EY's Annual Financial Reporting Developments Series

Financial Reporting Development session for private companies

November 22, 2021

Building a better working world

1. The latest updates on Accounting Standards for Private Enterprises (ASPE)

   Adam Rybinski and Andrew Coates

3. Recent developments in transactions and capital markets

   Bill Wu

2. A Canadian tax update

   Gabriel Baron

4. Transaction real estate market and how you can capitalize on your real estate portfolio

   Zach Pendley

5. Québec-only tax update for private companies

   Jonathan Bicher

The latest updates on Accounting Standards for Private Enterprises (ASPE)

Presented by

Adam Rybinski
National Professional Practice Leader, EY Private

Andrew Coates
Senior Manager, Audit, EY Private

Building a better working world

Agenda

Approved amendments:

- Leases
- Retractable or mandatorily redeemable shares issued in a tax planning arrangement
- Related party financial instruments
- Investments
- Income taxes
- Revenue
- Employee future benefits
- Agriculture

Active projects:

- Financial instruments (IBOR reform)

Note: Content is current to September 30, 2021

Approved amendments

Effective for annual periods ending on or after December 31, 2020

Leases
(Section 3065)

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Leases

Accounting for COVID-19-related lease concessions

Entities can account for COVID-19-related lease modifications:

- As a new lease (per Section 3065), or
- Using simplified accounting methods (practical expedient)

Decision can be made on a lease-by-lease basis

All three conditions must be met:

- Rent concession occurred as a direct consequence of the COVID-19 pandemic;
- The total payments resulting from the rent concession are the same or less than the total payments required by the original lease contract; and
- Any reduction in lease payments affects only those payments originally due on or before December 31, 2021 (however, such repayments can occur after December 31, 2021)

Accounting under the practical expedient:

- Lease expense/revenue recorded in accordance with terms of the original lease
- Lease payable/receivable recorded for the amount of lease payments deferred
- If rent concession reduces total rent payable/receivable under original lease contract, such reduction is recognized in net income in period to which lease payments relate

The Accounting Standards Board ("AcSB") issued an exposure draft proposing to extend the optional relief for both lessees and lessors to December 31, 2022; currently in deliberation

Leases

Accounting for COVID-19 related lease concessions

Required disclosures relating to COVID-19 rent concessions:

- The fact that an enterprise has used the practical expedient
- When the practical expedient has been applied to some but not all leases that meet the criteria for use, the reasons therefor
- For a deferral of lease payments, the aggregate carrying amount of lease payables and lease receivables recognized in the reporting period relating to the deferral
- For a reduction of lease payments, the total amount recognized in net income for the reporting period relating to the reduced payments

Approved amendments

Effective for annual periods beginning on or after January 1, 2021

Retractable or mandatorily redeemable shares (ROMRS) issued in a tax planning arrangement
(Section 3856)

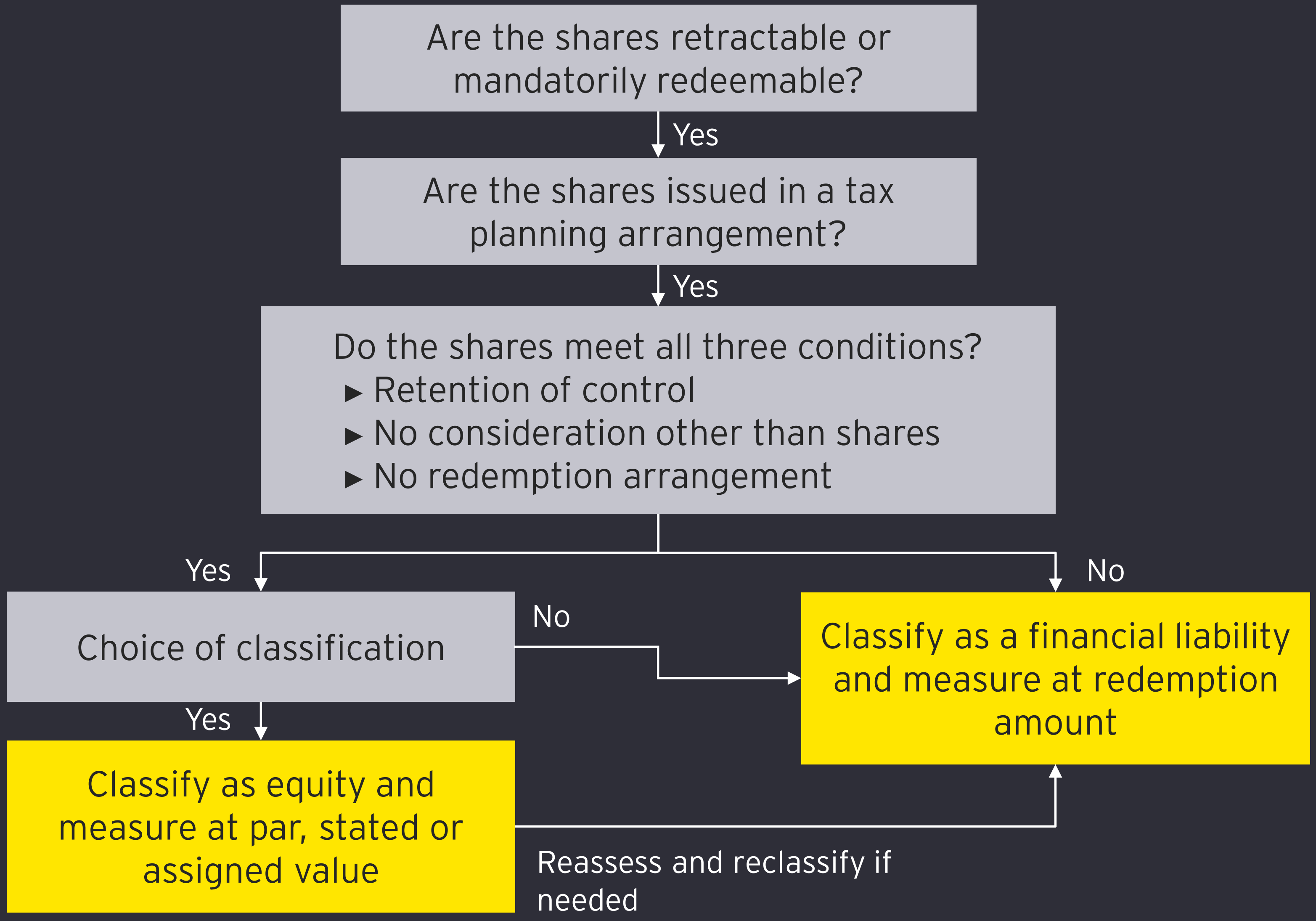
ROMRS issued in a tax planning arrangement

Summary of major features

- The classification exception for an entity that issues preferred shares in certain prescribed tax planning arrangements was amended to focus on whether control of the enterprise issuing the shares is retained
- Reclassification of ROMRS to financial liabilities is required when the conditions for equity classification are no longer met on reassessment
- ROMRS issued in a tax planning arrangement initially classified as financial liabilities are prohibited from being subsequently reclassified to equity even if conditions change
- ROMRS issued in a tax planning arrangement classified as financial liabilities are to be measured at the redemption amount
- Retrospective application is required with an option to not restate comparative financial information

ROMRS issued in a tax planning arrangement

Amendments

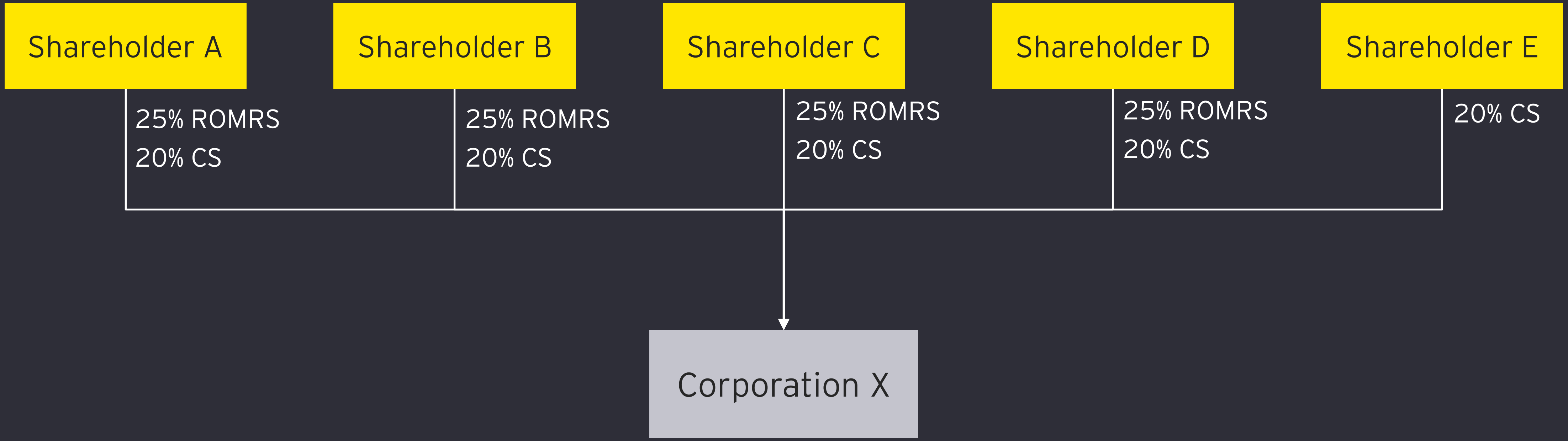


ROMRS issued in a tax planning arrangement

Amendments

Control of an enterprise is the continuing power to determine its strategic operating, investing and financing policies without the co-operation of others.

Example:



ROMRS issued in a tax planning arrangement

Amendments

- A reassessment of the classification of the ROMRS issued in a tax planning arrangement classified as equity is required when a subsequent event or transaction occurs that indicates one or more of the conditions for equity classification may no longer be met
- Reclassification of ROMRS to financial liabilities would be required when the conditions for equity classification are no longer met at the reassessment date
- ROMRS issued in a tax planning arrangement initially classified as financial liabilities would be prohibited from being subsequently reclassified to equity even if conditions change

ROMRS issued in a tax planning arrangement

Transition

An enterprise may choose to apply the amendments:

- At the beginning of the earliest period presented; or
- At the beginning of the fiscal year in which the amendments are first applied

Retrospective adjustments are not required in respect of ROMRS issued in a tax planning arrangement that were extinguished prior to the beginning of the fiscal year in which the amendments are first applied

The effect of classifying and measuring the ROMRS as financial liabilities is presented in either retained earnings or a separate component of equity

ROMRS issued in a tax planning arrangement

Transition

Apply amendments:

- At the beginning of the earliest period presented
- At the beginning of the fiscal year in which the amendments are first applied

Does the enterprise choose equity or liability classification?

