



TAX MEASURES ANNOUNCED AT THE TIME OF
THE TABLING OF THE GOVERNMENT ACTION PLAN
TO FOSTER AN EXECUTIVE-DRIVEN ECONOMY

This information bulletin explains in detail the tax measures announced in the document entitled *For An Open and Prosperous Economy: A Plan to Strengthen the Québec Economy As an Executive-Driven Economy*.

These measures ease existing tax provisions, in order to strengthen the presence of decision-making centres, and foster the presence of executives, in Québec.

The purpose of the amendments to the tax legislation is therefore to extend the easing of the tax provisions applicable to the transfer of family businesses to all sectors of economic activity, and to permit, in certain circumstances, the deferral of the payment of tax on income stemming from certain deemed dispositions of interests in a public corporation.

The amendments also provide for the harmonization of the deduction for stock options allowed under the Québec tax system with that available under the federal system, where the options concern shares of publicly traded corporations having a significant presence in Québec.

For information concerning the matters dealt with in this information bulletin, contact the Secteur du droit fiscal, de l'optimisation des revenus et des politiques locales et autochtones at 418 691-2236.

The English and French versions of this bulletin are available on the Ministère des Finances website, at www.finances.gouv.qc.ca.

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1. EXTENSION, TO ALL SECTORS OF ACTIVITY, OF THE EASING OF THE TAX PROVISIONS APPLICABLE TO THE TRANSFER OF FAMILY BUSINESSES

As part of the budget speech of March 26, 2015, an easing of the tax provisions applicable to the transfer of family businesses was announced.¹ Among other things, the announcement specified the technical conditions related to the easing, along with the type of corporation that would be covered by the new provisions, essentially corporations in the primary and manufacturing sectors.

The announcement did not define the exact type of transfer to which the easing would apply. That was done as part of the budget speech of March 17, 2016,² with the presentation of the qualification criteria for transfers of a qualified family business. As will be recalled, the easing was to apply to dispositions of qualified shares of the primary and manufacturing sectors made after March 17, 2016.

For the purposes of this tax measure, “qualified share of the primary or manufacturing sector”³ means:

- a share of the capital stock of a family farm corporation;
- a share of the capital stock of a family fishing corporation; or
- a qualified small business corporation share of a corporation in the primary or manufacturing sector.

To extend the scope of this easing to all sectors of activity, the restriction limiting this benefit solely to corporations in the primary and manufacturing sectors, in the case of qualified small business corporation shares, will be lifted.

As a result of this amendment, the easing of the tax provisions applicable to the transfer of family businesses will target qualified shares. For the purposes of this easing, “qualified share” will therefore refer to:

- a share of the capital stock of a family farm corporation;
- a share of the capital stock of a family fishing corporation; or
- a qualified small business corporation share.

This amendment will apply to dispositions of shares made after March 17, 2016.

¹ MINISTÈRE DES FINANCES DU QUÉBEC, *Budget 2015-2016 – Additional Information 2015-2016*, March 26, 2015, pp. A.113-A.117.

² MINISTÈRE DES FINANCES DU QUÉBEC, *The Québec Economic Plan – Additional Information 2016-2017*, March 17, 2016, pp. A.38-A.44.

³ *Taxation Act*, s. 517.5.3.

2. DEFERRAL OF THE PAYMENT OF INCOME TAX ON CERTAIN DEEMED DISPOSITIONS OF INTERESTS IN A QUALIFIED PUBLIC CORPORATION

The presence of head offices of public corporations in Québec fosters Québec's economic development. However, certain tax provisions may discourage the establishment or maintenance of such head offices in Québec.

Indeed, the tax legislation provides for the deemed disposition of all property at fair market value in certain circumstances.

This is the case, for example, on a person's death. Subject to certain exceptions, a person who dies is deemed to have disposed of all of his or her property at fair market value immediately before death.

Similarly, the tax rules applicable to trusts provide for the deemed disposition of all of a trust's property at fair market value every 21 years after the date on which the trust was created, subject to certain conditions.

These tax provisions may cause liquidity problems, because deemed dispositions do not generate a cash inflow for the taxpayers concerned, potentially leaving them with no choice but to actually dispose of an interest in a public corporation.

If the interest in the public corporation is substantial, there may be an immediate or future impact on the control of the corporation by Québec interests or on the influence of Québec decision-makers on the strategic directions of the corporation.

To foster the maintenance of substantial interests in public corporations, tax relief will be introduced.

Briefly, subject to certain conditions, this tax relief will enable an individual or the individual's legal representative to elect to defer, for a maximum period of 20 years, the payment of Québec income tax attributable to the deemed disposition of qualified shares.

This relief will apply to a share that is a qualified share at the time of the deemed disposition.

