

The J Thomas McCallum Letter

Advancing the understanding of income tax and valuation matters

Special Issue — October 2003

As noted in the last issue of this letter, we've been waiting for Finance to change the *Income Tax Act* to bring non-competition payments within its confines. Well, we need wait no more!

On October 7th Minister Manley announced that he'd be amending the Act to make amounts received or receivable for restrictive covenants taxable as **ordinary income**. Presumably this means income from property.

An exception is proposed for restrictive covenants granted in arm's length dispositions of partnership interests and shares in a corporation.

No draft legislation was released, but the "backgrounder" issued with the news release indicated that **capital treatment** will be allowed to the extent the value of the underlying interest/share exceeds what it would be without the restrictive covenant.

Finance gave the example of Terence and Isabelle. They are considering selling their small business corporation shares for \$2 million if Terence provides a non-competition covenant and \$1.8 million if he does not.

If they sell the shares for \$2 million (ignoring any ACB) Isabelle has a capital gain of \$900,000; and Terence has a capital gain of \$1 million and ordinary income of \$100,000.

Amounts paid for restrictive covenants will, as applicable, be added to the purchaser's cumulative eligible capital account or the ACB of the interest/shares.

These proposals apply to amounts received or receivable after October 7th, other than to amounts received *before* 2005 under arm's length written agreements made on or before October 7th.



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