Paul. The owners are concerned about the fit of their replacement with the existing team. They would prefer to sell the business to their employees, who are like family to them. They do not know how to make that happen. If a sale to employees is not an option, they will go to market in search of a 3rd party buyer. They have come to their business advisor for advice.

Asset Share vs Share Sale

Demonstrating to Jen and Paul the after-tax cash available through a share sale, the advisor provides them with information so they can structure the deal in a way that indeed makes employee ownership possible.¹ If the shares of the abattoir qualify for the capital gains exemption, the sale of the shares can be accomplished on a tax-free basis. Assuming this is the case, the after-tax cash would be the agreed purchase price of the business. The differential tax treatment of

capital gains makes it attractive for Jen and Paul to sell shares of the business vs the assets, even if the sale price is at the lower end of the valuation range. A lower purchase price will favourably impact employee ownership. Some lenders may require vendors to defer their payments until the lender has been fully repaid.² Assuming a 5-year term loan to the lender, that would mean Jen & Paul would receive the majority of their funds on closing from the bank financing and the employee down payments. The remaining vendor financing payments would begin 4-5 years after the sale, when the lender's loan has been substantially repaid.

There are two levels of tax with an asset sale.

- Tax paid by the corporation on the sale of assets and
- Tax paid personally by the seller when the net proceeds are withdrawn from the company

After tax proceeds to Jen and Paul are \$352,809.69. Please refer to Appendix 4 for full calculations.

The Next Decade for Jen and Paul

Table 1 below outlines a potential scenario of how the next decade could roll out for Jen and Paul. **Numbers are for illustrative purposes only. Each situation is unique and after-tax proceeds must be calculated for the specific circumstances.**

Assumptions:

TABLE 1: ABATTOIR ASSUMPTIONS		Interest	Interest only (Annual)	Principal + Interest (Monthly)
Sale Price	\$475,000			
Cash on Closing:				
From the Bank loan – 50%	\$237,500	10%		\$4,746.36
From the Down Payment – 25% ³	\$118,750			
Vendor Financing – 25% - Paid to Jen and Paul	\$118,750	8%	\$9,500	\$2,407.82

1. Net cash from sale invested at 6%. Income withdrawn each year to fund retirement to approximately \$60,000
2. Seller receives interest only payments for 4 years, simple interest calculated for illustrative purposes
3. Vendor financing principal & interest commences in year 5 (final year of bank loan)
4. Have not factored in tax on personally received dividends or interest on an annual basis

Tables 2 and 3 below demonstrate two scenarios for the next decade of cash flows related to the transaction, financing and investing activities that could be undertaken. In this example, we've assumed an annual income (cash) requirement for Jen & Paul is approximately \$60,000. We have not factored in other income or assets that may be available to the couple to fund their retirement.

TABLE 2: PRE-TAX CASH FLOW - ASSET SALE

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	Total
Salary/Dividend	\$60,000	\$60,000									\$120,000
											\$-
Cash on Closing		\$356,250									\$356,250
Income Tax (See Appendix 4)		-\$122,190									-\$122,190
Invested net proceeds from sale		\$234,060									\$234,060
Interest from Vendor Financing			\$9,500	\$9,500	\$9,500	\$9,500					\$38,000
Cash Withdrawn from investment			\$35,000	\$35,000	\$40,000	\$45,000	\$25,000	\$30,000	\$24,060	\$-	\$234,060
Principal & Interest Vendor Financing							\$28,894	\$28,894	\$28,894	\$28,894	\$115,576
Investment Income			\$14,044	\$11,944	\$9,844	\$7,444	\$4,744	\$3,244	\$1,444	-\$0	\$52,705
Total Cash (pre-tax)	\$60,000	\$528,119	\$58,544	\$56,444	\$59,344	\$61,944	\$58,638	\$62,138	\$54,398	\$28,894	\$1,028,460

Investment Account - Beginning	\$-	\$-	\$234,060	\$199,060	\$164,060	\$124,060	\$79,060	\$54,060	\$24,060	-\$ 0	
Deposit / Withdrawal	\$-	\$234,060	-\$35,000	-\$35,000	-\$40,000	-\$45,000	-\$25,000	-\$30,000	-\$24,060	\$-	-\$0
Investment Account - End	\$-	\$234,060	\$199,060	\$164,060	\$124,060	\$79,060	\$54,060	\$24,060	-\$0	-\$0	

Interest @ 6%			\$14,044	\$11,944	\$9,844	\$7,444	\$4,744	\$3,244	\$1,444	-\$ 0	
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TABLE 3: PRE-TAX CASH FLOW - SHARE SALE

