

Planning for the BCE conversion: Tax Minimization Strategies

On September 30, 2007, BCE Inc. Canada's largest telecommunications group announced that it had reached an agreement to be bought by a group led by the Ontario Teachers' Pension Plan for \$51.7 billion, making it the largest takeover in Canadian history.

The good news for current shareholders is that they will receive a reported \$42.75 cash per-share as part of the deal. The downside is that many Canadians who have owned and held onto BCE shares (in some cases) for decades, will now trigger large capital gains taxes for holdings in non-registered accounts. Since capital gains are 50 per cent taxable, a sizeable tax liability is looming on the horizon for some BCE investors.

Considering this is a cash transaction, tax minimization strategies are somewhat limited. However, we have highlighted a few common alternatives available to shareholders for information purposes only. Please contact your tax advisor for advice before the implementation of any of the strategies listed below.

Utilizing previous Realized Capital Losses:

The simplest remedy to offset these gains is with realized Capital Losses within your portfolio. Capital Losses are generated by selling securities and/or mutual fund units for less than the cost at which they were acquired. If these losses are currently available, then they can be used to directly offset the capital gains generated from the BCE shares. As a rule, Capital Losses do not expire and thus can be carried forward indefinitely and applied to offset capital gains generated in the future, or back to prior years.

Tax loss selling to crystallize Unrealized Capital Losses:

As we approach the end of the 2007 personal taxation year, it is just about that time to review your portfolio in an effort to identify positions currently trading at a loss that may be sold in order to take advantage of the associated tax benefit. This is the time for you to sell positions that may be used to offset taxable gains on the BCE shares. Canada's tax rules require sellers to wait at least 30 days before repurchasing the same security in order to be able to claim the full amount of the capital loss.

Transferring Unrealized Capital Losses from spouse or common-law partner:

A more complex version of tax loss selling is using the Unrealized Capital Losses of a spouse or common law partner. This might be an attractive option if a BCE shareholder does not have Capital Losses themselves. In short, to be able to access Capital Losses of a spouse (or a common law partner) the capital loss can be transferred by selling the security on the open market at fair market value, and then having your spouse reacquire the same security. Although a superficial loss will be triggered, your spouse will be able to use this loss on his/her own tax return. Given that this transaction has a higher degree of complexity and requires that certain conditions be met and adhered to, we strongly advise that you contact your own tax accountant/advisor for more details of this strategy in order to find out if this alternative is a suitable option for you.



Utilizing Future Capital Losses:

In the event that investors have no Capital Losses to utilize, you should keep in mind that Capital Losses can be carried back three years to offset any capital gains in those years and recover some of the taxes already paid. Thus, if in the coming years you have Capital Losses, they can be carried back and used against the BCE capital gain realized in the 2008 taxation year.

Charitable Donation Strategies:

Another simple and worthwhile alternative to plan against any BCE gain is to donate some or all BCE stock to charity before the conversion is completed. The reason for this is because of the 2006 federal budget which announced that donations of publicly traded securities to registered charities are 100% free of the capital gains tax. This has been a welcome change to the charitable giving regime in that prior to the May 2nd 2006 federal budget, the tax rate on donated securities was half the normal capital gains rate. Today it is zero. As a result, BCE investors will avoid the tax on the unrealized capital gains and will benefit from the fair market value donation receipt received in the year of donation.

Shareholders will be able to eliminate some or all of the capital gain taxes by donating some of their BCE shares “in-kind” prior to the closing of the transaction with the Ontario Teachers’ Pension Plan. The donation tax credit can be used to minimize or eliminate the capital gains taxes on the portion of the BCE shares tendered to the offer.

A second option (though not as tax efficient) as donating the BCE stock “in-kind” is where BCE investors who wish to hold their shares until after the sale and then donate the cash received to a registered charity. The difference between the two options is that when donating shares directly, the BCE investor will get a 0% capital gains inclusion rate, whereas in the case of donating cash to a registered charity, they do not.

Illustrating the difference in tax treatment:

Donating BCE Shares Prior to Sale:

Jim has 1000 shares of BCE valued at \$40.00 per-share; His original cost for the shares is \$20.00 per-share. Jim’s marginal tax rate is 45%, and he has decided to donate all of his shares to a registered charity.

Tax on Unrealized Capital Gain = $(\$40,000 - \$20,000 \times 50\%) \times 45\% = 0$ (due to exemption on donated shares)

Tax Benefit from Charitable Donation Receipt = $\$40,000 \times 45\% = \$18,000$

Net Tax Savings = \$18,000



Donating the Cash Received After Sale:

The BCE sale results in an immediate disposition and Jim receives cash for his shares, upon which he donates the cash to a registered charity.

Capital Gains Tax resulting from Sale = $(\$40,000 - \$20,000) \times 50\% \times 45\% = (\$20,000 \times 50\%) \times 45\% = \$4,500$

Tax Benefit from Charitable Donation Receipt = $\$40,000 \times 45\% = \$18,000$

Net Tax Savings = $\$18,000 - \$4,500 = \$13,500$

Thus the benefit of donating shares In Kind vs. Cash = $\$4,500$

Note: This example assumes that donor can claim full charitable tax credit in the year of donation (i.e. Donation is less than 75% of net income for the year).

As an aside, one does not have to donate all the BCE stock to charity in order to receive the benefit of minimizing their capital gains exposure. Some BCE shareholders may find that a partial donation of their BCE holdings will be the right approach for them. It may be possible for a situation to occur where the charitable tax credit nullifies the capital gains taxes on the shares that are held back and sold for a profit. Please consult with your own accountant or tax advisor for the required analysis pertaining to the number of BCE shares that you will need to donate to shield your capital gain taxes with the donation tax credit.

Furthermore, donating other securities other than the BCE stock may be a better idea to offsetting the tax liability, including donating mutual fund units to a registered charity.

The commentary and/or information provided herein should not be construed as legal or tax advice. Clients are strongly encouraged to seek the expertise of independent professionals, such as tax, legal and accounting experts prior to the final implementation of any strategy. Only after a diligent analysis of the client's needs, objectives and financial circumstances, including the client's financial position and tolerance for risk can an appropriate recommendation be made.

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