□ **Qualified share**

For the purposes of this tax measure, a qualified share will mean:

- a share that is included in a large block of shares, or in part of a large block of shares, of a qualified public corporation; or
- a share of a private corporation more than 95% of the value of which is attributable to a large block of shares, or to part of a large block of shares, of a qualified public corporation.

■ Qualified public corporation

A corporation is a qualified public corporation at a particular time if it meets the following conditions:

- it is a public corporation;
- it has its head office⁴ in Québec;
- its base payroll in Québec for the taxation year including the particular time represents at least 75% of its base payroll in Québec for the taxation year in which the deemed disposition of the shares occurred,⁵ where the particular time does not correspond to the time of the deemed disposition.

The third condition makes it possible to verify that the corporation maintains a significant presence in Québec at all times. Briefly, for the purposes of this condition, a corporation's base payroll in Québec for a particular taxation year will correspond to its average annual payroll in Québec, calculated over a three-year period ending in the particular taxation year.

More specifically, a corporation's base payroll in Québec for a particular taxation year will correspond to the amount determined by the following formula:⁶

$$\frac{A \times 365}{B}$$

In this formula:

- A is the corporation's total mass payroll in Québec for each of the corporation's taxation years ended in the 1 095-day period ending at the end of the particular taxation year;
- B is total number of days included in each of the taxation years contemplated by A.

■ Large block of shares

"Large block of shares of a qualified public corporation" will refer to a block of shares that, in all circumstances, gives the owner more than 33⅓% of the corporation's voting rights.

Thus, shares held by an individual in a private corporation whose only asset is a large block of shares in a qualified public corporation will be qualified shares, regardless of whether the individual is related to the other shareholders of the private corporation. This will also be so in the case of shares held by an individual in a personal private corporation whose only asset is shares in another private corporation whose only asset is a large block of shares in a qualified public corporation.

⁴ The term "head office" must be given its ordinary meaning and refer to the principal place of business, where the bulk of the corporation's legal, administrative and management activities are carried out.

⁵ In both cases, the base payroll in Québec must be calculated by adding the aggregate of the base payrolls in Québec of the corporations with which the public corporation is associated for the taxation year concerned.

⁶ For greater clarity, where a corporation's base payroll in Québec must be calculated by adding the aggregate of the base payrolls in Québec of the corporations with which the corporation is associated for the taxation year concerned, the base payroll in Québec of such an associated corporation must be determined on the basis of the parameters specific to that corporation, in particular by using the 1 095-day period applicable to it.

❑ Part of a large block of shares

“Part of a large block of shares of a qualified public corporation” will refer to one or more of the corporation’s shares held by an owner that is a member of a related group of holders of shares of the corporation, where this group has a block of shares that, in all circumstances, gives it more than 33⅓% of the corporation’s voting rights.

In this regard, “related group of holders in respect of a qualified public corporation” will refer to a group in which each of the persons composing it is related to each of the other persons in the group and owns shares of the corporation.

For the purposes of the definition of “part of a large block of shares of a qualified public corporation,” any share of the qualified public corporation that is held by a member of the related group of holders of shares of the corporation will be deemed to be held by the group.

Thus, shares held by an individual in a qualified public corporation that, in all circumstances, give this owner 2% of the voting rights of the qualified public corporation will be part of a large block of shares if the individual’s brother or sister holds, in all circumstances, 32%⁷ of the voting rights of the qualified corporation.

❑ Income tax attributable to the deemed disposition of qualified shares

Briefly, income tax attributable to the deemed disposition of an individual’s qualified shares will correspond to the difference between the income tax payable by the individual for the taxation year in which the deemed disposition occurred and the income tax that would be payable by the individual for that taxation year if the deemed disposition of the qualified shares covered by the election were not taken into account.

A separate calculation must be done for each class of qualified shares held by an individual.

In this regard, income tax attributable to the deemed disposition of a qualified share in a particular class will correspond to the product obtained by multiplying the proportion that the share is of the total number of shares in the particular class held by the individual at the time of the deemed disposition, by the income tax attributable to the deemed disposition of the qualified shares in the particular class by the individual.

❑ Security

For an individual to be able to take advantage of the tax relief in respect of a qualified share in a particular class, security satisfactory to Revenu Québec must be furnished by or on behalf of the individual on or before the individual’s balance-due day for the taxation year in which the deemed disposition occurred.⁸

However, the security may not be less than 120% of the amount of income tax attributable to the deemed disposition of the qualified shares covered by an election.

⁷ This will be so even if the brother or sister holds in his or her own right, in all circumstances, 35% of the voting rights of the qualified public corporation.

⁸ The legislative provisions will be similar to those applicable to security for departure from Canada (sections 1033.2 to 1033.13 of the *Taxation Act*), with the necessary adaptations being made to take into account, in particular, the special features of this measure.