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	Total
Salary/Dividend	\$60,000	\$60,000									\$120,000
											\$-
Cash on Closing		\$356,250									\$356,250
Income Tax (AMT may apply)											\$-
Invested net proceeds from sale		\$356,250									\$356,250
Interest from Vendor Financing			\$9,500	\$9,500	\$9,500	\$9,500					\$38,000
Cash Withdrawn from investment			\$35,000	\$35,000	\$35,000	\$35,000	\$20,000	\$20,000	\$20,000	\$20,000	\$220,000
Principal & Interest Vendor Financing							\$28,894	\$28,894	\$28,894	\$28,894	\$115,576
Investment Income			\$21,375	\$19,275	\$17,175	\$15,075	\$12,975	\$11,775	\$10,575	\$9,375	\$117,600
Total Cash (pre-tax)	\$60,000	\$416,250	\$65,875	\$63,775	\$61,675	\$59,575	\$61,869	\$60,669	\$59,469	\$58,269	\$967,426

Investment Account - Beginning	\$-	\$-	\$356,250	\$321,250	\$286,250	\$251,250	\$216,250	\$196,250	\$176,250	\$156,250	
Deposit / Withdrawal	\$-	\$356,250	-\$35,000	-\$35,000	-\$35,000	-\$35,000	-\$20,000	-\$20,000	-\$20,000	-\$20,000	\$136,250
Investment Account - End	\$-	\$356,250	\$321,250	\$286,250	\$251,250	\$216,250	\$196,250	\$176,250	\$156,250	\$136,250	

Interest @ 6%			\$21,375	\$19,275	\$17,175	\$15,075	\$12,975	\$11,775	\$10,575	\$9,375	
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The Next Decade Total Cash Comparison

Table 4 below summarizes the differences in the pre-tax cash flows under each scenario assuming the same price is negotiated in either an asset or share sale. It is not uncommon for the prices to be different under each scenario to account for differing tax consequences. The after-tax proceeds under either scenario factor into the cash available to invest which impacts the investment income as well as the annual draws to fund post-sale activities.

TABLE 4: COMPARISON SHARE SALE & ASSET SALE	Share Sale	Asset Sale	Difference
Salary / Dividend	\$120,000	\$120,000	\$-
At Closing	\$356,250	\$234,060	\$122,190
Interest on Vendor Financing	\$38,000	\$38,000	\$-
Vendor Financing Principal + Interest	\$115,576	\$115,576	\$-
Investment income on net proceeds invested	\$117,600	\$52,705	\$64,895
Total	\$747,426	\$560,341	
Total Share Sale Advantage			\$187,085

As this simple example demonstrates, there are significant tax savings to the seller (Jen and Paul) if the deal is structured as a share sale (\$187,085). Should the seller accept an offer at the lower end of the valuation for a share sale, they can not only net higher after-tax proceeds when compared with an asset sale, but also make the acquisition more attractive to employees and reduce the cash flows required by these buyers to service the debt on the deal.

KEY MESSAGES:

- Encouraging clients to consider a share sale may significantly impact their net proceeds, thus enabling them to invest more funds to finance their post-exit lifestyle
- Financial institutions may require vendors to “go second” requiring them to defer principal repayments of their loans until the bank has been substantially repaid
- Advisors can support a client in addressing common buyer reservations associated with a share purchase such as potential liabilities, restructuring, cleansing the company⁴ and / or removing assets that they do not want to sell with the business (i.e. real property)

Should the seller stay on in a consulting or employee role, additional income potential from salary or consulting fee is possible through the transition years.

Based on this information Jen and Paul decide to approach their employees to see if they are interested in buying the business from them. The following shows some of the options Jen and Paul could pursue. In these examples, we make a few assumptions:

- The lenders agree to lend 50% with 25% Vendor Financing and 25% contributed by employees.
- The lender will take the tangible assets as security (i.e. real estate, equipment, vehicles, machinery) and require personal guarantees from the employees (and often their spouses).⁵
- The lenders will likely require a General Security Agreement (GSA) extending their security to all assets.
- The employees have the financial capacity and enough confidence to pursue ownership of the business.⁶

Sale to Employees

Ideally, Jen and Paul would like to see their employees take over the company. They have developed the team over time and have confidence in their ability to grow the company as owners. Contrary to some of their counterparts, Jen and Paul are not worried about their employees running the business into the ground or making risky decisions. The team has close family ties, and strong relationships that can allow for working through conflicting perspectives. The following explores two examples of how Jen and Paul could facilitate the transition of ownership to the employees. The first is through a direct sale using a Unanimous Shareholder Agreement (USA), and the second is a Worker Co-operative.