Equity

Liability

ROMRS issued prior to January 1, 2018?

Yes

No

Are the following conditions met?

- Control held by owner of ROMRS
- No redemption arrangement

Are the following conditions met?

- Retention of control
- No consideration other than shares
- No redemption arrangement

Yes

Yes

No

No

Classify as equity and measure at par, stated or assigned value

Classify as financial liability and measure at redemption amount

Record impact of applying amendments:

- In retained earnings
- As a separate component of equity

ROMRS issued in a tax planning arrangement

Example

Assumptions:

- ROMRS have a stated amount of $100 and a redemption amount of $200,000
- One or more of the three conditions previously discussed are not met
- $80,000 of dividends were declared on these ROMRS during the year

Before amendments	
Assets	
Cash	120,000
Accounts receivable	250,000
	370,000
Liabilities	
Accounts payable	120,000
Equity	
Common shares	100
ROMRS	100
Retained earnings	249,800
	250,000
	370,000

ROMRS issued in a tax planning arrangement

Example (continued)

Adjustment is presented in retained earnings	
Assets	
Cash	120,000
Accounts receivable	250,000
	370,000
Liabilities	
Accounts payable	120,000
ROMRS liability	**200,000**
	320,000
Equity	
Common shares	100
Retained earnings	**49,900**
	50,000
	370,000

Adjustment is presented in a separate component of equity	
Assets	
Cash	120,000
Accounts receivable	250,000
	370,000
Liabilities	
Accounts payable	120,000
ROMRS liability	**200,000**
	320,000
Equity	
Common shares	100
Retained earnings	**249,800**
Other equity	**(199,900)**
	50,000
	370,000

ROMRS issued in a tax planning arrangement

Example (continued)

Before amendments	
Operating income	150,000
Net income	**150,000**
Retained earnings, beginning	179,800
Net income	150,000
Dividends declared	(80,000)
Retained earnings, ending	**249,800**

After amendments	
Operating Income	150,000
Interest	(80,000)
Net income	**70,000**
Retained earnings, beginning	179,800
Net income	70,000
Retained earnings, ending	**249,800**

ROMRS issued in a tax planning arrangement

Potential impact

- Breach of existing covenants with lenders (e.g., current ratio, debt-to-equity ratio, rolling covenant calculations, etc.)
- Reclassification of ROMRS from equity to a liability may result in existing users (e.g., vendors, contractors, etc.) evaluating the enterprise differently and may impact the enterprise's ability to bid on contracts
- Impact on existing arrangements that rely on certain figures from the financial statements (e.g., profit sharing arrangements, bonus calculations)

ROMRS issued in a tax planning arrangement

Key action items

- Review for issued and outstanding ROMRS and assess impact of amendments
- Determine optimal transition option and elections
- Review current contracts and agreements for references to amounts per the financial statements and assess the impact, if any
- Work collaboratively with the users of the financial statements to amend contracts and agreements, if necessary, for the approved amendments

Related party financial instruments
(Section 3856)

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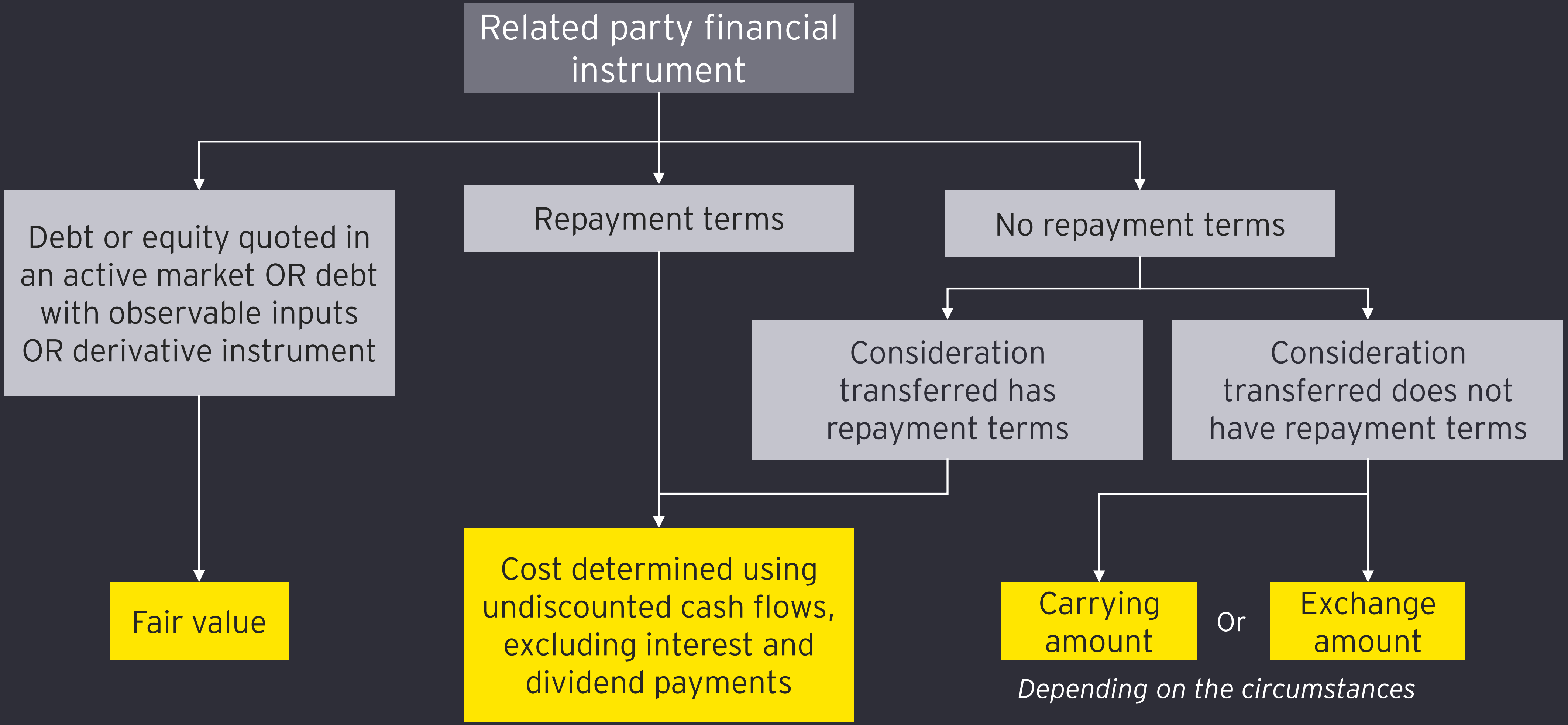
Related party financial instruments

Summary of major features

- Initial and subsequent measurement guidance for related party financial instruments to be added to Section 3856, *Financial instruments*
- Allocation of proceeds between liability and equity elements of related party compound financial instruments should be consistent with the treatment of third party compound financial instruments
- Modification of all related party financial instruments will be accounted for as an extinguishment and the modified instrument will be measured using the initial measurement concepts for related party financial instruments
- Approach to distinguish between impairment and forgiveness of related party loans

Related party financial instruments

Initial recognition



Related party financial instruments

Initial recognition (continued)

An enterprise would be permitted to:

- Initially measure the equity component of a related party compound financial instrument as zero; or
- Allocate the residual amount to the equity component after measuring the liability component

An enterprise does not initially measure the variable or contingent portion of a related party financial instrument, except for indexed liabilities

Except for ROMRS that meet equity classification exceptions, any gain or loss from initial recognition is:

- Included in net income (unless another ASPE section requires alternative treatment) if the related party transaction is in the normal course of operations, or is not in the normal course of operations and meet the three criteria for "exchange amount"
- Otherwise, included in equity

Related party financial instruments

Subsequent measurement

Subsequent measurement of a related party financial instrument is based on how the financial instrument was initially measured:

Initial measurement	Subsequent measurement
Cost	Cost (e.g., investments in equity instruments that are not quoted in an active market; debt instruments that are not quoted in an active market and for which the inputs significant to the determination of the fair value of the debt instrument are not observable, either directly or indirectly)
Fair value	▶ **Investments in equity instruments quoted in an active market;** and ▶ **Derivative contracts** → fair value (without any adjustment for transaction costs that may be incurred on sale/disposal)
	▶ **Debt instruments quoted in an active market;** and ▶ **Debt instruments for which inputs significant to the determination of their fair value are observable, either directly or indirectly** → amortized cost or fair value (if elected)
	▶ **All other financial assets** → amortized cost
	▶ **Financial liabilities** → amortized cost

Related party financial instruments

Impairment

When a significant adverse change in the expected timing or amount of future cash flows from a related party financial asset is identified, the carrying amount of the asset is reduced to the highest of the following:

- ***Undiscounted*** cash flows expected to be generated by holding the asset, or group of similar assets, excluding the interest and dividend payments of the instrument;
- The amount that could be realized by selling the asset, or group of assets, at the balance sheet date; and
- The amount the enterprise expects to realize by exercising its right to any collateral held to secure repayment of the asset, or group of assets, net of all costs necessary to exercise those rights

Related party financial instruments

Forgiveness

An enterprise would be required to first assess for, and recognize in net income, any impairment of a related party financial asset before the forgiveness of the related party financial asset is recognized

The forgiveness of a related party financial asset would be recognized in:

- Equity when the original transaction that resulted in acquiring the financial asset was not in the normal course of operations; or
- Net income when the original transaction that resulted in acquiring the financial asset was in the normal course of operations, when it is impracticable to determine whether the amount forgiven originated outside the normal course of operations, or when the financial asset is due from a counterparty that is acting solely in the capacity of management of the enterprise

Related party financial instruments

Modification and extinguishment

An enterprise would account for all modifications of a related party financial liability as an extinguishment of the original financial liability and the recognition of a new financial liability

Gains or losses on extinguishment is included in:

- Equity, when the original transaction that resulted in the issuance or assumption of the financial liability was not in the normal course of operations; or
- Net income when:
  - The original transaction that resulted in the issuance or assumption of the financial liability was in the normal course of operations; or
  - It is impracticable to determine whether the amount extinguished was issued or assumed in the normal or not in the normal course of operations

Related party financial instruments

Transition

Amendments are applied retrospectively with transitional relief:

- Related party financial instruments are remeasured at the beginning of the fiscal year immediately preceding the date at which the amendments are applied for the first time
- Any related party financial instrument that was settled or extinguished before the date that the amendments are first applied is not remeasured

Related party financial instruments

Key action items

Review for and assess related party financial instruments outstanding as at the beginning of the earliest comparative period:

- Repayment terms (including variable and contingent repayments);
- Inputs to related party debt instruments (whether observable);
- Whether or not to elect to subsequently measure certain related party debt instruments at fair value; and
- The nature of transactions that created the related party financial instruments (when practicable)

Investments
(Section 3051)

Investments

Guidance in Section 3051 *Investments* related to the cost method was clarified such that it also applies to interests in jointly controlled enterprises (JCE) accounted for using the cost method

Initial measurement using cost method:

- Cost is measured at the acquisition-date fair value of the consideration transferred in exchange for the investment/interest in the JCE
- Acquisition-related costs are expensed in the period incurred, except for:
  - Costs to issue debt securities (apply Section 3856 *Financial instruments)*
  - Costs to issue equity securities (apply Section 3610 *Capital transactions)*

Income taxes
(Section 3465)

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Income taxes

All future income tax assets and liabilities are required to be classified as ***non-current*** (irrespective of the timing of the reversal of the temporary differences that creates them)

New requirement to disclose the amount of future income tax assets and liabilities for each significant type of temporary difference for each period presented

Amendments to Section 3465 are to be applied retrospectively

Approved amendments

Effective for annual periods beginning on or after January 1, 2022

Revenue
(Section 3400)

Revenue

Summary of major features

Additional guidance in new appendix of Section 3400 on:

- Identifying units of account
- Multiple-element arrangements
- Percentage of completion method
- Reporting revenue gross or net
- Bill and hold arrangements
- Upfront non-refundable fees or payments

Most of the additional guidance were obtained from Emerging Issues Committee (EIC) Abstracts from Part V of the *CPA Canada Handbook – Accounting*

The following slides discuss select topics only

Revenue

Identifying units of account

The first step in applying Section 3400 recognition criteria is to determine the unit of account for a revenue transaction

Why is it important to determine the unit of account?

- Recognition criteria are usually applied separately to each revenue transaction; however, this may not be appropriate in certain circumstances

Identifying the unit of account for a revenue transaction involves:

- Determining whether to segment or combine revenue contracts
- Determining whether a single contract or a group of combined contracts contains one or more deliverables

Revenue

Identifying units of account (continued)

Determining whether to segment or combine revenue contracts

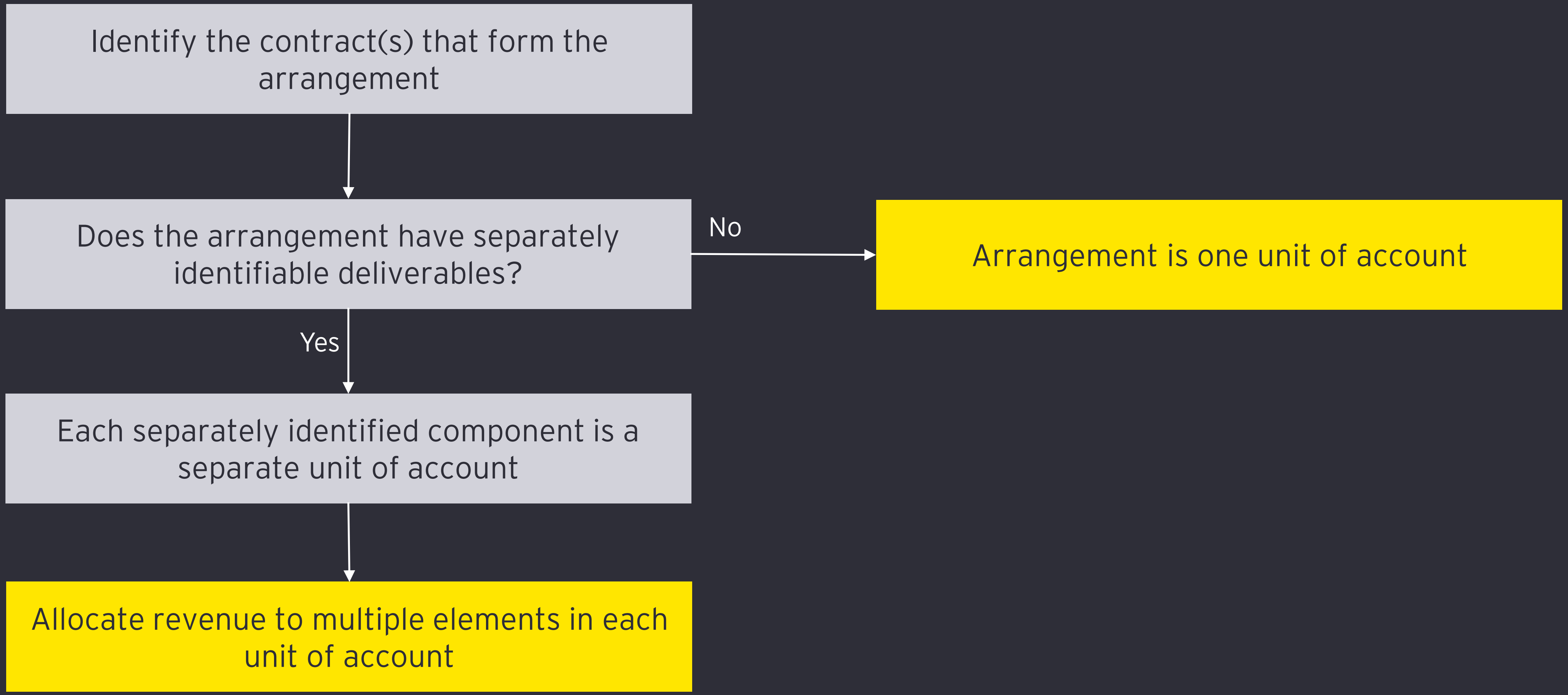
- A group of contracts is treated as a single contract when the contracts:
  a) Are negotiated as a package in the same economic environment with an overall profit margin objective;
  b) Constitute an agreement to do a single arrangement with a single customer;
  c) Are so closely interrelated that they are, in effect, part of a single arrangement with an overall profit margin; and
  d) Are performed concurrently or in a continuous sequence

Determining whether a single contract or a group of combined contracts contains one or more deliverables

- In an arrangement with multiple deliverables, the deliverables should be considered a separate unit of account, if both of the following criteria are met:
  a) If the arrangement includes a general right of return relative to the deliverable(s), delivery or performance of the remaining deliverable(s) is considered probable and substantially in the control of the vendor; and
  b) The deliverable(s) have value to the customer on a stand-alone basis

Revenue

Identifying units of account (continued)



Key concepts:

- Multiple-element arrangements
  - Consideration is allocated at the inception of the arrangement to all deliverables on a relative **stand-alone selling price** basis
  - The stand-alone selling price is the price at which an enterprise would sell a promised good or service separately to a customer

- Percentage of completion method
  - Use of percentage of completion method versus the completed contract method is **not** an accounting policy choice
  - Percentage of completion method **must** be used on service or long-term contracts **unless**:
    - Performance consists of the execution of a single act; or
    - The enterprise cannot reasonably estimate the extent of progress toward completion
  - Acceptable measures of completion can be based on input or output measures
  - **Loss Contracts:** When it is probable that total contract costs will exceed total contract revenue, the entire expected loss is recognized as an expense immediately

Revenue

Transition and disclosure

Disclosure:

- If contracts **in progress** are accounted for using the percentage of completion method at the end of the reporting period, the following disclosures are required (3400.32A):
  - The method or methods of measuring the degree of completion
  - The aggregate amount of costs incurred and recognized profits (less recognized losses) to date
  - The aggregate amount of advances received
  - The aggregate amount of holdbacks withheld
  - Uncertainties affecting the measurement of the degree of completion
- No other new Section 3400 disclosures based on amendments; however, revenue recognition policies should be changed where guidance has been provided and applied
- Consider change in accounting policy note disclosure required by Section 1506 *Accounting Changes*

Transition:

- Additional guidance to Section 3400 is effective for fiscal periods beginning on or after January 1, 2022, with early adoption permitted

Employee future benefits
(Section 3462)

Employee future benefits

Key changes

Amendments were made to:

- Remove the accommodation to allow the use of a funding valuation for defined benefit plans **without** a funding valuation requirement:
  - There is no longer a policy choice available
  - For defined benefit plans with **no** legislative, regulatory, or contractual requirement to prepare a funding valuation, entities **must** use an accounting valuation
- Amount required to be funded by contributions
  - The amendments clarify that when legislative, regulatory or contractual requirements stipulate calculations of various components of the funding requirement separately, the aggregate of those components makes up the funding valuation that is reflected in the financial statements
  - Ontario's Provision for Adverse Deviation (PfAD) and Québec's Stabilization Provision (SP) are components of an Ontario and a Québec funding valuation, respectively, and therefore must be included in the measurement of the DBO

Employee future benefits
Transition

- Amendments are effective for annual financial statements relating to fiscal years beginning on or after January 1, 2022
- Earlier application is permitted, but only if applied to all of an entity's defined benefit plans

Transitional relief

- Upon transition, an enterprise is not required to:
  - Obtain a new funding valuation on transition, and can wait until one is required
  - Retroactively restate its financial statements for the effects of the amendments – the cumulative effects of applying the amendments are recorded in opening retained earnings at the date the amendments are first applied

Agriculture
(Section 3041)

Agriculture

Introduction of Section 3041

- Section 3041, *Agriculture* establishes standards for recognition, measurement, presentation and disclosure of an agricultural producer's agricultural inventories and productive biological assets
- A private enterprise must be an agricultural producer as defined in Section 3041 in order to apply the guidance in that section
- Assets that result from secondary production are excluded from the scope of the standard

Productive Biological assets	Agricultural inventories	Assets that result from secondary production
		
In Scope		Out of Scope

Active projects: Financial instruments
(Section 3856)

Financial instruments

Exposure draft

In September 2021, a financial instruments exposure draft was issued reflecting proposals made by the AcSB for comment

Many jurisdictions, including Canada, are replacing existing interbank offered rates (IBORs) benchmarks with alternative benchmarks

The AcSB has decided that standard setting is required to provide relief to:

- Simplify the current accounting analysis for debt modifications solely due to IBOR reform; and
- Allow hedging relationships to continue upon a change in certain critical terms related to IBOR reform

The exposure draft therefore proposes optional expedients for debt modifications and exceptions to hedge accounting guidance

Amendments would be effective for fiscal years ending on or after February 1, 2022, with earlier application permitted

Canadian capital markets update

Presented by

Bill Wu
Capital Markets Advisory leader

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Financing market update

Market update

- Strong liquidity, lenders are flush with cash/capital, approximately over a trillion of undeployed capital
- Competitive credit terms
- Credit spreads are compressing
- Leverage increasing to pre-COVID-19 levels
- Non-bank lenders highly active and now account for 40% of all lending transaction
- Cost of capital remains at historic lows

What you should be thinking:

1. **Certainty of capital.** Is your business well capitalized to handle unforeseen changes in the economy?
2. Take **advantage of low rates.** Refinancing short-term expensive rates with cheaper long-term rates.
3. Was my business resilient during COVID-19? What further **enhancements or changes** do I need to make under the "new normal"?