Where such security is accepted by Revenu Québec, the income tax attributable to the deemed disposition of the qualified shares covered by the election will be deemed to be an amount paid by the individual. Accordingly, no interest or penalty will be applicable to the income tax amount throughout the period during which the security is valid.

Revenu Québec will conduct regular checks to make sure that the security furnished continues to be satisfactory. If the security is no longer satisfactory, the individual or the individual's legal representative will have the possibility of furnishing additional security within a specific period of time.

☐ Income tax that becomes payable

A number of situations may cause income tax attributable to the deemed disposition of a qualified share to become payable.

■ Inadequate security

If the security furnished is no longer adequate to secure 120% of the income tax attributable to the deemed disposition of the qualified shares covered by the election, a portion of the income tax, proportionate to the decrease in the value of the security, will become payable. Thus, security equivalent to 108% of the amount of income tax attributable to the deemed disposition of the qualified shares would result in a payment corresponding to 10% of the income tax.

■ Cessation of share qualification

Income tax attributable to the deemed disposition of a qualified share will become payable on the individual's balance-due day for the taxation year in which the share ceases, for a full month, to be a qualified share.

For greater clarity, a share may cease to be a qualified share for an individual for reasons completely beyond the individual's control, as when another member of the related group of shareholders of which the individual is a member disposes of its own shares or the corporation ceases to be a qualified public corporation.

■ 20th anniversary of the deemed disposition of a qualified share

Income tax attributable to the deemed disposition of a qualified share will become payable on the individual's balance-due day for the taxation year in which the 20th anniversary of the deemed disposition of the qualified share occurs.

Where income tax attributable to the deemed disposition of a qualified share becomes payable because it is the 20th anniversary of the deemed disposition of the qualified share, and where adequate security is maintained, an individual may make a new deferral in respect of part of the income tax if the value of the qualified share at the time is lower than its value at the time of the deemed disposition, unless Revenu Québec is of the opinion that the decrease in value is attributable to a distribution in any form whatsoever.

The amount of the new deferral will correspond to the product obtained by multiplying the percentage of decrease in the value of the share by the income tax that would otherwise become payable. The percentage of the decrease in value is obtained by comparing the value of the qualified share on the 20th anniversary of the deemed disposition to its value at the time of the deemed disposition.

For greater clarity, this additional deferral is not based on a new calculation of the income tax attributable to the deemed disposition, but solely on the percentage change in the value of the qualified share.

In addition, a new calculation will subsequently be done every two years so that, as applicable, another part of the income tax attributable to the deemed disposition of the qualified share becomes payable should the value of the qualified share increase.

Take, for example, the deemed disposition of a qualified share having a value of \$1 000, in respect of which a deferral of \$80 in income tax was initially possible.

If the value of this share were \$750 on the 20th anniversary of the deemed disposition, it would allow for a new deferral of \$20⁹ in income tax; an amount of \$60 would therefore be payable.

Assuming that the qualified share had a value of \$850 on the 22nd anniversary of the deemed disposition, a new deferral of \$12¹⁰ in income tax would be possible; \$8 would therefore be payable.

For greater clarity, the deferral amount must be either maintained or reduced, and the new calculation will always be done on the basis of the highest value reached during previous adjustments. No income tax paid previously will therefore be refunded if the value of the qualified share decreases between two calculations of the possible deferral amount.

■ Disposition of a qualified share

Income tax attributable to the deemed disposition of a qualified share will become payable on the individual's balance-due day for the taxation year in which the qualified share is disposed of.¹¹ This will also be so in the case of a distribution of a qualified share by a succession or trust.

However, where a succession or trust distributes a qualified share to one of its beneficiaries, a novation may be effected and the debt represented by the income tax attributable to the deemed disposition of the qualified share thus distributed will become that of the beneficiary. In addition, such a novation will be possible only if, immediately after the distribution, the share thus distributed remains a qualified share.

Such a novation will constitute full and final payment of the income tax attributable to the deemed disposition of the qualified share.

Moreover, the terms and conditions of payment of this debt by the beneficiary of the distribution must be in line with the rules applicable to the security that was to have been furnished by the succession or trust. In addition, the above-mentioned rules, in particular those relating to the requirement that the qualified share remain a qualified share and to the 20-year deferral limit,¹² will apply, with the necessary adaptations being made, to the debt of the beneficiary of the distribution.

⁹ This amount represents 25% of the initial deferral, a percentage corresponding to that of the decrease in value of the qualified share.

¹⁰ This amount represents 15% of the initial deferral, a percentage corresponding to that of the decrease in the remaining value of the qualified share.

¹¹ Even though the disposition may otherwise be made with no tax consequences.

