



Sale of a business: Could alternative minimum tax apply?

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Changes to the alternative minimum tax (AMT), set to take effect on January 1, 2024, could impact some business owners who sell their business in 2024, or beyond. Our companion report, [Alternative minimum tax: What's changing for 2024](#), goes through the details of what's changing for 2024, but, briefly, AMT is calculated under a tax system parallel to the regular tax system. AMT can apply to levy tax in some situations where tax calculated under the regular tax system is lower than that calculated under the AMT system. If you pay AMT, it can be used to offset tax arising under the regular tax system for the following seven years.

Let's take a look at the possible impact of AMT where a large capital gain is realized on the sale of a business under both the current and proposed rules, including where a large charitable donation is made in the year of sale. Where a large amount of AMT arises, high amounts of income would be needed in the subsequent seven years to offset that AMT.

Sale of a business

Amir is the sole shareholder of a private corporation carrying on a manufacturing business. Amir started this business 30 years ago by investing a nominal amount of his own capital. The business has grown substantially in value and Amir expects to sell the shares of his private corporation, which have a nominal adjusted cost basis, for a capital gain of \$50,000,000 at some point in 2023 or 2024.

Under the regular tax system, only 50% of capital gains are included in income, and when calculating adjusted taxable income under the current AMT rules, 80% of a capital gain is included. Starting in 2024, 100% of capital gains will be included in adjusted taxable income.

When a capital gain is realized on the sale of qualified farming or fishing property, or shares of a qualified small business corporation (QSBC), all or part of the gain may be sheltered from tax using the lifetime capital gains exemption (LCGE¹.) Simply stated, QSBC shares are shares of a Canadian-controlled private corporation in which "all or substantially all" (interpreted to mean 90% or more) of the value of the corporation's assets is used in an active business in Canada at the date of sale or transfer. In addition, either you or someone related to you must have owned the shares for at least two years prior to their disposition. Also, during that entire two-year period, more than 50% of the corporation's assets must have been used in an active business in Canada. If the shares of the corporation satisfy the definition of QSBC shares, and the LCGE is available, the amount of AMT may differ.

¹ For 2023, the LCGE limit is \$971,190 for QSBC shares, and is \$1 million for qualified farm and fishing property. Under current rules, 30 per cent of capital gains eligible for the lifetime capital gains exemption are included in the AMT base. The government proposes to maintain this treatment.

Example 1: Capital gain on sale of private corporation shares

The following table shows the expected tax calculations if Amir sells his private corporation shares in 2023 or 2024. For simplicity, we'll assume the shares do not qualify for the lifetime capital gains exemption, and assume 2023 tax rates and brackets apply in 2024, and the only non-refundable credit claimed is the donation credit, where applicable.

Item	Regular tax calculation	2023 AMT calculation ²	2024 AMT calculation ³
Taxable capital gain (50%)	\$25,000,000	\$25,000,000	\$25,000,000
Additional taxable capital gain (n/a for regular tax / 30% or 50% for AMT)	n/a	\$15,000,000	\$25,000,000
AMT exemption	n/a	(40,000)	(165,430) ⁴
Taxable income / Adjusted taxable income	\$25,000,000	\$39,960,000	\$49,834,570
Tax at graduated rates / Minimum tax at 15% for 2023 / 20.5% in 2024	\$8,226,806	\$5,994,000	\$10,216,087
AMT	n/a	\$0	\$1,989,281

Source: CIBC and Tax Templates Inc.

2023 AMT calculation: For the shares sold, 50% of the capital gain (\$25,000,000), plus an additional 30% of the capital gain (\$15,000,000) is included in Amir's income under the AMT system. Minimum tax of \$5,994,000 (at the current 15% AMT tax rate) is lower than regular tax of \$8,226,806, so there is no AMT.