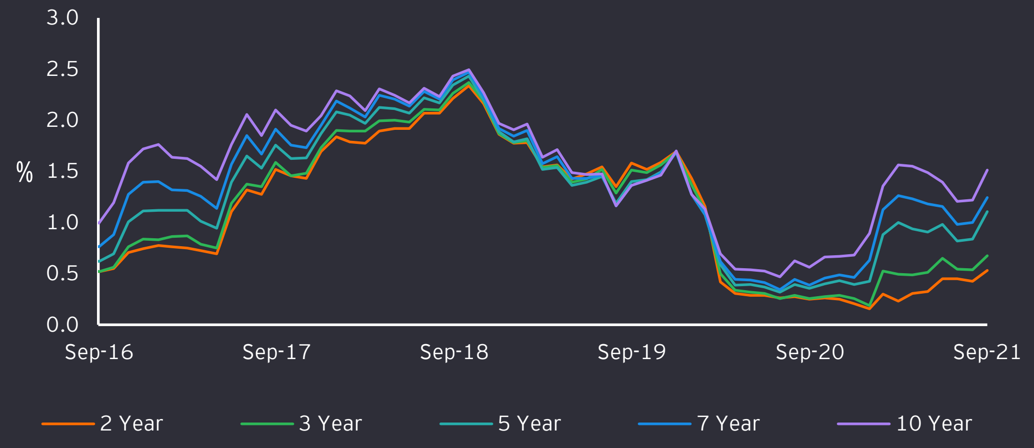
Interest rates

Market update

- COVID-19 induced contraction in benchmark yields that continued till December 2020, yields have shown an upward trend starting in January 2021 supported by government's liquidity infusion programs
- Moreover, long-term yields are expected to advance further as the economy recovers, supported by market pricing in expected rate hikes in 2022/2023
- Short-term rates have remained low, similar to long-term yields, short-term rates are expected to increase latter part of 2022 and early 2023

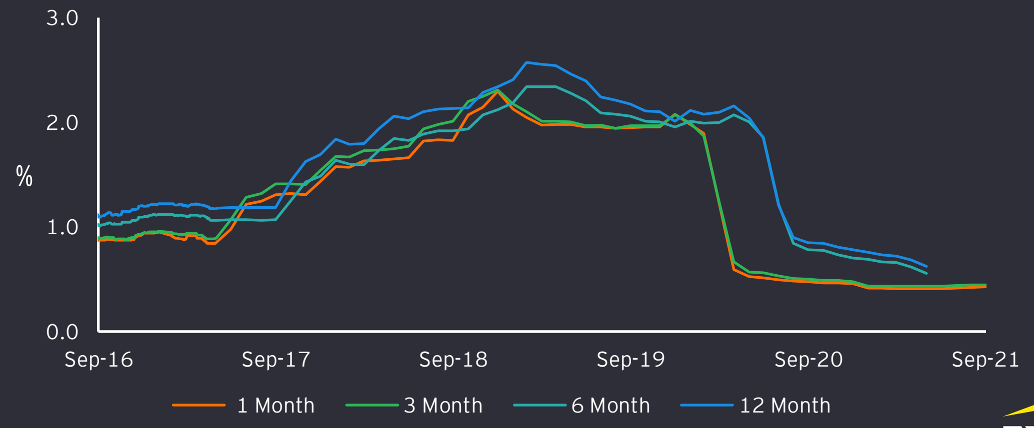
Canadian benchmark bond yields

Source: Bloomberg



CDOR prices*

Source: Bloomberg

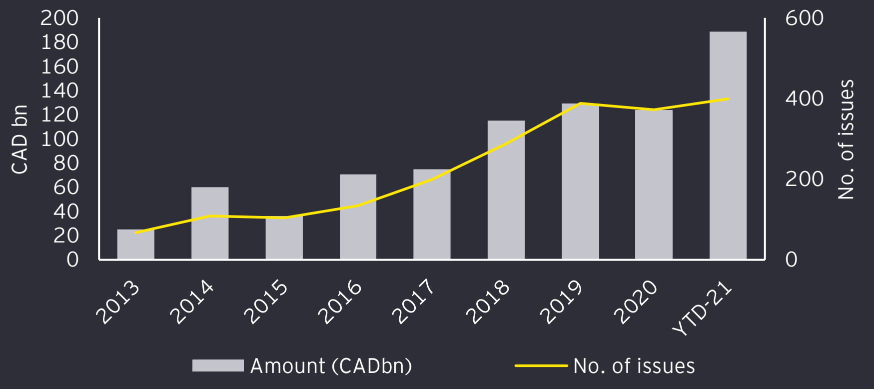


*Note: 6 and 12 months rates are not available after May 2021

Debt issuance and leverage profile

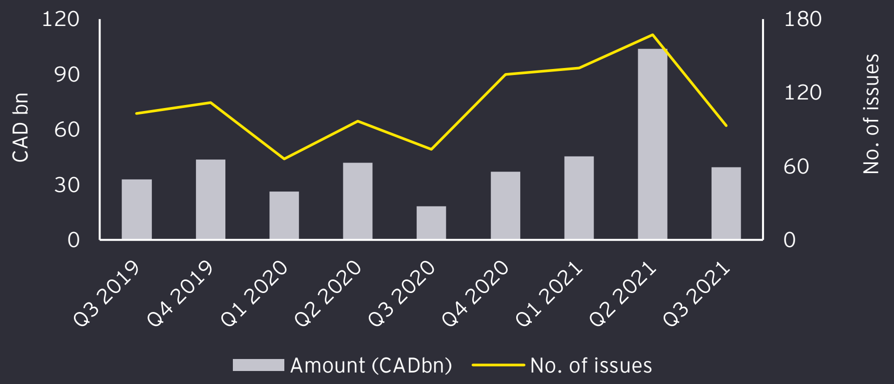
Canadian loan issuances, 2013-YTD 2021

Source: Bloomberg



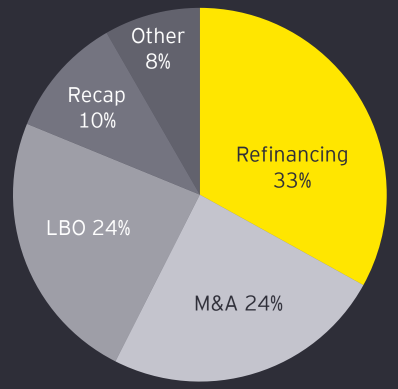
Canadian loan issuances, Q3 2019 to Q3 2021

