



# FORESIGHT

CONTEMPORARY IDEAS FOR BUSINESS MANAGEMENT

FALL/WINTER 2024

## Normalizing Earnings or Cash Flow



**B**usinesses with active operations are commonly valued based on their ability to generate earnings or cash flow. For mature businesses that demonstrate consistent earnings or cash flow, a Chartered Business Valuator (CBV) or other valuation practitioner may employ a capitalized earnings or cash flow methodology to assess the value of the business operations if future results are expected to be stable. Under this type of methodology, historical business results are analyzed to estimate a sustainable level of earnings or cash flow. A capitalization rate or multiple is then applied to determine the hypothetical amount an investor would pay for the business operations. In order to determine the sustainable level of earnings or cash flow a business can generate, historical results are reviewed. Adjustments are made to the reported results to arrive at “normalized” earnings or cash flow, which are then considered when selecting the sustainable level

or range. Below are some examples of common normalizing adjustments made to determine a business’s normalized earnings or cash flow:

### Related Party Transactions

Businesses often have transactions with related individuals (such as shareholders or their family members) and companies controlled by these individuals. These transactions may involve discretionary payments or do not always reflect the economic value transferred. When normalizing earnings or cash flow, these transactions are typically adjusted to market rates that would be paid or received from an arm’s-length (unrelated) party. Examples include compensation paid to owners or their family members working in the business, rent for real estate or equipment owned by a related individual or corporation, sales or purchases with related entities, and consulting or management fees. These can be in the normal course of business, but they may sometimes

be for other purposes such as tax planning.

### Redundant Asset Adjustments

Businesses may own redundant assets – assets not used in active operations. Under an income approach, the value of redundant assets is considered separately from the value of business operations to avoid double counting. Income or expenses related to these redundant assets are removed from normalized earnings. Examples include dividend or interest income from marketable securities and loans, investment management fees, and life insurance premiums. If a business owns real estate not essential for operations, treating it as a redundant asset involves adjusting earnings by adding back ownership costs and deducting a “market” rental rate.

### Non-Recurring and Non-Operating Adjustments

Non-recurring items are amounts that are not expected to occur in the future on a predictable basis. Examples of non-recurring items

2

Consequences of Emigration of a Canadian Taxpayer

3

Life Insurance: Do I Really Need it?

5

US Tax Issues for US Citizens and Green Card Holders Living in Canada

6

Disbursement Quota

include lawsuit settlements, moving costs, discontinued operations, and revenue from one-time projects. These nonrecurring revenues and expenses are removed from normalized earnings/ cash flow. Non-operating expenses are also removed and include personal expenses paid by a business on behalf of a shareholder.

### Selecting a Maintainable Level

There is no precise method or formula to determine the maintainable earnings of a business. Normalized historical results are one factor among others considered when estimating the maintainable future earnings for valuing business operations. Other factors include short-term budgets/ forecasts, industry and economic

data, management input on the future business outlook, and the professional judgment of the valuation practitioner.

*If you have any questions regarding your business's earnings or cash flow, please contact a member of our Financial Services Advisory Team (FSAT) team.*

**Article written by: Jonathan Corobow, CBV**

# Consequences of Emigration of a Canadian Taxpayer



**I**n a more globalized world, and especially after the COVID-19 pandemic brought about a seismic shift in our workplaces and the adoption of remote work, emigration has become a more popular option for many taxpayers in the past few years. Emigration also represents the “final departure from Canada” of a taxpayer, and potentially the final opportunity for the Canada Revenue Agency (CRA) to tax a taxpayer, which can therefore mean large tax liabilities. The purpose of this article is to explore some of the more common consequences of emigration of a Canadian taxpayer.

### Determination of Residency

Any discussion of emigration pivots around the concept of residency in Canada. In Canada, the Income Tax Act (ITA) taxes Canadian residents on their worldwide income, and non-residents on their Canadian-sourced income.

Per CRA policies and technical bulletins, the most important determinants of residency are significant residential ties, or what are colloquially referred to as the “house and spouse” ties. These ties include whether you keep a dwelling place in Canada available for occupation by you, and whether

your spouse or common-law partner, or other dependents, continue to be in Canada (or in a separate country).

After the significant residential ties are assessed, secondary residential ties are then assessed – these include personal property such as cars, furniture, and clothing, any economic ties (like a job or investment accounts), or insurance coverage in Canada.

