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## SUMMARY

A recent decision of the Tax Court of Canada in the case of *Line Durocher c. Sa Majesté La Reine*<sup>1</sup> illustrates the dangers of granting a simple option for acquiring shares in the specific context of the implementation of a shareholder agreement in respect of the Canadian-controlled private corporation status (CCPC) for the purposes of the *Income Tax Act* (Canada) (ITA) and the possibility of being eligible to the capital gain exemption upon the disposition of "qualified small business corporation shares" (QSBCS).

## LOSS OF THE CAPITAL GAIN EXEMPTION RELATED TO THE DISPOSITION OF QUALIFIED SMALL BUSINESS CORPORATION SHARES: BEWARE OF THE OPTIONS FOR ACQUIRING SHARES

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### BACKGROUND

Aviva Canada Inc. ("Aviva"), a financial institution and a wholly-owned Canadian subsidiary of Aviva International Holdings Limited ("Aviva International"), a corporation which does not reside in Canada, acquired, in the context of a shareholder agreement entered into during fiscal year 2002, an option allowing it to acquire the shares of the financial holding corporation ("Holdco"), which indirectly controlled the Dale Parizeau corporation, which operated an insurance firm. This option, if exercised, gave control of Holdco and, indirectly, of Dale Parizeau.

Beginning in 2002, due to the grant of the option for the Holdco shares to Aviva, Holdco's shares and, accordingly, those of Dale Parizeau, could no longer qualify as QSBCS under the ITA since Aviva was controlled by Aviva International. Accordingly, these shares no longer met the conditions to be considered as QSBCS, with the result that the related capital gain exemption was lost.

Holco's shares were sold to Aviva during fiscal year 2008. The taxpayers unsuccessfully tried to claim the capital gain exemption from the disposition of the Holdco shares. Holdco's shareholders, 15 in total, were denied the exemption by the Canada Revenue Agency, a decision which was upheld by the Tax Court of Canada.

The ITA provides for an exception whereby granting an option or other right to acquire shares has no impact on the CCPC status for the purpose of the capital gain exemption. However, this exemption is only applicable if the rights are granted in the context of a purchase-sale agreement respecting a share of the share capital of a corporation<sup>2</sup>. The exception does not apply in the context of a shareholder agreement.

It is to be noted that pursuant to section 148 of the *Act respecting the distribution of financial products and services*, not more than 20% of the shares of an insurance firm or the related voting rights may be held directly or indirectly by financial institutions, financial groups or legal persons related thereto. However, this prohibition does not apply to an option for acquiring shares.

## COMMENTS

It is important to mention that the grant to Aviva of the option for acquiring Holdco's shares in the context of entering into a shareholder agreement has had serious consequences for the 15 Holdco shareholders, that is, the loss of the capital gain exemption for each of them. Everything had been put into place to allow them, through family trusts, to multiply the exemption for the beneficiaries of the trusts.

This obviously highlights the importance of retaining the services of tax experts in the context of conducting business transactions and establishing corporate structures, particularly with respect to the impact of entering into a shareholder agreement.

It is to be noted that the above decision has been appealed before the Federal Court of Appeal. ◀

<sup>1</sup> 2011-1393 (IT) G, dated December 9, 2015.

<sup>2</sup> 110.6(14)(b) ITA.

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