Source: Bloomberg



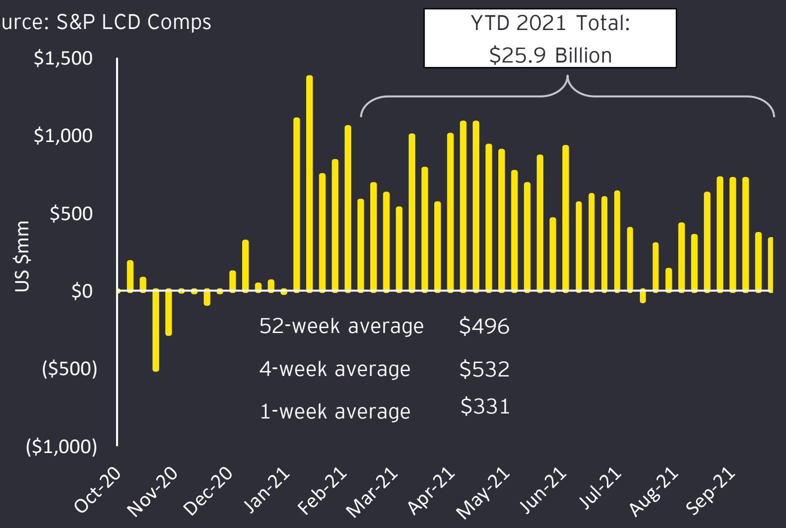
Loan Volume by Purpose

Source: S&P LCD Comps



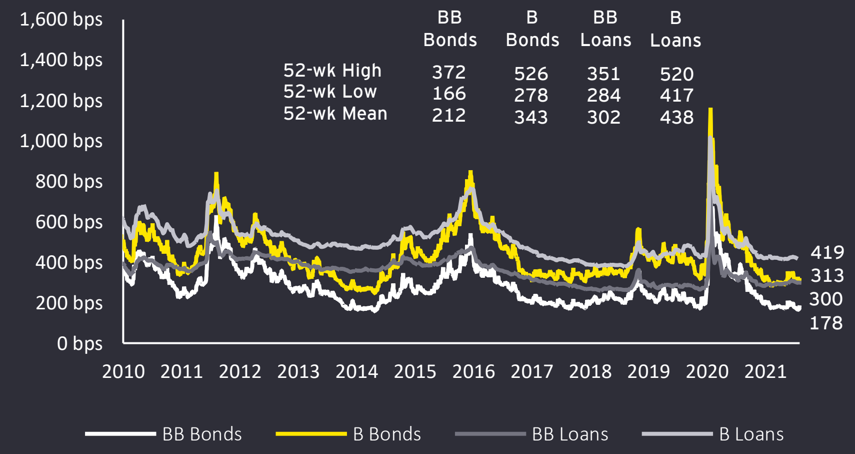
Loan Fund Flows

Source: S&P LCD Comps

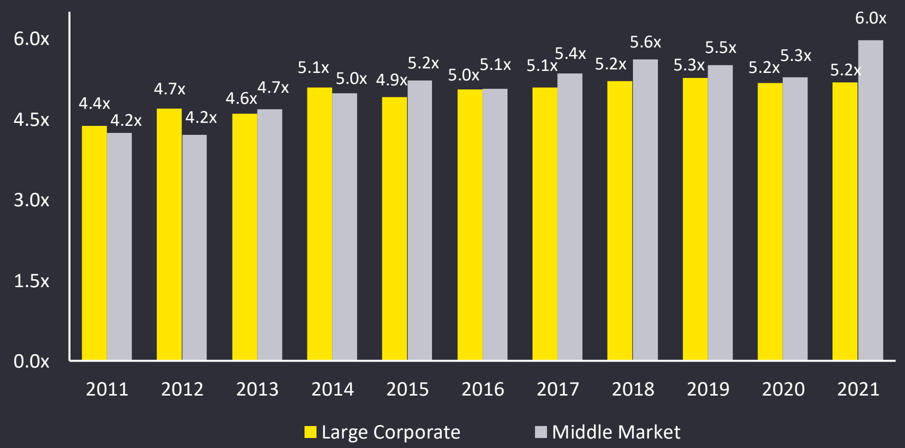


Debt issuance and leverage profile
(continued)

Leveraged Loan & High Yield Secondary Spreads
Source: S&P LCD Comps

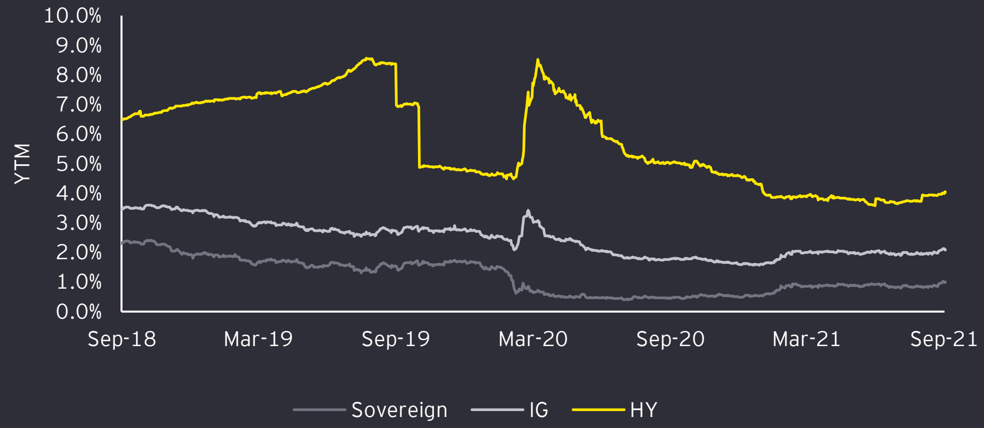


Leverage Multiples
Source: S&P LCD Comps



LTM Default Rate by Principal Outstanding
Source: S&P LCD Comps

S&P Canada bond yield index
Source: S&P data



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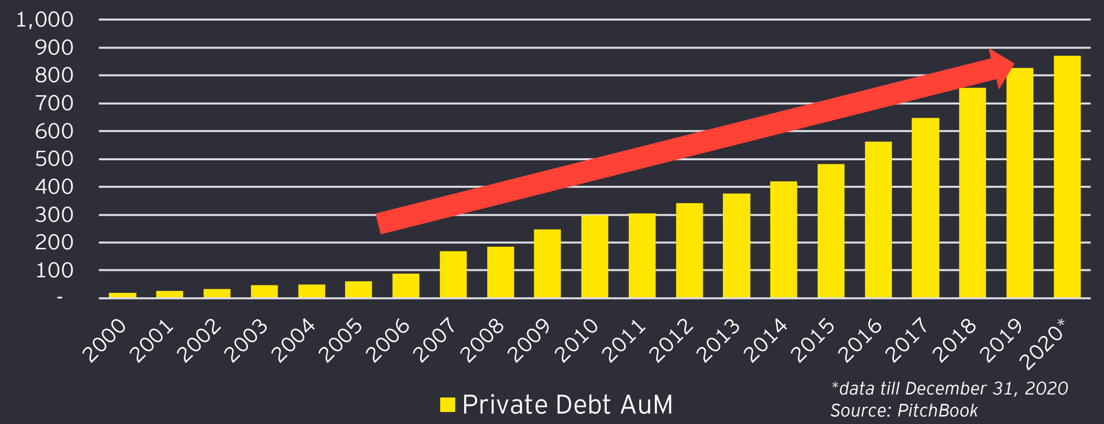
Private debt market

- Private debt fundraising kept a steady course in the first half of 2021 and is expected to remain robust in the coming months as more than US$40b was raised for North America-focused private debt funds in the first six months of the year.
- While the private debt market experienced a downfall during the COVID-19 pandemic, portfolios recovered rather quickly driven by improving economy, surging liquid credit markets and low default rates.

Private Debt Boom



*data till December 31, 2020
Source: PitchBook

Why consider private debt lenders:

- Existing bank giving less favourable credit terms post COVID-19
- Credit structuring more flexible and creative
- Longer-term thinking
- More dynamic, can fund quicker

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Q3 and beyond: How your company can take advantage

Given the robust market, we are seeing companies executing on the following priorities:

- Refinance today's debt to a longer tenured debt to solidify low interest rate
- Increase debt capacity to assist with pent up/deferred strategic spend around acquisitions and CapEx investments
- Renegotiate to simpler, less restrictive covenants
- Take advantage of the debt capital structures in the US as they are not readily available in Canada

A Canadian tax update

- Uncertain times: Revisiting past private company tax proposals
- Addressing possible capital gains tax rate increases
- Bill C-208 planning update
- Government stimulus updates
- Revisiting Scientific Research and Experimental Development (SR&ED) tax incentives

Presented by

Gabriel Baron
Partner, Tax, EY Private

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Uncertain times: Revisiting past private company tax proposals

Summer of 2017 saw significant private company tax proposals, almost all were not enacted (except for anti-income splitting proposals, which became effective January 1 , 2018)

Summer 2017 proposals not enacted:

- Elimination of "multiplication" of Lifetime Capital Gains Exemptions through family trust structures
  - Today, each Canadian individual is eligible to shelter ~$892,000 of gains on qualifying private company sales
- Increase tax rates on investment income for accumulated capital inside private corporation
  - Today, tax rates on investment income inside private Canadian companies flow to the family shareholders with marginal incremental tax
  - Proposal was to increase the effective tax to ~73% to penalize for accumulation of corporate surplus
- Increase tax rates on capital gains realized by corporations if considered part of a tax planning arrangement
  - Proposal would double the effective tax rate on corporate gains when fully distributed to the family shareholder

Uncertain times: Revisiting past private company tax proposals

Recent federal electoral campaign platforms also give indication to possible future tax changes

Federal election 2021 campaign discussions:

- NDP: 1% wealth tax on Canadian families with net-wealth in excess of $10m
- NDP: Increase capital gains inclusion rate from 50% to 75%
- NDP: Increase top marginal rate from 33% to 35% (for example, in Ontario top-rate of 55.53% would result)
- NDP: Temporary additional 15% corporate tax on "windfall profits" arising during COVID-19 period
- Liberal: 15% minimum tax for top-rate taxpayers, regardless of tax deductions/other tax shelters available

Tax planning trends observed in the market:

- Greater interest in departure/emigration planning
- Tax planning being effected based on speculation/belief of uncertain future tax changes

Addressing possible capital gains tax rate increases

Current inclusion rate of 50% means only reporting half the gain in income

Rates range today from ~24% in Alberta, to ~27% in Ontario, British Columbia and Québec

An increase in the inclusion rate from ½ to ¾ would respectively increase the rates to ~36% in Alberta, and 40% in Ontario, British Columbia and Québec

Historic speculation and recent electoral dialogue have driven tax planning transactions to possibly mitigate application of higher tax rate

Tax planning for managing capital gains inclusion rates generally involves a prepayment of tax and may not be financially appropriate for assets held, and not to be sold, for an extended period of time (for example, family recreational real estate)

Tax planning for sales of private business are structurally more complex and, even with a possible change in the capital gains inclusion rate, may not warrant a pre-sale prepayment of capital gains tax

Addressing possible capital gains tax rate increases

Examples of tax planning being engaged in by taxpayers involve prepaying tax and increasing the tax cost of the asset to its current market value, thereby reducing tax to pay on a future sale (at whatever the then-prevailing tax rate is):

- Sell the asset in the open market and re-purchase
  - Used mainly with marketable securities
  - Not practical for real-estate that may attract a land transfer tax (dependent on province of residence)
- Sell the asset to a spouse
  - Would allow for deferral of decision as to whether to pay tax on value of asset until April 30th of following year
  - Any future gain/loss and income generated on the asset attributes back to the original transferring spouse
- Sell asset to "yourself" in a tax planning/restructuring transition
  - Typically involves the formation of a new company or partnership
  - Allows for scalable effect whereby no, full, or partial asset value step-ups may be effected through the use of tax elections
  - Allows for 6 to 18 months "look-see" into future possible tax rate changes
  - More complex and requires lawyer/accountant involvement

Bill C-208 planning update

Bill C-208 refresher ("what is it")?

- Private member's bill/legislation introduced in summer
- Neutralizes punitive tax rule otherwise limiting use of Lifetime Capital Gains Exemption on the sale of a private family business between related family members
- Legislation as previously drafted incentivized outside third-party sale instead of sale to family, and revised legislation intended to help facilitate estate planning and transfers of the family business across generations

Legislation widely criticized as having flaws and received extensive media attention about tax planning opportunities, specifically that an individual can leverage their Lifetime Capital Gains Exemption to extract approximately $892,000 of funds from a family corporation in-lieu of a dividend

The Government announced it would accept legislation, but introduce new legislation to "fix" what was drafted. To be effective the later of November 1, 2021 or when the revised draft legislation is introduced

Bill C-208 planning update

The government shared some hallmarks of the new draft legislation would include:

- The requirement to transfer legal and factual control of the corporation carrying on the business from the parent to their child or grandchild;
- The level of ownership in the corporation carrying on the business that the parent can maintain for a reasonable time after the transfer;
- The requirements and timeline for the parent to transition their involvement in the business to the next generation; and
- The level of involvement of the child or grandchild in the business after the transfer.