Direct sale to Employees or Private Employee-owned Company

Depending on the financial capacity of employees, one (or more than one) employee could purchase the company. If it were more than one, they could have equal ownership if each employee contributed an equal investment. Or there could be a majority shareholder with other employees holding a minority interest.

Some employees may have competing goals and although buying the business might be nice, it plays second fiddle to buying a house or financing another large purchase. A direct sale to one or more employees is often a best fit when employees are already in a leadership / management position and there are a small number of employees. Although it might initially seem inclusive to have each employee with equal voting power (equal ownership), this may lead to major challenges in the future when decisions need to be made.

For clarity regarding decision making and future entry and exit of owners, a Unanimous Shareholders' Agreement (USA) is a critical document to create. The intent is that all shareholders are bound by, and subject to the USA, which is the rulebook for how communication and owner-related transactions occur.

Establishing an Employee Stock Ownership Plan (ESOP)

Alternatively, if Jen and Paul were willing to exit the company over time, an Employee Stock Ownership Plan (ESOP) can be established. This allows them the flexibility to leave the company on their own time and terms. If the company was set up with a small number of shares (i.e. 100 Class A shares),

each share may be very expensive for an employee to buy. A simple stock split can be done which could result in, for example, 1 million shares. This effectively reduces the market value of each share to make them affordable for the employees.

Jen and Paul can sell their own shares to the employees over a period of a few, or many years. Typically, an ESOP is set up so there is an annual offering of shares to employees.

To ensure broad ownership, there is typically a restriction on how much of the company each employee can own. For example, the restriction could be that no individual employee can own more than 5% of the common shares.

With an ESOP, the employee-owners are subject to an ESOP Shareholders' Agreement, which is significantly different than a USA. It describes how employees buy shares, how they sell their shares, and a variety of other rules affecting ownership. The agreement is clear that the ESOP employees do not sit on the Board and are not involved in the strategic decision-making of the company.

The ESOP Shareholders' Agreement is superseded by a Unanimous Shareholders' Agreement, if one is in place.

Regardless of how the share transaction occurs, when Jen and Paul sell their own shares, they take the money from the sale. This allows them to exit in a tax preferred way where they may be able to utilize the Lifetime Capital Gains Exemption. Alternatively, the company could issue new shares from its treasury, effectively diluting Jen and Paul's interest in the company. When treasury shares are sold, the money stays in the company and can be used to grow the business without requiring Jen and Paul to sell their shares.

If the company were to buy back shares (redeem for cancellation) from Jen, Paul, or employees, a deemed dividend is triggered which is less tax-advantageous than selling to another shareholder or another third party.

Should a change in control take place, CRA requirements will impact accounting and legal fees during the year the change in control occurs. In essence, the company will need to create financial statements and file returns with CRA when the change of control occurs, effectively doubling the accounting fees in the year this happens.

Sale to a Worker Co-operative

Another option for the employees could be to form a worker co-operative. Some reasons for this could be:

- The cost of incorporation may be lower than establishing and administering an ESOP and the minimum requirement is three member-owners. A lower investment on due diligence may offset the investment in setting up the ESOP. The cost of incorporating a co-op will be higher than setting up a regular private company as it requires a specialist.
- Worker co-ops are based on a one-member one-vote governance structure. This works well for groups that want to share responsibility equally, have a great track record of working together and want to see the business have long-term success. The team may not be ready for collective decision making if the company has been run by management.
- The cost of a share in the company may be too expensive for an individual employee. A worker co-op may provide a structure that could raise the capital in a way that puts less burden on the individual employee.

This last point is likely a driving factor for many employees. The risk of being a business owner, counter-balanced with existing personal financial obligations, can make buying all or part of a business seem unattainable. A worker co-op structure provides a different share structure as well as an opportunity to, potentially, access other funds.

If the employees in this case study were to pursue purchasing the abattoir through a worker co-op, we might see a different scenario. For example, the fourteen employees could incorporate a worker co-op and follow this type of pathway:

- Cost of incorporation: \$2,000.00
- Membership shares in the co-op: 14 employees at \$5,000 each = \$70,000
- Canadian Worker Co-operative Federation support
 - » \$2,000.00 Technical Assistance Grant
 - » Tenacity Works Loan of \$50,000.00

In this scenario the newly formed worker's co-op has \$120,000.00 in combined equity and debt. They use this to secure a loan from the bank for \$237,500.00.