It should be noted from the above that citizenship does not equal residency – a taxpayer can be a citizen of Canada but not a resident of Canada for tax purposes.

If a taxpayer leaves Canada, and they are determined to have “severed ties” with Canada, they are determined to have ceased residency on that date, i.e. emigrated from Canada.

### Consequences of Ceasing Residency

If a taxpayer ceases residency in the year, they will be deemed to have disposed of certain types of capital property, the gain on which will trigger “departure tax”. Under the ITA, any securities, cryptocurrencies, or other investments held will be deemed to be disposed of at their fair market value, potentially creating a large tax liability. Notably, Canadian real estate

is excluded from this rule.

If the taxpayer holds an RRSP, TFSA, or RRIF, these accounts will be excluded from the deemed disposition. Any withdrawals are likely to be taxed as passive income and subject to the withholding tax requirements discussed below. However, it is important to note that the other country in which the taxpayer is now resident may not recognize the RRSP or TFSA as a tax deferring vehicle, and thus tax any income earned in the plan.

### Non-residents earning income in Canada

Employment or self-employment income earned in Canada as a non-resident will be subject to Part I tax in Canada, and a regular T1 income tax return is required to be filed.

If passive income, such as dividends, interest, or royalties, is received by a non-resident, such income will be subject to a 25% withholding tax that will be withheld and remitted to the CRA at source. The withholding rate could be lower than 25% for residents from certain countries having tax treaties with Canada.

RRSP, RRIF, OAS, and other pension payments are also subject to a 25%

withholding tax. However, an election is available to a non-resident to file a tax return with the CRA and report the income as if they were a Canadian resident, claiming certain tax credits, and enjoying lower tax brackets.

Income from a rental property is usually subject to the 25% withholding tax as well. However, an election is available for a non-resident to file a tax return with the CRA and report the income as if they were a Canadian resident, claiming rental expenses and certain tax credits, and enjoying lower tax brackets.

Note that the election to file a return does not eliminate the requirement of withholding tax at source.

If a non-resident owns a piece of Canadian real estate, or other “taxable Canadian property”, prior to or upon disposition, 25% of the net gain must be remitted to the government and a Request for a Clearance Certificate, T2062, must be filed with the CRA. Tax returns are available to be filed

to receive a partial refund of this. Of note, the government has introduced legislation to increase this withholding tax to 35% effective January 1, 2025.

#### Other tax considerations

There are certain provisions of the ITA that only apply to Canadian residents. Three notable instances of this are:

1. Capital Gains Exemption with regards to a share sale, which requires that the shares in question be held by a Canadian resident throughout the year.
2. The definition of a Canadian-Controlled Private Corporation states that a corporation must not be controlled by a non-resident.
3. The emigration of a trustee/beneficiary and their subsequent non-resident status has an impact on the taxation of a Trust.

Absent proper planning, running afoul of these rules can yield a significant unplanned tax liability.

Finally, as a non-resident, a taxpayer

may still have social, employment, or tourism-related desires to return to Canada. Under the ITA, a non-resident who is temporarily staying (“sojourning”) in Canada for 183 days or more in a calendar year will be considered a deemed resident of Canada for the entire year. As discussed above, a resident of Canada will be taxed on their worldwide income, which can yield a significant tax liability.

*Determining residency can be a complex endeavour, and dealing with the consequences of a change in residency can be overwhelming. Our experienced advisors at DJB are well versed in international and domestic tax and can gladly assist you with the development of an exit plan, advise on the consequences of moving, or can help advise you on any other issues that can arise with regards to emigration.*

**Article written by: Aleksa Kenjic, MAcc, CPA**



## Life Insurance: Do I Really Need it?

This is a question I've been asked hundreds of times over the years and the answer is: it depends!

Everyone's situation is unique and the only way to really know if you need life insurance is to complete a Comprehensive Life Insurance Needs Analysis with a licensed insurance professional or a Certified Financial Planner. A proper analysis for personal insurance should take into account the following details:

#### Financial Liabilities

- Mortgage, loans, or other debts

- Funeral expenses
- Legal & accounting fees
- Taxes
- Education fund
- Emergency fund

#### Need for Income Replacement

- Amount
- Length of time required
- CPP benefits

#### Assets

- Savings
- Investments

- Real estate
- Life insurance (personal, group, mortgage, credit)
- Business/farm assets
- Government benefits
- Other assets (vehicles, coin collections, etc.)