Government stimulus update

Three new/updated programs as Canada Emergency Wage Subsidy (CEWS) expired:

- Tourism and Hospitality Recovery Program (THRP): Targeted measure specific to certain economic sectors
- Hardest-Hit Business Recovery Program (HHBRP): Wage and rent subsidies (similar to the CEWS/Canada Emergency Rent Subsidy) to entities that have experienced the most significant losses since the outset of the pandemic (and that do not qualify for the THRP above)
- Public health lockdown support: For entities that become subject to a qualifying public health restriction, eligible for subsidy rates under the THRP if entities become subject to a qualifying public health restriction
- Canada Recovery Hiring Program: Existing program extended to May 7, 2022, with possible extension to July 2, 2022. Only available to Canadian-controlled private corporations

Government stimulus update

October 24, 2021 to March 12, 2022 (qualifying periods 22 to 26)					
	Industry-specific	Minimum current-month revenue decline	Minimum revenue decline in periods 1-13	Minimum subsidy rate	Maximum subsidy rate
THRP	Yes	40%	40%	40% for an entity with a 40% current-month revenue decline	75% for an entity with a current-month revenue decline of 75% or higher
HHBRP	No	50%	50%	10% for an entity with a 50% current-month revenue decline	50% for an entity with a current-month revenue decline of 75% or higher
Public health lockdown support	No	40%	None required	40% for an entity with a 40% current-month revenue decline	75% for an entity with a current-month revenue decline of 75% or higher
Canada Recovery Hiring Program	No	10%	None required	Incremental remuneration x 50%	Incremental remuneration x 50%

Government stimulus update

Anecdotal EY experience on the CRA audit and enforcement activity for CEWS claims:

- EY supported and recently completed P1 to P3 CRA audit of one of the largest CEWS claims submitted
- CRA audit protocols still being developed and evolving, i.e., the early-day audits will set the stage for future enforcement activity protocols
- Moderate to challenging process requiring patience and empathy
- Extensive new roster of auditors hired/assigned to CEWS and CERS program
- Emphasis of P1 to P3 audits were revenue-focused (in assessing the 15%/30% revenue decline thresholds), whereas we speculate P4 and beyond may be more payroll-focused

Revisiting Scientific Research and Experimental Development (SR&ED) tax incentives

New eligibility guidelines

- Seek to provide clearer and simpler information about how SR&ED work is defined under the *Income Tax Act*
- There are no planned updates to the prescribed forms (T661)

Establishment of industry committees of practice to discuss emerging trends in specific sectors

- Biomed
- Clean Tech

CRA reviews

- Continue to occur virtually
- Revert to in-person when feasible

Revisiting Scientific Research and Experimental Development (SR&ED) tax incentives

New CRA services

- EPCR (pre-claim review)
  - Launched October 2021, quarterly service to help companies assess SR&ED eligibility throughout fiscal year
- Self Assessment and Learning Tool (SALT)
  - SALT will improve the predictability of receiving the SR&ED tax incentives through a self-assessment of your work and expenditures. The online SALT is an enhanced version of the current Eligibility Self-Assessment Tool

Reminder on government assistance

- SR&ED must be reduced by matching employees who have been claimed for SR&ED and CEWS in the same period
- Other government assistance must also be deducted

Transaction real estate market update

How private companies can capitalize on their real estate portfolio strategy

Presented by

Zach Pendley
Partner, Transaction Real Estate Group, EY

Building a better working world

Real estate trends

- Trends we are observing include:
  - A focus shifting towards recovery;
  - An increased focus on ESG related initiatives as we seek to "build back, better";
  - The redevelopment and repurposing of certain assets;
  - Continuously evolving consumer behaviours: increasing demands on logistics and supply chain related assets, coupled with low vacancies and rising rents in most Canadian cities as consumer demand from Canadians continues to grow;
  - Cities seeking to overcome certain 2020 shortfalls and seeking new revenue streams;
  - Whisperings of perhaps an increase in interest rates between now and early 2022;
  - Sellers looking to take advantage of renewed optimism and strong pricing for certain assets in real estate; and
  - Inflation will have a major impact on development feasibility. Capital allocation decisions may change given the tremendous pressures on construction costs. Project feasibility will be called into question.
- While the market continues to evolve by the day, the real estate market is evolving differently by asset class
- Real estate capital markets/transactions:
  - Plenty of "dry powder" is on the sidelines seeking to be deployed by major pension funds and family offices and the post-COVID real estate market will be a haven for the opportunistic investor
  - There will be opportunity for investors to solve broken capital stacks and provide liquidity in distressed situations

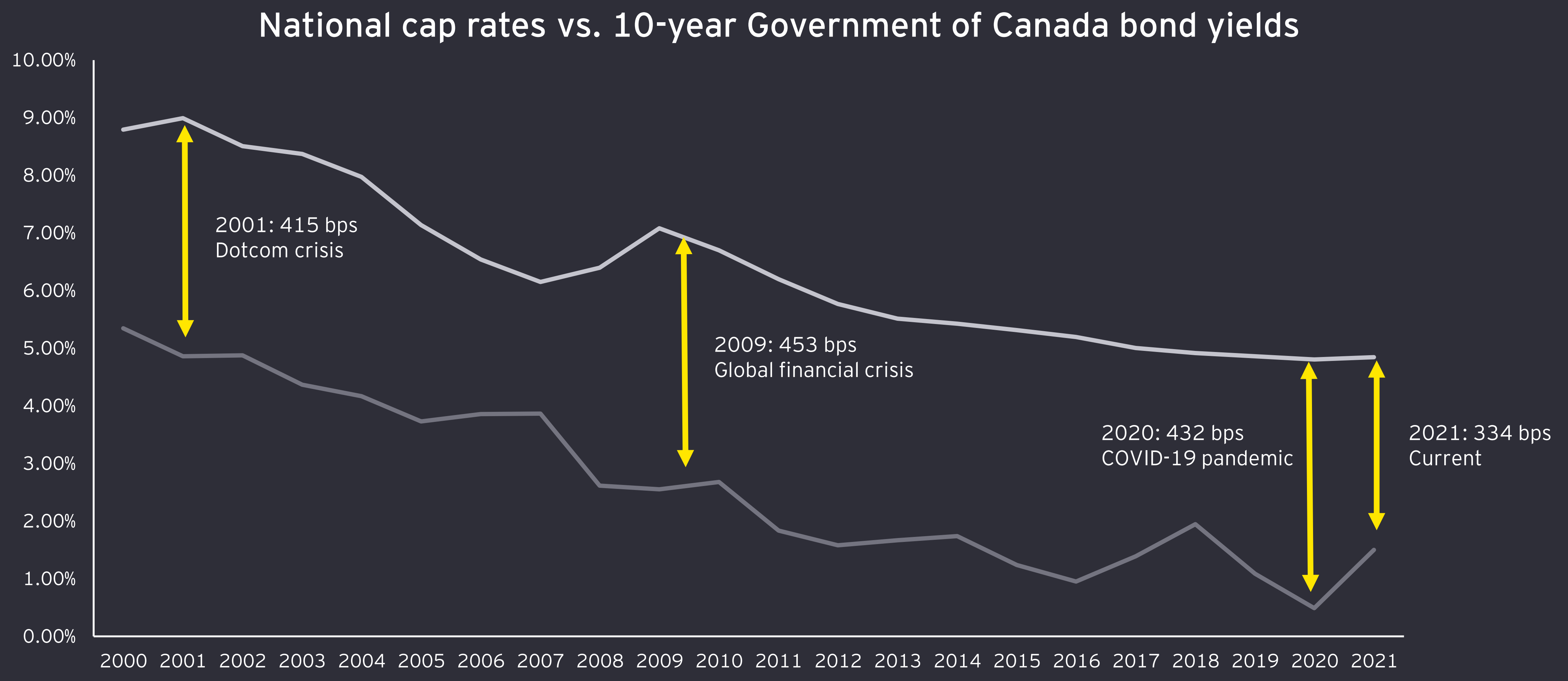
EY

Real estate overview by asset class

Recovery ← → **Stable** | **Strong**

Hospitality	Retail	Senior Residence	Office	Multi-residential	Industrial and Logistics
Distressed transactions in this sector in 2020 never manifested; however it remains the most challenged asset class in 2021. Reductions in government stimulus, coupled with banks becoming impatient, could spell trouble. Will the return of travel be sufficient for asset owners to weather the storm?	Reports coming out of the US suggest that consumers are returning to malls in droves as lockdowns are eased. Could we be in store for a similar phenomenon in Canada?	Redefining the operational structure and business model of these facilities will likely be a major government priority post-COVID-19.	Everyone has an opinion on what return to work will look like, but one thing is clear: There is no one-size-fits-all model and as such, this asset class will be quite dynamic over the course of FY22. Users of office space will require support as they reimagine how they use the office.	Demand for purpose-built rental product will likely remain strong as vacancies are at all-time lows. Rising rents and a lack of supply in most major metro areas in the country mean there continues to be need for more affordable housing options.	Low vacancies and high rents continue to drive massive growth in this sector across the country.

