**Corporate structure**

* Mavis Corp:
  + Shoe wholesaler
  + 2007 EBT $700,000
* Triple A:
  + Retail summer shoes
  + Acquired in 2002
  + pre-tax profit $100,000 (usual)
* Double A:
  + Retail high fashion shoes
  + Acquired in 2003; profitable
  + End of 2007 has business loss of $400,000 (post acquisition = not transferrable)
  + Expect losses of $50,000 for next 3 years.
  + Assets: buildings with potential capital gain
* Beans:
  + Canning business
  + Acquired in 2006 with losses:
    - ABIL $150,000 but locked in corporation since dissimilar industry
    - Capital losses of $40,000 expired at acquisition
  + End of 2007, operating losses of $250,000 (post acquisition therefore unrestricted)
  + No assets, everything leased

Required: review financial structure of Mavis and enhance growth potential

**Current tax effect for Mavis Group operational cash flow**

Revenues

Mavis $700,000

Triple A $100,000

Active Business Income $800,000

Corporate Tax (38%) $304,000

Less

Abatement for provincial tax (10%) $ 80,000

Small Business Deduction (17%) $136,000

Total reduction $216,000

**Current Structure Tax liability $ 88,000**

Potential tax reduction from ongoing operational losses if they can be used with restructure

Annual Losses

Double A $ 50,000

Bean $250,000

Total unused losses $300,000

Potential savings (38%-10%-17%) $ 33,000

**Potential Tax liability $ 55,000**

**Issues to be addressed**

1. Under the current structure, the losses of 2 corporations can’t be used to offset revenues of the 2 profitable ones; they simply accumulate as ABIL
2. There is existing ABIL locked into the 2 non-profitable corporations, since they are not expected to be profitable soon, there is a risk of expiration:
   * Double A has:
     + $400k ABIL expiring in 20 years
     + Expected new losses of $50k/y for the next 3 years
   * Beans has:
     + $150,000 ABIL expiring 19 years (came with acquisition)
     + Expected new losses of $250k
3. One subsidy with ABIL and significant operating losses, and no sign of imminent recovery

Issues 1 and 2: Fixed by restructuring some companies together

For Double A, there are 3 options:

* 2A assets transfer to 3A @ FMV (ITA 85)
  + New aggregated income of $100,000-$50,00=$50,000
  + Annual tax reduction of $50,000x11%=$5,500
  + Assuming land/buildings have appreciated, capital gain can be offset by part or all of the $400,000 ABIL
  + If the full $400,000 can’t be used, the remaining portion will be left in a corporation without assets – will most likely expire
* 3A assets transfer to 2A @ Cost of acquisition (ITA 85)
  + New aggregated income of $100,000-$50,00=$50,000
  + Annual tax reduction of $50,000x11%=$5,500
  + $50,000 from the $400,000 ABIL can be used to offset the remaining $50,000 NI
  + Additional tax reduction of $50,000x11%=$5,500
  + Since the company “usually” has NI of $100,000, remainder $350,000 ABIL will all be used to save taxes in the next 4 years, generating additional $350,000x11%=$38,500 in tax savings
  + Since 3A will now be a corporation without assets or ABIL, cash can be extracted to 2A or Mavis via inter-co dividend and 3A closed to save on overheads
* Amalgamate 2A and 3A (ITA 87):
  + Same tax consequence as above option
* Wind up 2A into Mavis (ITA 88)
  + New amalgamated income of $700,000-$50,000=$650,000
  + Annual tax reduction of $50,000x11%=$5,500
  + On the first year, entire $400,000 ABIL can be used to offset the remaining NI, bringing it to $650,000-$400,000=$250,000
  + For the first year only, this will generate tax savings of $400,000x11%=$44,000

All options address the first issue of tax reduction by merging incomes into a single Income Statement, but regarding ABIL:

* Section 85 2A->3A: Not preferred since ABIL is used to offset unnecessary capital gains
* Section 85 3A->2A: Good, but ABIL will only be usable over multiple years
* Section 87 2A+3A: same tax consequences therefore same rational as section 85, but potentially costly (cost of dissolving 2 companies)
* Windup: Preferred since full ABIL is used to generate additional cash in year 1

Issue 3: Unprofitable Beans

This can be resolved by 2 options:

* Cease operations and dissolve company:
  + No significant capital gains expected since the corporation has minimal assets
  + The $150,000 ABIL will go to waste unused
  + After ceasing operations, amalgamate with Mavis such that the $250,000 of losses incurred in 2007 can be used to offset some of the $700,000 Mavis revenue, generating $250,000x11%=$27,500 in savings
* Sell as a going concern:
  + The company has no assets, only ABIL of $150,000 + new operating losses of $250,000 = $400,000
  + These ABIL can have value for a business operating at profit, especially for acquiring business that:
    - Operates in a similar industry therefore can transfer the losses post-acquisition
    - Can’t benefit from SBD of 17% if NI > $500k or not a CCPC
    - Is not eligible for general rate reduction of 13% for CCPC > 500k or manufacturing
  + Tax savings for the acquiring company will range between 38%-10% (provincial amendment)=28% and 11% for CCPC <500k$ of NI of $400,000, giving a value range of $112,000 and $44,000

Obviously, the second option is preferred since it is extremely likely that Beans could be sold for more than the $27,500 in savings generated from option 1.