¹² For greater clarity, the date on which the 20-year limit begins to be calculated will remain the date of the initial deemed disposition; it will not be the date of distribution.

For greater clarity, fluctuation in the value of a qualified share between the time of its deemed disposition and that of a subsequent disposition will not affect the initial gain on the deemed disposition or, consequently, the income tax attributable to the deemed disposition of the qualified share.

□ **Application Date**

This measure will apply to any deemed disposition of a qualified share that occurs after the date of publication of this information bulletin.

3. INCREASE OF THE DEDUCTION FOR STOCK OPTIONS OF PUBLICLY TRADED LARGE BUSINESSES

As a rule, an employee who transfers or disposes of rights in respect of a stock option granted to the employee by the employer or by a person with which the employer is not dealing at arm's length is deemed to have received, because of the employee's office or employment, a benefit equal to the amount by which the value of the consideration for the transfer or disposition exceeds the amount paid by the employee to acquire those rights. The value of the benefit must be included in computing the employee's income for the taxation year in which the transfer or disposition of the rights occurred.

Similarly, an employee who acquires shares under a stock option granted to the employee by the employer or by a person with which the employer is not dealing at arm's length is deemed to have received, because of the employee's office or employment, a benefit equal to the amount by which the value of the shares at the time the employee acquired them exceeds the aggregate of the amount paid or to be paid by the employee for the shares and the amount paid by the employee to acquire the right to acquire the shares.

In the case of a stock option granted by a Canadian-controlled private corporation to an employee of such a corporation, the value of the benefit must be included in computing the employee's income for the taxation year in which the shares were disposed of. In all other cases, the value of the benefit must be included in computing the employee's income for the taxation year in which the shares were acquired.

Moreover, under the existing tax legislation, an employee who is required to include, in computing his or her income for a particular taxation year, the value of a benefit the employee is deemed to have received in respect of a stock option granted to the employee by the employer or by a person with which the employer is not dealing at arm's length may deduct, in computing his or her taxable income for the year, an amount equal to 25% of the value of the benefit, subject to certain conditions.

However, if the option was granted after March 13, 2008 by a small or medium-sized business (SMB) engaged in innovative activities,¹³ the amount that may be so deducted is increased to 50% of the value of the benefit.

¹³ Briefly, an SMB engaged in innovative activities is a corporation that, in the calendar year in which the option is granted (base year), carries on a business in Québec and has an establishment in Québec, where, for its taxation year ended in the calendar year preceding the base year, the corporation had assets of less than \$50 million, taking into account the assets of corporations with which it was associated in the taxation year, and where an amount was granted to the corporation as a refundable R&D tax credit for its taxation year ended in the base year or for one of the previous three taxation years.

To enable Québec to offer the heads of large businesses a competitive fiscal environment compared to that in the rest of Canada, the rate of the stock option deduction will also increase from 25% to 50% in the case of options for shares of publicly traded companies having a strong presence in Québec.

More specifically, the increase to 50% of the rate used to compute the stock option deduction will apply to any event, transaction or circumstance pertaining to a stock option granted by a corporation that agrees, after the date of publication of this information bulletin, to sell or issue a share of its capital stock or the capital stock of a corporation with which it is not dealing at arm's length to one of its employees or to an employee of a corporation with which it is not dealing at arm's length, provided the following conditions are met:

- the option concerns shares that belong to a class of shares listed on a recognized stock exchange;¹⁴
- the option is granted to an employee of a corporation that is a qualified corporation at the time the agreement is entered into or the shares are acquired.¹⁵

To that end, a corporation will be considered a qualified corporation at a particular time, where, for the calendar year that includes that time, the aggregate of the wages each of which is a wage that it pays to an employee who reports for work at its establishment in Québec, that it is deemed to pay to its employee or that it pays in respect of its employee, or to an employee to whom the wage, if the employee is not required to report for work at an establishment of the employer, is paid, deemed to be paid or paid in respect of the employee from such an establishment in Québec, is at least \$10 million.

For greater clarity, the aggregate of the wages thus paid or deemed to be paid by a corporation for a particular calendar year must be determined in accordance with the rules governing the computation of the employer contribution to the Health Services Fund.

¹⁴ This is essentially a stock exchange, or that part of a stock exchange, designated by the Minister of Finance of Canada, or a stock exchange located in Canada or in a country that is a member of the Organisation for Economic Co-operation and Development and that entered into a tax treaty with the Government of Canada.

¹⁵ The *Taxation Act* provides that, where a person ceases to be an employee before all conditions have been fulfilled that would make the legislative provisions pertaining to the inclusion of the value of a benefit respecting a stock option applicable, those provisions apply as though the person were still an employee and as though the office or employment were still in existence.