Bond yields, spreads and cap rates



Source: Government of Canada, CBRE, Colliers, Altus

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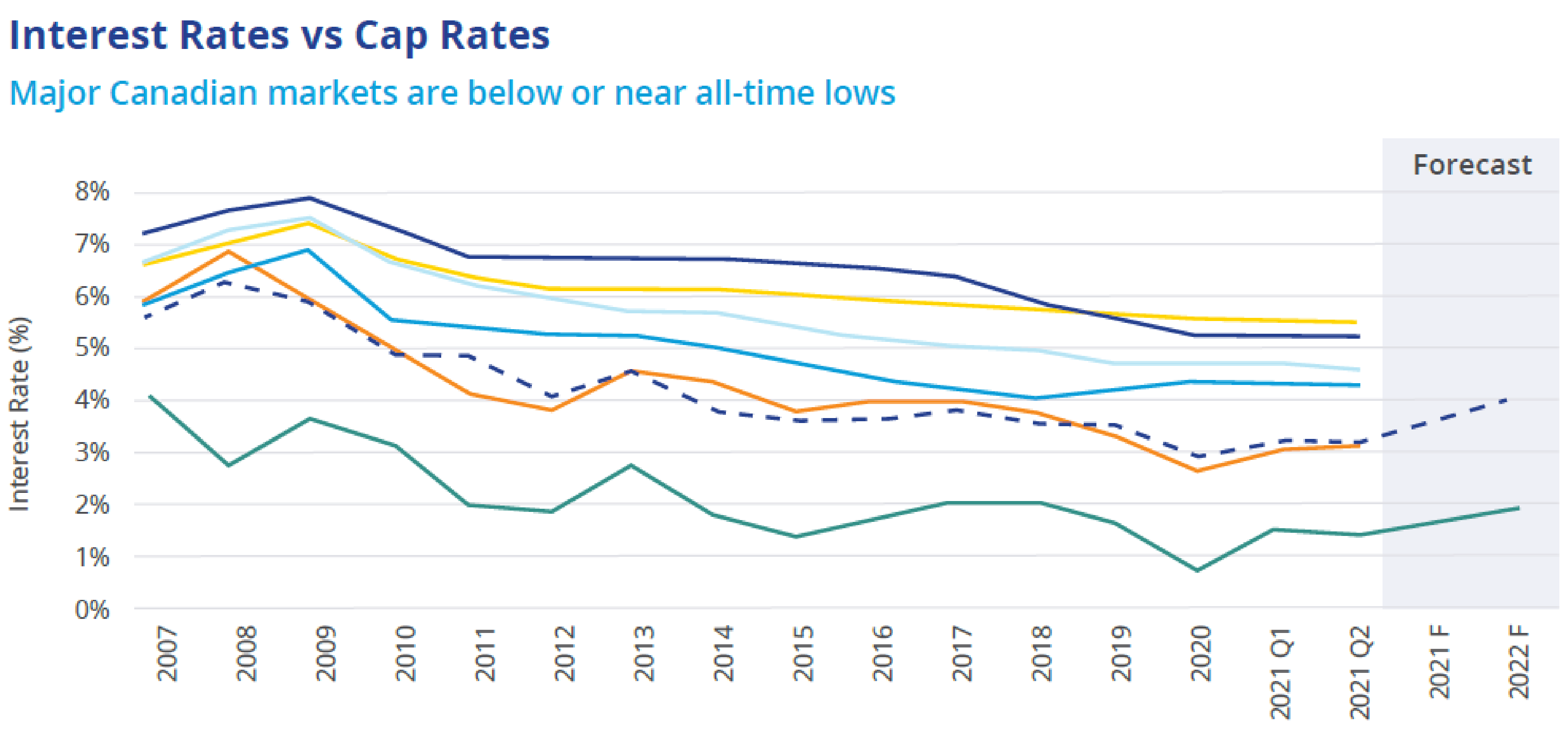
Rise in interest rates



Source: Colliers Cap Rate Report, Q2 2021, Bank of Canada and Big 6 Banks, July 09, 2021.

Rise in interest rates

- Many reports are forecasting an increase in interest rates in the next few years.
- An increase in interest rates will typically result in an increase in cap rates, driven by the higher cost of debt financing, which impacts overall return metrics.
- Similarly, higher interest rates will drive up debt service costs, which will impact free cash flows to the landlord.

Understanding your real estate portfolio

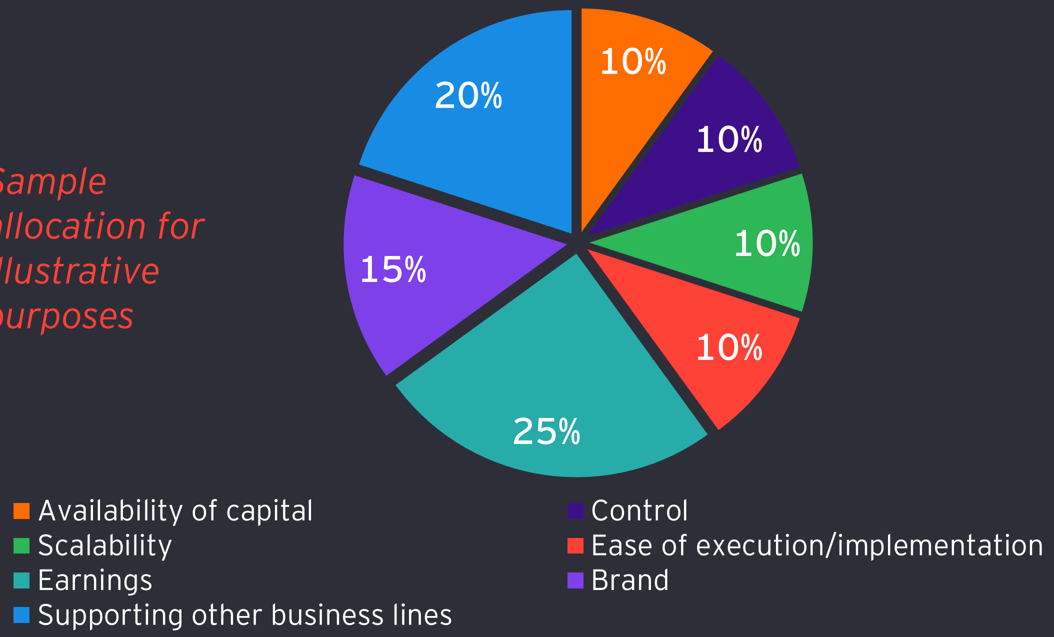
To capitalize on your real estate portfolio strategy, it is important to perform a strategic options analysis on alternative ownership structures for your real estate portfolio:

- What does success look like to you? What would be a great outcome?
- What are the capital needs of the business? And timing of these needs?
- How important is control vs. ownership (both financial and decision making ability) over the real estate assets?
- How is the differential between the assets' book/carrying value and current FMV best realized?
- What is the most efficient structure with consideration for tax implications, profitable growth and a potential exit at a later date?
- What is the most suitable investment horizon and eventual exit strategy?
- What are the benefits of an open-ended vs. close-ended structure?
- Is the portfolio allocation mix optimized and attractive to external investors? Are there assets that might be a drag on performance or diminish interest from external investors?

EY can work with you to establish the key evaluation criteria to assess various alternatives as well as the relative importance of each of the criteria identified in evaluating the options.

Establishing Scoring Index and Weight

Criteria allocation

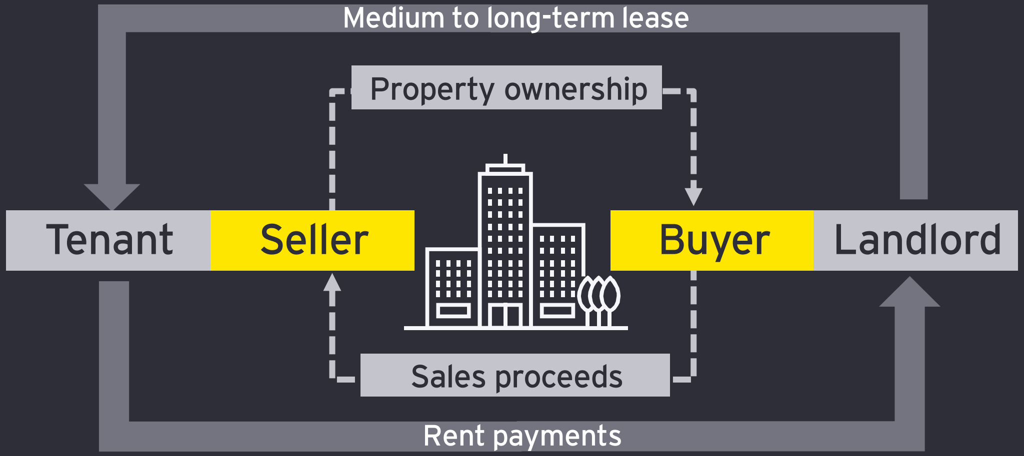


Scoring index*	
Score	**Value**
Excellent	5
Good	4
Average	3
Poor	2
Very poor	1
Does not support	0

Sale-leaseback strategy

With the costs of real estate ownership increasing and uncertainties in future workspace needs, sale-leaseback transactions have become an increasingly attractive option for companies to extract value from owned assets and improve their balance sheet.

The arrangement is effectively two transactions in one, in which the owner disposes of the property to the buyer (often in the business of operating or developing real estate), who will then lease all or partial space back to the seller.



Transaction terms can be catered to maximize flexibility to the seller through varying the length (medium to long-term) and footprint (leaseback of partial or full building) of the lease. Above or below market sale price, rent and varying tenant inducements can also be negotiated to optimize the seller's immediate or future cash flow needs.

Benefits of a sale-leaseback transaction

- Frees up investment capital to deploy into business or other pursuits
- Provide alternative financing to repay debt
- Improve solvency and liquidity ratios
- Maximize value of owned property and unlock site value for redevelopment potential
- Transfers ownership risk for current and future capital costs
- Increase transparency and predictability of future accommodation costs
- Increase flexibility in long-term real estate strategy
- Redefine terms of leasehold commitments to fit more closely to business needs
- Right sizing of real estate footprint

Unlocking real estate value: How can EY help?

Our Transaction Real Estate practice provides objective advice to companies engaging in, or considering a transaction for the purpose of growth, financing or monetization. We recognize that transactions are key to business strategies and require multidisciplinary skill sets. We provide a single point of contact and a fully integrated service offering to help companies throughout the entire transaction lifecycle.

Strategic analysis

We can help you fully understand the attributes of your real estate, manage risks, assess opportunities to enhance and unlock value and outline the critical steps to help you get there. Strategic analysis for real estate assets, portfolios and markets includes options analysis, strategy development, lease vs. own analysis and cash flow modelling.

Financing services

Our thorough understanding of real estate, financing structures and funding sources allows us to properly position the assets in the market and present the opportunity to those investors and/or lenders most likely to participate. Our services include developing financing options and strategies and sourcing and arranging equity and debt, including secured and unsecured debt for permanent, recapitalization and construction/project financing requirements.

Acquisitions, divestitures and partnerships

Our experience in assessing real estate assets and market trends allows us to thoroughly evaluate each situation in the context of your business objectives and, in the case of dispositions, position the asset in the market to enhance proceeds.

Unlocking real estate value: How can EY help?