In addition to personal protection, some people purchase life insurance to accumulate wealth or to create or enhance their wealth for their family. As an example, Sue and Gord, both age 55, plan to leave \$200,000 of their current wealth to their family. If they

were to allocate their current savings into a life insurance plan, they could potentially increase the inheritance to their children from \$500,000 at death to more than \$775,000, assuming they both live to age 90. Others use life insurance to provide a significant donation to their favourite charity.

In addition to personal insurance needs, business owners have other areas of concern for which life insurance may provide the best solution. While insuring debts is important, businesses often use life insurance to fund shareholder or buy/sell agreements to ensure that funds are available when they are needed without having to leverage the business at a time when it's lost a key stakeholder. It also protects the remaining business owner(s) from being forced into a partnership with the heirs of their recently deceased partner and provides guaranteed funds to the family to ensure a fair and timely settlement after the loss of their loved one.

Imagine that Jen and Berry enter into a business deal, starting with nothing more than a sweet idea and a few start-up dollars, then become successful beyond either of their imaginations! They have each developed a different expertise in the management of their business and have agreed to reinvest the bulk of their profits back into their enterprise to continually expand their growing empire. Jen has become the product developer and professional tester, creating products craved by millions, while Berry is the consummate marketer, getting their product on the shelves of thousands of retailers. Each partner knows that they would not be as successful without the expertise and hard work of the other and that neither would be easy to replace. Jen and Berry work with their accountant to determine a formula for calculating the fair value of their business, should either partner predecease the other. They agree that the remaining partner will pay the deceased partner's family

a fair value for the business and do so in a timely manner at the same time that both agree that their estates will be bound to sell the deceased shareholder's interest in the business to the surviving shareholder at a fair price. Neither partner relishes the idea of selling their creation to fund the buyout of the deceased partner's shares and are not sure about borrowing the funds, given that there may be a great deal of upheaval at the loss of either critical partner. Jen and Berry meet with their Certified Financial Planner and discuss their concerns. Their planner connects them with an insurance professional who works with them and their team of professionals to find a life insurance contract that works best in their situation. Now Jen and Berry can get back to what they enjoy doing most and not have to worry about the future of their business or family.

For some businesses, it might be important to insure a 'key person'. As an example, I was once referred to a client to insure the owner of the business, only to find out in discussion with the owner that he was really not the 'key person'. He had a salesperson who was responsible for 80% of the business revenue and in our discussions, the owner recognized the significant loss of revenue if he lost this 'key person' due to disability or death. Some business owners use life insurance to shelter capital being held in the business owner's holding company to protect the hard-earned money from significant income tax on the growth and provide a tax-preferred method for the eventual distribution of the proceeds out of the holding company to the beneficiaries. An insurance contract can also cover the cost of capital gains tax or, similar to how it might be used personally, it could be used to enhance the value of the estate for the next generation or as a tax-preferred retirement fund.

*Not every person, family, or business needs life insurance, but if you think you might, talk to an insurance*

*professional. If you don't have an insurance advisor, speak with your other trusted advisors, such as your Certified Financial Planner, Accountant, or Lawyer and ask for a referral to someone they trust. Interview the person and only agree to hire them if you're comfortable with their competency in dealing with your unique situation. Only agree to engage them as your trusted insurance professional if they agree to work with the other members of your Professional Advisory Team.*

**Article written by: Brad Giroux, CFP®, CLU, CHS**

# US Tax Issues for US Citizens and Green Card Holders Living in Canada



## Filing Requirement

The liability for US tax is based on both citizenship and residence. Therefore, as a US citizen, you must file annual US income tax returns regardless of where you live. The deadline for filing a US return is April 15th of the following year. However, there is an automatic extension until June 15th if you are a resident outside the US. Alternatively, you can also file a 6-month extension request, which would mean your US return would be due on October 15th.

Failure to file the annual US return and all related forms (noted below) can result in serious financial penalties.

## Common Tax Issues

### Registered Education Savings Plan (RESP)

- There may be negative US tax consequences for individuals that have set up these accounts as you cannot elect to defer the taxation of income earned in the account.

### Tax-Free Savings Accounts (TFSA)

- Like the RESP, you cannot elect to defer the taxation of the income earned in the account. In addition, many US advisors also consider the TFSA to be a foreign trust for US purposes, which as noted above, would mean additional reporting requirements for foreign trusts (Form 3520 and 3520-A).