Summary - Abattoir Example

Table 5 below outlines the assumptions and data for possible deal structures with different buyer groups. Note the ability of the worker co-operative option to access loan grants from co-operative lenders, thus effectively reducing the amount required from each employee.

TABLE 5: DEAL STRUCTURE - SHARE SALE	Sale to Workforce	Sale to Strategic Buyer	Sale to a worker co-operative	Sale to Individual
Purchase Price	\$475,000	\$475,000	\$475,000	\$475,000
Down Payment from Buyer (25%)	\$118,750	\$118,750	\$70,000	\$118,750
Loan & Grant - Canadian Worker Co-operative			\$50,000	
Remainder	\$356,250	\$356,250	\$355,000	\$356,250
Bank Financing (50%)	\$237,500	\$237,500	\$237,500	\$237,500
Remainder	\$118,750	\$118,750	\$117,500	\$118,750
Vendor Financing (paid 2nd to Bank)⁷	\$118,750	\$118,750	\$117,500	\$118,750

When a sale to employees is contemplated, the number of buyers may exceed 1, thus spreading the 25% down payment amongst the employee ownership group. This may allow individual employees to secure financing through character loans, term loans secured with their home equity, or loans designed to support a specific group of individuals such as women, Indigenous individuals; or from groups such as the Worker Co-operative Federation. With 14 employees involved in either a direct acquisition or a worker co-operative, the 25% down payment of approximately \$8,500 may be available from savings, loans from family/friends or a home equity loan.

Although debt service obligations will fall to the buyer, sellers are wise to consider the cash flow required to service debt when negotiating and during the Prepare phase. The Prepare Phase includes ensuring the business can service any debt that will be incurred on the transaction, which is included in projections that would be shared during the Due Diligence step in Finalizing the Sale phase. Sellers who assume they will receive full cash on closing are often disappointed. The buyers may not have the liquidity to close the deal without a financial partner. This additional debt servicing cost must be built into the plan because it can significantly affect the operating cash flows. Table 5 below outlines the annual debt service for financing from lenders including vendor financing.

TABLE 6: ANNUAL DEBT SERVICE REQUIREMENTS FROM CASH FLOW	Payment	Principal
Bank (assumed 10% interest & 5-year loan)	\$56,950	\$237,500
Vendor (assumed 10% interest & 3 yr amort. Principal payments deferred to yr 4)	\$43,318	\$118,500

Automotive Repair Shop

Hank grew up in the region and after completing his automotive mechanic journeyman certificate, he returned to his hometown and married his high school sweetheart. After working for a car dealership and commuting to the city for a few years (an hour away), he decided to open a local automotive repair shop. That was 20 years ago. With their children ready to leave the nest, Hank and his wife are thinking about retirement and what to do with the business. There are only a few competitors in the region. That said, there are many hobbyists who work out of their home-garages and many farmers who manage most of their maintenance tasks fairly well. Yet, Hank does not want to close the doors. People in the surrounding communities rely on his shop, as do the 6 employees and their families.

The business has been valued at \$170,500, including \$80,000 in equipment and supplies. Most of the income has been reinvested in the business but Hank has drawn a healthy paycheque for the past decade allowing him to have a nest egg set aside for retirement. That investment coupled with his wife's teaching pension will provide them with a comfortable retirement. Any proceeds from the sale of the business will help with the little extras and projects around the house. Hank is willing to stay involved in the business for a few years, if necessary, to mentor the new ownership and pass on his knowledge. He'd like the mentorship role to be part-time, giving him flexibility to explore his hobbies and enjoy more holiday time with his wife.

As was the case in the abattoir example above, there will be no tax on the capital gain if the transaction is structured as a share sale. If structured as an asset sale, there will be tax in the corporation on the recaptured capital cost allowance, if any, and the goodwill.

Utilizing the Exit Checklist (Appendix 3), Hank and his advisors decide that the most likely exit options are:

- 1. Sale to workforce**
- 2. Sale to 3rd party**
- 3. Sale to an ODC**

However, Hank is concerned about selling to employees. In the past, he's found it difficult to recruit and retain quality employees. He has a tough time seeing any one of them stepping into a leadership role and being a suitable owner. A few of them are pretty green, with just a few years experience since school. Several have indicated their marriages are on the rocks, which could drastically affect their focus and financial capacity.

Selling to a 3rd party is a viable option. There are a few reputable shops within an hour's commute that may be interested in expanding their operations into a second location. However, Hank is concerned that they might buy his shop and close the doors. He is also concerned about a values fit, as they run their businesses very differently from Hank. It may be a clash of cultures, so to speak. He is also aware of his own mental baggage from high school days when he competed against those potential buyers in football and hockey. Past rivalries run deep.