Capital markets advisory

We are an independent investment bank and exempt market dealer. Our independent objective advice allows us to assist public real estate companies (and also private companies contemplating an IPO) in assessing market acceptance and public markets strategy in order to maximize share price.

Our services include corporate finance, fairness opinions and valuations, private equity, M&A, private verification of value/options/strategy, equity and debt raises, real estate brokerage and advisory, and assistance in all aspects of investor relations amongst others.

Valuation

Our team values and reviews appraisals for billions of dollars of properties each year, giving us a thorough understanding of each asset class and geography. We provide current independent and objective valuations supported by up-to- date market data.

Due diligence

Our due diligence services are focused on reviewing and understanding historical and projected operating metrics for assets and portfolios. We provide independent confirmation to assess the reasonability of underwriting, completeness of all due diligence procedures, and detailed review and analysis of all components of the property or portfolio.

Québec tax update for private companies

Presented by

Jonathan Bicher
Partner, Tax, EY

Building a better working world

Corporate tax rates

Corporate tax rates – 2021*

	Active business income			Investment income	
	Income eligible for small-business deduction (SBD) (generally up to $500,000)	Manufacturing and processing (M&P) income not eligible for SBD (greater than $500,000)	General income not eligible for SBD (non-M&P income)	Investment income earned by Canadian-controlled private corporations (CCPCs)	Investment income earned by other corporations (non-CCPCs)
Federal	9.00%	15.00%	15.00%	38.67%	15.00%
Prior to March 26, 2021	4.00%				
After March 25, 2021	3.20%				
Québec	3.38%	11.50%	11.50%	11.50%	11.50%
Prior to March 26, 2021	13.00%				
After March 25, 2021	12.20%				
Total	12.38%	26.50%	26.50%	50.17%	26.50%

*Rates represent calendar-year rates unless indicated otherwise. Includes all rate changes announced up to June 15, 2021

New tax credit for investments and innovation (C3i)

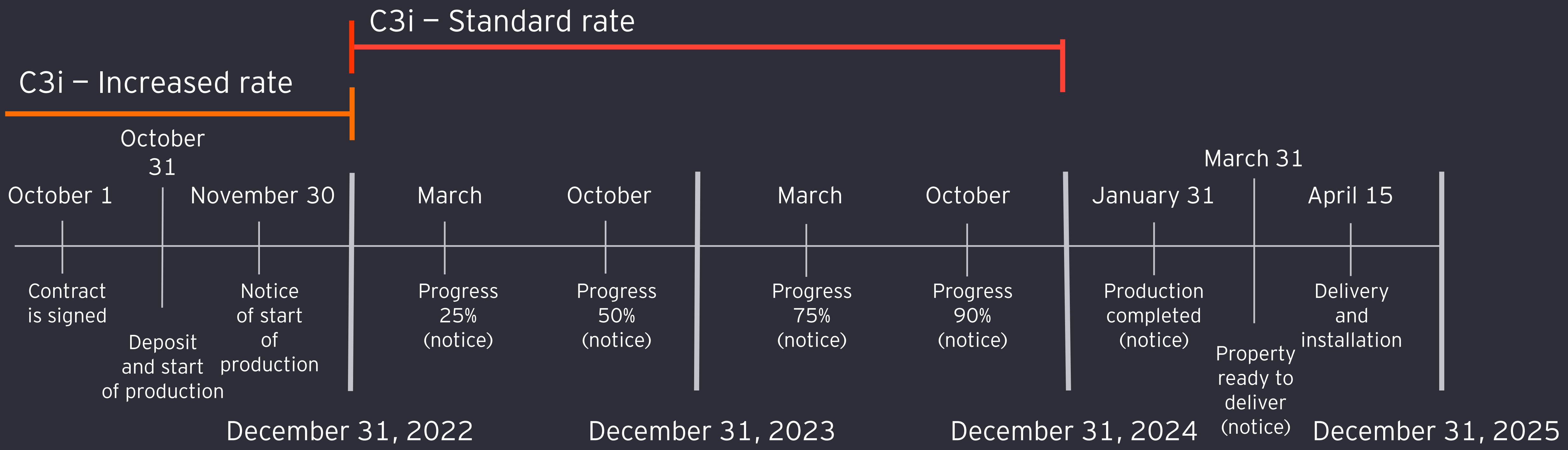
C3i – brief reminder

- The Quebec government introduced the new tax credit for investments and innovation (commonly referred to as C3i in French) in the March 10, 2020 budget.
- The C3i has been introduced to encourage productivity gains of businesses, while more particularly promoting investments in regions where the economic vitality index is low. In short, a qualified corporation may claim the C3i in respect of expenses incurred that exceed the exclusion threshold for the acquisition of manufacturing or processing equipment, computer equipment or certain software packages.
- The C3i standard rate is 10%, 15% or 20% of the specified expenses depending on whether the property is acquired for use mainly in the high economic vitality zone, the intermediate zone or the low economic vitality zone.
- A specified property eligible for this tax credit must have been acquired after March 10, 2020 and before January 1, 2025.
- The tax credit is not applicable to a property acquired pursuant to a written obligation entered into prior to March 11, 2020, or for which construction had begun on March 10, 2020.

C3i – brief reminder (continued)

- In the March 25, 2021 budget, the Québec government temporarily **doubled** the rates applicable to eligible property **acquired after March 25, 2021 but before January 1, 2023**.
- The increase will also apply to property acquired before April 1, 2023 if the property is acquired pursuant to a written obligation entered into before January 1, 2023 or if construction of the property began before January 1, 2023.
- The transfer of a real right in a property determined only as to kind vests the acquirer with that right as soon as he is notified that the property is certain and determinate. A property that has been the subject of an order may not be acquired until a few months later, when its construction is completed, and the purchaser has been notified that the property is certain and determinate.

C3i – Scenario



C3i – Questions to Revenu Québec – Scenario 1

Question 1

- Can Revenu Québec outline its position on **when a property is considered "certain and determinate"**, and confirm the date of acquisition of the property described in the scenario?

Response

- The acquisition takes place at the time the property is considered to be certain and determinate and the purchaser has been informed of this status, as soon as it is possible to clearly identify the property intended for the purchaser at the time its production is completed.
- The property would be acquired on January 31, 2025, despite the fact that some testing remains to be done.
- The property would not be a specified property and no tax credit could be claimed.

C3i – Questions to Revenu Québec – Scenario 1

Question 2

- Where expenses incurred in a taxation year are paid within 18 months of the end of that year, the tax credit claim must be filed for that taxation year within 18 months of the end of that year.
  - This would be the case in this scenario where the deposit is made in October 2022.
- Can Revenu Québec confirm how the taxpayer should file their claim if they do not yet know the date of acquisition of the property or the applicable rate at the time the claim is filed?
  - RQ assumes for purposes of its response that the property would be acquired on December 31, 2024, which is before January 1, 2025.

Response

- The corporation may claim the tax credit for the amount of the deposit for 2022 using the rate in effect based on the date of acquisition of the property.
  - RQ assumes for purposes of its response that the property would be acquired on December 31, 2024, which is before January 1, 2025.

C3i – Questions to Revenu Québec – Scenario 2

Question

- February 15, 2020: A purchase order is issued to a supplier and the property is certain and determinate (the property qualifies as an eligible specified property).
- March 12, 2020: Signature of a contract between the corporation and the supplier setting out the terms of the agreement between the parties.
- March 15, 2020: Delivery of the property.
- March 20, 2020: Issuance of the invoice by the supplier.
- What is the acquisition date of the property?

Response

- Depends on when the exchange of consents took place.

Determined transactions

Determined transactions – brief reminder

- Extension of the scope of the rules on mandatory disclosure of tax planning to **specified transactions**
- Specified transaction: Transaction whose form and substance of the facts specific to the taxpayer (or partnership) are significantly similar to the form and substance of the facts of a transaction determined by Revenu Québec and published in the *Gazette officielle du Québec* (**determined transactions**)
- To date, four determined transactions have been published (Schedule A of the *Mandatory Transaction Disclosure Regulation*):
  - Transaction 1: Avoidance of deemed disposal of trust property
  - Transaction 2: Payment to a non-treaty country
  - Transaction 3: Multiplication of the capital gains deduction
  - Transaction 4: Tax attribute trading
- Mandatory disclosure applies to taxpayers and to advisors/promoters
- Significant consequences for non-disclosure:
  - Penalty (taxpayers): $10,000 + $1,000/day (max. $100,000) and 50% of the tax benefit
  - Penalty (advisors/promoters): $10,000 + $1,000/day (max. $100,000) and 100% of the fees
  - Statute-barred period (taxpayers): three additional years
  - RENA: No impact unless the transaction is within the ambit of GAAR or a sham

Determined transactions – multiplication of the capital gains deduction (CGD)

Targeted transactions

- Used by a person (generally the business owner) of accommodators to claim multiple CGDs, often through a trust, while receiving all or part of the accommodators' gains (e.g., *Laplante v. The Queen*, 2017 TCC 118, confirmed in 2018 FCA 193)
- Introduction in the shareholding of the shareholder's spouse in order to claim multiple CGDs by manipulating the attribution rules (e.g., *Gervais v. Canada*, 2018 FCA 3)

Potential "excluded" transactions

- Situation where a non-taxable amount is retained in the trust (Question #21)
- Situation where the non-taxable portion allocated by the trust is loaned (Question #22)
- Gift by an individual to a non-arm's-length person of a portion of the capital gain after the individual has claimed his or her CGD (Question #23)
- Related persons who reinvest the gain they realized on the sale of a corporation (and for which they claimed the CGD) in another corporation they have formed (Question #24)

Determined transactions – tax attribute trading

Targeted transactions:

- Use of one taxpayer's tax attributes (e.g., operating losses, tax credits that can be carried over, or SR&ED expenses balances) by another taxpayer that was not affiliated with the taxpayer immediately before the start of the series of transactions
- Use of tax attributes, resulting in a loss, by a corporation or trust further to its capitalization by a third party, notably in order to carry on a new business, if there is a relationship between the capitalization and the use of the corporation's or trust's tax attributes

"Excluded" transactions (i.e., transaction or series of transactions that Revenu Québec considers not to fall under the general definition of a determined transaction or that should be excluded from its application):

- Use of tax attributes generated in respect of a taxpayer (initial taxpayer) by another taxpayer (given taxpayer) who is **related to** the initial taxpayer immediately before the series of transactions begins