### Canadian Mutual Funds, ETFs & REITs

- If you own Canadian mutual

funds, ETFs, and or REITs, the US may consider such investments to be a Passive Foreign Investment Company (PFIC). If you have invested in a PFIC, you are required to complete additional US forms for each PFIC that you own as part of your US return (Form 8621).

### Foreign Financial Assets

- Depending how many foreign financial assets you own, you may be required to complete disclosure forms explaining the nature of the investments and the income that each has generated as part of your tax return (Form 8938).

### Foreign corporations

- If you own shares of, or control a Canadian private corporation, there can be several implications for your US return ranging from disclosure of information about the Canadian company to the accrual of passive income earned by the Canadian company on your US return (Form 5471).

### US Treasury Reporting

- If you have foreign financial assets in excess of \$10,000 at any time in the year you must complete the US treasury forms and submit them electronically every year by June 30 of the following year. These forms require details regarding your financial institutions, account numbers, addresses, and highest balances in the accounts (FinCEN report 114, formerly TD F 90-22.1 aka FBAR).

## Voluntary Disclosure

If you have not filed US returns, action should be taken immediately. The IRS has set up a voluntary disclosure program called the Streamlined Filing Compliance Procedure. Under this program, if the taxpayer qualifies, they can file the three previous US returns and 6 previous FinCEN reports to get caught up without penalties.

## US Estate Tax

US citizens and long-term green card holders are subject to the US estate tax regime. Unlike the Canadian tax system which taxes accrued gains upon death, the US estate tax regime is a wealth tax based on the value of the deceased's estate. For 2024, every US citizen receives an exemption of \$13,610,000 (indexed annually). For estate's exceeding \$13,610,000, the excess will be taxed at the highest estate tax rate of 40%. US citizens living in Canada that have wealth in excess of the exemption should consider estate and tax planning strategies to minimize their US estate tax exposure.



Connect  
with Us

### DJB Burlington

5045 South Service Road  
Burlington, ON  
L7L 5Y7  
Tel: 905.681.6900  
Email: burl@djb.com

### DJB Hamilton

570 Highland Road West  
Hamilton, ON  
L8W 0C4  
Tel: 905.525.9520  
Email: hamilton@djb.com

### DJB St. Catharines

20 Corporate Park Drive  
St. Catharines, ON  
L2S 3W2  
Tel: 905.684.9221  
Email: stcath@djb.com

### DJB Welland

171 Division Street  
Welland, ON  
L3B 5N9  
Tel: 905.735.2140  
Email: welland@djb.com

## Disbursement Quota



**I**n January 2023, Canada Revenue Agency increased the required disbursement quota for charities from 3.5% to 5.0% on the portion of property over \$1 million. Many charities however, do not know how the value of this property for the determination of the quota is calculated or how they meet the disbursement target.

As part of the annual Registered Charity Information Return, there is a question on the amount of property that the organization owns that is not used directly for charitable activities or administration. This could include excess cash or investments on hand or other capital property such as a building that is not used by the charity.

If this amount is more than \$100,000 for charitable organizations (or \$25,000 for public or private foundations) then you must calculate and enter the amount. Rather than take the amount at a specific date, it is instead determined based on the average over the prior 24 months.

Once this average value of property not used in charitable activities is computed, the next step is calculating the disbursement quota. It is determined at 3.5% of the value less than \$1 million and 5% for any amount exceeding \$1 million. For example, an average value of \$1.5 million will result in a disbursement quota of \$60,000.

To meet the disbursement quota, the organization must have total expenditures on charitable activities and gifts to qualified donees in the year more than the quota or be offside and have a shortfall.

If however, a shortfall exists the charity can draw on disbursement excesses from the previous five years to help meet the shortfall or if no excesses are available they have one year grace to create an excess the following year to cover the prior year shortfall.

**Article written by: Amanda Pyper, CPA, CA**

This publication is distributed with the understanding that the authors, publisher, and distributor are not rendering legal, accounting, tax, or other professional advice or opinions on specific facts or matters and, accordingly, assume no liability whatsoever in connection with its use. The information in this publication is not intended to be used for the purpose of (i) avoiding penalties that may be imposed under local tax law provisions or (ii) promoting, marketing, or recommending to another party any transaction or matter addressed in this publication. © 2024