Sale to Opportunity Development Co-operative

Hank's advisor mentioned the possibility of finding a group of local or regional investors (community citizens) who would be able to purchase the shop, potentially over time, especially if Hank is willing to be active in the transition period.

This might be a great alternative to consider, but Hank doesn't know what to do next. His advisor referred him to ACCA where he learned about Opportunity Development Co-operatives, or ODC (read more about an ODC in Appendix 1). Hank was happy to learn there was a group of people exploring an ODC in his town. More importantly, as someone who has been involved in his community, Hank knew a lot of people, including other business owners and accredited investors.⁸

After a few meetings with Hank, the ODC board members realized they could acquire the business, keep the existing staff working, and there would be no breaks in continuity. If needed, they could hire a manager.

The track-record of the shop demonstrated the investment could provide a return to the ODC: a dividend at least equal to the paycheque Hank was drawing from the business. To bolster the potential for long-term success, the ODC decided any returns for the first 2 years would be used to pay Hank as a contractor to facilitate the transition in management, and to reinvest in a few critical areas to grow the company. The ODC's expectations are that the business will have better margins in the third year, which will provide a great dividend to the member-investors. Future profits could result in opportunities to acquire other repair shops in the region.

Over the next three months,⁹ the ODC was incorporated and an offering document was created to sell shares. A pool of local capital was collected to acquire Hank's business. The offer was structured as an 80% share sale on closing, with the final 20% equity purchased in 2 years when Hank plans to exit. As the ODC had a great board of directors and Hank had a strong reputation in his community, the funds raised for the ODC to acquire the business was completed within six weeks.

Summary - Automotive Shop, 2 Years Later

Hank continued to work in the shop, transitioning his knowledge to the newly hired manager, and together they implemented the new strategies suggested by the Board. Hank hadn't experienced the benefits of an Advisory Team before, and he noticed how quickly the business grew under the ODC's leadership. Through implementing a few strategic changes to increase efficiency and enhance business development practices, the shop quickly became more profitable. Hank felt good about leaving the shop in good hands and seeing the shop's value improve from \$170,500 to \$187,500 in 2 years. The ODC's 80% share was now valued at \$150,000 or 10% ROI. Hank's 20% share now valued at \$37,500.

APPRECIATION VALUE	
Deal Structure	Sale to ODC
Purchase Price	\$170,500
80% purchase	\$136,400
Value of Hank's retained 20% interest	\$34,100
20% purchased in 2 years at FMV (Assumed)	\$37,500

The Next Decade

Tables 7 outlines a potential scenario of how the next decade could roll out for Hank under the scenario outlines in the previous section. **Numbers are for illustrative purposes only. Each situation is unique and after-tax proceeds must be calculated for the specific circumstances.**

Detailed calculation can be found in Appendix 4 where the tax on a share sale is compared to taxes if the sale were structured as an asset sale.

TABLE 7: PRE-TAX CASH FLOW - SHARE SALE

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	Total
Dividend	\$60,000	\$12,000									\$72,000
Consulting Fees		\$50,000									\$50,000
Cash on Closing (80% sale)	\$136,400		\$37,500								\$173,900
Income Tax (Assumed 0 with LCGE)	\$-		\$-								\$-
Income Tax	Tax on dividend, consulting fees and investment income										
Funds Withdrawn (invested)	-\$136,400	-\$10,000		\$30,000	\$30,000	\$30,000	\$30,000	\$26,400	\$-	\$-	\$-
Investment Income		\$8,184	\$8,784	\$8,784	\$6,984	\$5,184	\$3,384	\$1,584	\$-	\$-	\$42,888
											\$-
Total Cash (pre-tax)	\$60,000	\$60,184	\$46,284	\$38,784	\$36,984	\$35,184	\$33,384	\$27,984	\$-	\$-	\$338,788

Investment Account - Beginning	\$-	\$136,400	\$146,400	\$146,400	\$116,400	\$86,400	\$56,400	\$26,400	\$-	\$-	
Deposit / Withdrawal	\$136,400	\$10,000		-\$30,000	-\$30,000	-\$30,000	-\$30,000	-\$26,400	\$-	\$-	\$-
Investment Account - End	\$136,400	\$146,400	\$146,400	\$116,400	\$86,400	\$56,400	\$26,400	\$-	\$-	\$-	