2024 AMT calculation: For Amir's AMT calculation, 100% of the capital gain (\$50,000,000), is included in income. The AMT exemption of \$165,430 is deducted, leaving adjusted taxable income of \$49,834,570. Using the proposed 2024 AMT rate of 20.5%, the minimum tax would be \$10,216,087. Since the minimum tax under the AMT calculation (\$10,216,087) is \$1,989,281 more than tax under the regular calculation (\$8,226,806), Amir's AMT is \$1,989,281.

Example 2: Capital gains on sale of private corporation shares, with a cash donation

Assume that Amir realizes the same \$50,000,000 capital gain on the sale of his private corporation shares, but plans to donate 10% of the sale proceeds, or \$5,000,000, to charity as a donation.

Under current AMT rules, the donation is eligible for the full non-refundable donation tax credit when calculating minimum tax. Starting in 2024, only 50% of the donation tax credit will be permitted in the AMT calculation.

² Under current rules, the AMT exemption of \$40,000 is deducted, and the rate for calculating minimum tax is 15%.

³ Under the 2024 rules, the AMT exemption will be set at the beginning of the fourth tax bracket (\$165,430), indexed to inflation. As this amount isn't known for 2024, we have used the 2023 amount. The rate for calculating minimum tax in 2024 will be 20.5%.

⁴ See footnote 3.

The following table shows the expected tax calculations if the transactions occur in 2023 or 2024.

Item	Regular tax calculation	2023 AMT calculation	2024 AMT calculation
Taxable capital gain (50%)	\$25,000,000	\$25,000,000	\$25,000,000
Additional taxable capital gain (n/a for regular tax / 30% or 50% for AMT)	n/a	\$15,000,000	\$25,000,000
AMT exemption	n/a	(40,000)	(165,430)
Taxable income / Adjusted taxable income	\$25,000,000	\$39,960,000	\$49,834,570
Tax at graduated rates / 15% / 20.5%	\$8,226,806	\$5,994,000	\$10,216,087
Donation tax credit	(1,649,964)	(1,649,964)	(824,982)
Tax / minimum tax	\$6,576,842	\$4,344,036	\$9,391,105
AMT	n/a	\$0	\$2,814,263

Source: CIBC and Tax Templates Inc.

2023 AMT calculation: As was the case above, 50% of the capital gain (\$25,000,000), plus an additional 30% of the capital gain (\$15,000,000) is included in Amir's income. Claiming the current AMT exemption of \$40,000 leaves adjusted taxable income of \$39,960,000. Tax at 15% is again \$5,994,000. Amir now claims a donation tax credit in recognition of his \$5,000,000 charitable donation. After deducting the tax credit of \$1,649,964, the minimum tax is \$4,344,036. Since the minimum tax is lower than regular tax of \$6,576,842, there is no AMT.

2024 AMT calculation: Once again, 100% of the capital gain (\$50,000,000), is included in Amir's income. Claiming the AMT exemption of \$165,430 leaves Amir with adjusted taxable income of \$49,834,570. Tax at the proposed 20.5% rate is \$10,216,087, as it was under Example 1. Under the proposed rule change, Amir is only able to claim a donation tax credit of \$824,982 (which is 50% of the regular donation tax credit of \$1,649,964). Since the minimum tax of \$9,391,105 under the AMT calculation is \$2,814,263 more than tax under the regular calculation (\$6,576,842), Amir's AMT is \$2,814,263.

The amount of AMT expected in 2024 is \$824,982 higher when the sale is coupled with the large cash donation because \$824,982 of the donation tax credit cannot be claimed. Whether or not this increased amount of AMT can be viewed as merely a pre-payment of tax, that is, it can be used to offset regular tax in the following seven years, will depend on whether income is sufficiently high in those years.

Example 3: Capital gains on sale of private corporation shares, with an in-kind donation of publicly listed shares

Now, let's assume Amir sells the private corporation shares, as above, and makes the same donation of \$5,000,000, but chooses to make that donation via a gift of publicly listed securities with a FMV of \$5,000,000 and an ACB of \$1,000,000, so there is a \$4,000,000 capital gain realized on the donation.

