TAX RULES FOR FINANCIAL ADVISORS

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There are many advisors currently considering buying or selling (merging, partnership, etc.) financial advice businesses.

I am not a tax expert and I strongly recommend speaking with an experienced income tax professional before finalizing any transaction – buying or selling.

Here is a basic overview of different situations for financial advisors whether buying or selling:

#1. Employee: if you are considered an employee the tax options are minimal. Do you receive a T4 – you are an employee. Does your firm own the clients – you are probably an employee. What does this mean from a tax perspective? Both buyer and seller have to be careful. ALERT: It will probably be treated as income BUT if not structured properly the buyer may not be allowed to deduct purchase price as an expense. There are ways to structure the deal so that the seller gets an income stream and the buyer can deduct as an expense.

#2. Not incorporated – Vendor: the sale will probably be treated as a sale of Goodwill and a capital gain (i.e., 50% taxable).

#3. Not incorporated – Buyer: the purchase will be treated as buying depreciable capital assets. In most cases in our industry this is Goodwill. Goodwill can be depreciated at 5% per year subject to the first year rule.

#4. Incorporated – Share Sale: Capital gain with 50% being taxable. The sale, if a Qualifying Small Business Corporation (QSBC), part or all may be eligible for the Capital Gains Exemption (currently $892,000).

#5. Incorporated – Share Purchase: Shares are purchased with after- tax dollars and form the buyers Adjusted Cost Base for a future sale. ALERT: No goodwill to amortize.

#6. Incorporated – Asset Sale: sale proceeds go into the corporation. 50% is a capital gain and investment income and therefore taxed at the top marginal tax bracket (>50%). This tax amount will be adjusted downward when a dividend is paid out of the corporation (RDTOH). The other 50% is tax fee and goes into the Capital Dividend Account and can be distributed as a tax-free dividend.

#7. Incorporated – Asset Purchase: the purchase will be treated as buying depreciable capital assets. In most cases in our industry this is Goodwill. Goodwill can be depreciated at 5% per year subject to the first year rule. This is so whether purchased by an individual or a corporation.

#8. Proceeds Paid Over Several Years – Reserves: if they sale amount is determined in advance but payable over several years – the entire amount is included in the proceeds of disposition in the year of the sale. A reserve should be able to be set up as it is a capital gain from sale of capital property (Goodwill). The Income Tax Act allows the reserve to be included in income over 5 years (minimum of 20% per year).

#9. Proceeds Paid Over Several Years – Earnout: ALERT: if the payments are based in part or all on production or use – all or part of the proceeds will be treated as income – wording is very important. Payments Based on Future Production: all amounts by the vendor are taxed as ordinary income. Even if an amount is "an installment of the sale price". Fixed Amount + Earn Out: Fixed amount is proceeds from a capital disposition and the earn out is income.

#10. Reverse Earn Out: If the purchase price is set as a maximum but may be adjusted downward in the future if certain projections do not materialize.

ALERT: IT 462 ARCHIVED – PAYMENTS BASED ON PRODUCTION OR USE: Paragraph 7 states that this tax clause (12(1)(g)) applies when the sale price is based on income or some other element based on production or use of the property.

I am not sure how or if this would apply to price adjustments based on clients or AUM leaving. The important part is to get good tax advice whenever doing a transaction.

For more information check out Jamie Golombek's article in Forum magazine