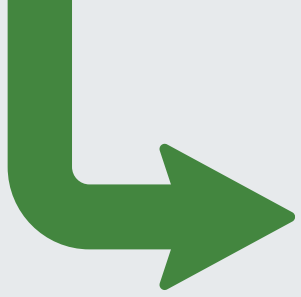
Interest @ 6%		\$8,184	\$8,784	\$8,784	\$6,984	\$5,184	\$3,384	\$1,584	\$-	\$-	
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KEY MESSAGES:

- Encouraging business owners to consider a share sale can significantly impact their after-tax proceeds, enabling them more funds to finance their post-exit lifestyle.
- It is less likely to negotiate a staged sale if the sale were structured as an asset sale.
- If the business owner is willing to continue working through the transition years as an employee, or in a consulting role, additional income from a salary or consulting fees is possible.
- If an ODC is able to raise funds from accredited investors, there could be a reduction in outside financing requirements (i.e. institutional lenders) to close the sale. This could accelerate the timeline for the seller and reduce complexity by having fewer players involved.
- An ODC can invest in shares of the business. It can also provide loans. Or a combination can be used to invest in transitioning and/or growing local businesses.

Case Studies Endnotes

1. Alternatively, the sellers freeze some (or all) of the value in preferred shares, which allows the employees to buy at a much lower rate. They may not need bank financing. The preferred shares are paid back over time (with an agreement) and may have interest or dividends paid to make it advantageous to the sellers too. As the preferred shares are paid out, it allows the employees to greatly leverage the value increase.
2. Some lenders will not require deferral of the VTB if covenants are being met and payments won't put them offside. In these cases, VTB might be repaid first if they are short term and when they bear higher interest rates. Bank financing on building can be very long term. Alternatively, the bank loan may be renewed at expiry and those funds used to pay the seller.
3. Bank financing at 50% is used for illustrative purposes only. Banks tend to finance hard assets. In some cases, banks may be willing to finance more of the purchase price (see discussion on Bankability).
4. Cleaning refers to the process of removing some assets from the company, most often cash, that currently prevents the sale of the company's shares from meeting the definition of Qualifying Small Business Corporation in order to qualify for the Lifetime Capital Gains Exemption.
5. Personal guarantees will be joint and several, so better off employees will be more on the hook for this than the less better off ones. Joint and several liability allows the lender to recover from any or all of them.
6. This is not always the case; some employees will need support from an advisor in navigating the gauntlet put up by lenders. They may have experience dealing with consumer lending such as a car loan or a home mortgage, but many have no experience dealing with small business banking financial advisors. It is important to explore resources that can help build the capacity of the employees to confidently take-on an ownership role.
7. Warrilow, J. (2021). *The Art of Selling your Business* describes post-sale roles sellers can play in the business. These include 1) a lender offering vendor financing, 2) an executive with an earnout, 3) a consultant under contract, or 4) as a shareholder if recapitalization occurs. The deal terms can include one of more of these roles.
8. An accredited investor is an individual or a business entity that is allowed to trade securities that may not be registered with financial authorities. They satisfy at least one requirement regarding their income, net worth, asset size, governance status, or professional experience.
9. Depending on the capacity of the group, and the availability of qualified investors, ODCs can often take six months to a year to incorporate. For the sake of this example, we assume some initial work has been completed and the Automotive Repair Shop is in a good position to be acquired.



Appendix

Case Study Data and Calculations



Abattoir

	COST	TAX VALUES	FMV
Cash + cash equivalents	\$60,000.00	\$60,000.00	\$60,000.00
Accounts receivable	\$7,300.00	\$7,300.00	\$7,300.00
Inventory	\$21,000.00	\$21,000.00	\$21,000.00
Building	\$84,000.00	\$60,000.00	\$180,000.00
Vehicle - Class 10 Equipment (UCC)	\$9,000.00	\$3,000.00	\$15,000.00
Furniture, Computers, Equipment - Class 8 Equipment (UCC)	\$60,000.00	\$85,000.00	\$ 149,634.00
Total Assets	\$241,300.00	\$236,300.00	\$722,300.00

Liabilities			
Accounts payable	\$25,000.00	\$25,000.00	\$25,000.00
GST Payable	\$3,750.00	\$3,750.00	\$3,750.00
Due to related parties	\$45,000.00	\$45,000.00	\$45,000.00
Total Liabilities	\$73,750.00	\$73,750.00	\$73,750.00

Shareholder Equity			
Share Capital / Paid-Up Capital	\$10.00	10	
Retained earnings, beg.	\$67,530.00		
Other Adjustments			
Net Income	\$100,010.00		
Dividends			
Retained earnings, end.	\$167,540.00	\$167,540.00	
Total Equity	\$167,550.00	\$167,550.00	
Liabilities + Equity	\$241,300.00	\$241,300.00	