Under the regular tax system, donors who make in-kind donations to a registered charity of publicly listed shares or mutual funds not only get a tax receipt equal to the FMV of the securities being donated (and can claim the non-refundable donation tax credit), but they also do not pay tax on capital gains on the donated shares.

Currently, this zero inclusion rate for capital gains on in-kind donations of publicly traded securities also applies for AMT purposes. Starting in 2024, 30% of capital gains on publicly listed securities that are donated in-kind will be included in adjusted taxable income under the proposed AMT rules.

The following table shows the expected tax calculations if the transactions occur in 2023 or 2024.

Item	Regular tax calculation	2023 AMT calculation	2024 AMT calculation
Taxable capital gains on donated publicly listed securities (0% / 0% / 30%)	\$0	\$0	\$1,200,000
Taxable capital gain on private corporation shares (50%)	\$25,000,000	\$25,000,000	\$25,000,000
Additional taxable capital gain on private corporation shares (n/a for regular tax / 30% or 50% for AMT)	n/a	\$15,000,000	\$25,000,000
AMT exemption	n/a	(40,000)	(165,430)
Taxable income / Adjusted taxable income	\$25,000,000	\$39,960,000	\$51,034,570
Tax at graduated rates / 15% / 20.5%	\$8,226,806	\$5,994,000	\$10,462,087
Donation tax credit	(1,649,964)	(1,649,964)	(824,982)
Tax / minimum tax	\$6,576,842	\$4,344,036	\$9,637,105
AMT	n/a	\$0	\$3,060,263

Source: CIBC and Tax Templates Inc.

2023 AMT calculation: Just as with Example 2, for the private corporation shares, 50% of capital gains (\$25,000,000), plus an additional 30% of capital gains (\$15,000,000) is included in Amir's income. Claiming the AMT exemption of \$40,000 leaves adjusted taxable income of \$39,960,000. Tax at 15% is \$5,994,000 and, after deducting the tax credit of \$1,649,964 (for the \$5 million donation), the minimum tax is \$4,342,008. Since the minimum tax is lower than regular tax of \$6,574,814, there is no AMT.

2024 AMT calculation: For donated securities with a \$4,000,000 capital gain, no capital gains are included for regular tax calculations but 30% of the capital gain (\$1,200,000) is included in the 2024 AMT calculation. For the private corporation shares sold, 100% of the \$50,000,000 capital gain is included in Amir's income. Claiming the AMT exemption of \$165,430 leaves him with adjusted taxable income of \$51,034,570, and tax at 20.5% is \$9,636,091. A donation tax credit of \$824,982 (which is 50% of the regular donation tax credit of \$1,649,964) can be claimed. Since the minimum tax of \$9,636,091 under the AMT calculation is \$3,061,277 more than tax under the regular calculation (\$6,574,814), Amir's AMT is \$3,061,277.

This amount of AMT in 2024 is the highest of the three examples because there is an extra capital gain of \$4 million on publicly traded shares, even though only 30% of this capital gain is included in the 2024 AMT calculation. Compared to Example 2, there is extra AMT of \$246,000 (\$4,000,000 capital gain on donated shares, times the 30% inclusion, times the 20.5% minimum tax rate.) Again, whether this difference can merely be viewed as a pre-payment of regular tax will depend on Amir's amount of income, and thus regular tax, in the following seven years.

Conclusion

If you are planning to sell your business in the near future, and are expecting to realize a large capital gain, if possible, you might consider having the sale occur in 2023 rather than 2024 to reduce your AMT exposure. It also may be wise to make large donations, whether in cash or in-kind by the end of 2023. This decision should be made in consultation with your tax advisor, who can help you estimate whether any AMT arising on a sale or donation after 2023 is recoverable as an offset against future regular tax, based on your expected income for the following seven years.

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