Valuation - Share Sale	-		\$475,000.00
Valuation - Assets			\$475,000.00

Share Sale After Tax

Proceeds from Sale of Shares	\$475,000.00
ACB	10
Capital Gain	\$474,990.00
Taxable portion of Capital Gain	50%
Taxable Capital Gain	\$237,495.00
Capital Gains Exemption	\$237,495.00
Net included in Taxable Income	\$ -
Tax	\$ -
After tax proceeds	\$475,000.00

IMPLICATION OF ALTERNATIVE MINIMUM TAX (AMT) CAN BE APPLIED

Note 1:

Assuming the shares are qualified small business corporation shares ("QSBC")

However, Alternative Minimum Tax (AMT) will be relevant in the current year, given the size of the gain. While this would likely not be a permanent cost, it would reduce current cash flow. (We ignored personal tax credit in the calculation below):

Calculation of AMT per shareholder:	
"Normal" taxable income	Nil
Capital gain	237,495.00
30% of capital gain (A)	71,248.50
Non-taxable portion of capital gain (B)	237,495.00
Enter the amount from line (A) or (B), whichever is less	\$71,248.50
Basic exemption	(40,000.00)
AMT taxable income	31,248.50
Federal AMT @ 15% per T691	\$4,687.28
Provincial AMT @ 35% of Federal AMT per T1219	\$1,640.55
Total obligation to pay AMT	\$6,327.82
If "Normal" taxable income is available, it is also subject to AMT.	

Asset Sale – After Tax Proceeds

The allocation of proceeds of \$454,000 to fixed assets resulted in the following gains being realized:						475,000.00
						(21,000.00)
						454,000.00
	Cost	UCC	CEC	Fair Market Value	Recaptured Depreciation	Capital Gain
Class 10	9,000.00	3,000.00		27,240.00	N/A	18,240.00
Class 8	60,000.00	85,000.00		177,060.00	-	117,060.00
Building	84,000.00	60,000.00		249,700.00	24,000.00	165,700.00
Goodwill	-			-		-
	\$153,000.00	\$148,000.00	\$-	\$454,000.00	\$24,000.00	\$301,000.00
				Costs and outlays		
					Commission	\$-
					Legal fees	\$-
					Capital gain	\$301,000.00

A)	Calculation of corporate taxable income:			
		Recapture	24,000.00	11%
		Gain from sale (50%)	150,500.00	20%
		Taxable gain from sale of assets	174,500.00	
		Calculation of corporate tax (federal-provincial combined)	32,740.00	

l)	Calculation of cash available for distribution to shareholder:		
		Cash from sale of assets	454,000.00
		Taxes payable from sale of assets	(32,740.00)
		Total liabilities (balance sheet)	(73,750.00)
		Total after-tax corporate cash available	347,510.00
	Calculation of distribution to shareholder:		
		Corporate cash available for distribution as a dividend	\$347,510.00
		Capital dividend account	(150,500.00)
		Balance = actual dividend to distribute to shareholder	\$197,010.00

B)	Calculation of personal tax to shareholder:		
	Calculation of taxable income:		
	Actual dividend received		\$197,010.00
	Gross-up dividend		29,551.50
	Taxable dividend		\$226,561.50
	Calculation of personal tax (federal-provincial combined)		
	Dividend @ 42.31%		\$83,000.31
C)	Calculation of after-tax cash to shareholder:		
	Total proceeds from sale of assets		\$475,000.00
	Cash		\$60,000.00
	AR		\$7,300.00
	Total liabilities (per balance sheet)		\$(73,750.00)
	Corporate taxes payable from sale of assets		(32,740.00)
	Personal tax (see above)		(83,000.31)
	After-tax cash to shareholder		\$352,809.69
	Compare		
	Net proceeds Share Sale		\$475,000.00
	Net proceeds Asset Sale		\$352,809.69
	Difference		\$122,190.31

Auto Shop

Assets	Book Value	Tax Values	FMV
Cash + cash equivalents	\$60,000.00	\$60,000.00	\$60,000.00
Accounts receivable	\$7,300.00	\$7,300.00	\$7,300.00
Inventory	\$11,850.00	\$11,850.00	\$11,850.00
Vehicle - Class 10 Equipment (UCC)	\$460.00	500	\$1,500.00
Furniture, Computers, Equipment - Class 8 Equipment (UCC)	\$43,200.00	15000	\$76,750.00
Total Assets	\$122,810.00	\$94,650.00	\$157,400.00
Liabilities			
Accounts payable	\$14,050.00	\$14,050.00	\$14,050.00
GST Payable	\$3,750.00	3,750.00	3,750.00
Due to related parties	\$45,000.00	\$45,000.00	\$45,000.00
Total Liabilities	\$62,800.00	\$62,800.00	\$62,800.00
Shareholder Equity			
Share Capital / Paid-Up Capital	\$10.00	10.00	10.00
Retained earnings, beg.	\$20,000.00		
Other Adjustments			
Net Income	\$40,000.00		
Dividends			
Retained earnings, end.	\$60,000.00	60,000.00	60,000.00
Total Equity	\$60,010.00	\$60,010.00	\$60,010.00
Liabilities + Equity	\$122,810.00	\$122,810.00	\$122,810.00

Proceeds from Sale of Shares	\$170,500.00
ACB	10
Capital Gain	\$170,490.00
Taxable portion of Capital Gain	50%
Taxable Capital Gain	\$85,245.00
Capital Gains Exemption (Qualify for the exemption - 2 years rule)	\$85,245.00
Net included in Taxable Income	\$-
Tax	\$-
After tax proceeds	\$170,500.00

IMPLICATION OF ALTERNATIVE MINIMUM TAX (AMT) CAN BE APPLIED

Note 1:

Assuming the shares are qualified small business corporation shares ("QSBC")

However, Alternative Minimum Tax (AMT) will be relevant in the current year, given the size of the gain.

While this would likely not be a permanent cost, it would reduce current cash flow.

(We ignored personal tax credit in the calculation below):

Calculation of AMT per shareholder:	
"Normal" taxable income	Nil
Capital gain	\$85,245.00
30% of capital gain (A)	\$25,573.50
Non-taxable portion of capital gain (B)	\$85,245.00
Enter the amount from line (A) or (B), whichever is less	\$25,573.50
Basic exemption	\$(40,000.00)
AMT taxable income	\$-
Federal AMT @ 15% per T691	\$-
Provincial AMT @ 35% of Federal AMT per T1219	\$-
Total obligation to pay AMT	\$-
AMT may recoverable in subsequent years.	
If "Normal" taxable income is available, it is also subject to AMT.	

Proceeds from Asset Sale

The calculations are based on the assumption that the assets are sold at the same time. The allocation of proceeds of \$170,500 to fixed assets resulted in the following gains being realized:						170,500.00
						(11,850.00)
						158,650.00
	Cost	UCC	CEC	Fair Market Value	Recaptured Depreciation	Capital Gain
Class 10	460.00	500.00	1,671.53	N/A	1,211.53	
Class 8	43,200.00	15,000.00	156,978.47	28,200.00	113,778.47	
Inventory						
Goodwill		-	-		-	
	\$43,660.00	\$15,500.00	\$-	\$158,650.00	\$28,200.00	\$114,990.00
				Costs and outlays		
					Commission	\$ -
					Legal fees	\$ -
					Capital gain	\$114,990.00

A)	Calculation of corporate taxable income:		
	Recapture	28,200.00	11%
	Gain from sale (50%)	57,495.00	20%
	Taxable gain from sale of assets	85,695.00	
	Calculation of corporate tax (federal-provincial combined)	14,601.00	
I)	Calculation of cash available for distribution to shareholder:		
	Cash from sale of assets		170,500.00
	Taxes payable from sale of assets		(14,601.00)
	Total liabilities (balance sheet)		(62,800.00)
	Total after-tax corporate cash available		93,099.00
	Calculation of distribution to shareholder:		
	Corporate cash available for distribution as a dividend		\$93,099.00
	Capital dividend account		(57,495.00)
	Balance = actual dividend to distribute to shareholder		\$35,604.00
B)	Calculation of personal tax to shareholder:		
	Calculation of taxable income:		
	Actual dividend received		\$35,604.00
	Gross-up dividend		5,340.60
	Taxable dividend		\$40,944.60
	Calculation of personal tax (federal-provincial combined)		
	Dividend @ 22.18%		\$7,896.97
C)	Calculation of after-tax cash to shareholder:		
	Total proceeds from sale of assets		\$170,500.00
	Cash		\$60,000.00
	AR		\$7,300.00
	Total liabilities (per balance sheet)		\$(62,800.00)
	Corporate taxes payable from sale of assets		(14,601.00)
	Personal tax (see above)		(7,896.97)
	After-tax cash to shareholder		\$152,502.03

COMPARE

Net proceeds Share Sale	\$170,500.00
Net proceeds Asset Sale	\$152,502.03
Difference	\$17,997.97



Exit to Community

**A Business Transition Guide for
Business Advisors & Business Owners**

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