

Tax on Book Sale

TAX COURT

BY JAMIE GOLOMBEK



Probably the most talked about tax topic among advisors is the tax treatment associated with the buying and selling of the advisor's own practice.

The tax treatment came to widespread attention in the now infamous 2004 decision of the *Supreme Court of Canada* in *Gifford* (2004 SCC 15).

Gifford, an employee and advisor at Midland Walwyn, paid \$100,000 to buy a client list. The other advisor agreed not to provide any further investment advice to his clients or to provide the client list to anyone else and agreed to promote Gifford as the new advisor of choice to his clients.

The Supreme Court concluded that the \$100,000 payment was not deductible since it was on account of capital. Since Gifford was an employee, he was limited in his ability to capitalize and depreciate

business assets – under the tax law, employees are only allowed to depreciate automobiles or airplanes. This differs from self-employed advisors who are free to capitalize and depreciate any business asset purchased to earn income, including a client list.

A 2006 tax case out of Quebec, which was just released in its official English translation last month, *Desmarais v. the Queen* (2006 TCC 417), deals with the tax treatment of the proceeds received by an advisor when he switched firms.

Jean Desmarais left BMO Nesbitt Burns in 2001 to join Valeurs mobilières Desjardins (VMD) as a branch manager. As part of his

transition, he received a \$350,000 lump-sum payment from VMD.

The issue before the court was whether the \$350,000 payment represented employment income to Desmarais and thus should be fully included in his income or rather represented proceeds in respect of the sale of goodwill, namely his client list, and thus subject to favourable capital-gains-like treatment.

The Canada Revenue Agency felt that the \$350,000, which was indeed reported by VMD on Desmarais' T4 slip as employment income, was essentially an incentive payment paid to him to join VMD – something akin to a sign-

ing bonus.

Desmarais argued that the \$350,000 he received was consideration for the transfer of his clients to VMD, as evidenced by clause 4.6 of the contract: "...the employer shall pay the employee having regard to clients already represented by the employee." This clause was under the heading "Remuneration."

Yet, despite having signed this contract, Desmarais later tried, unsuccessfully, to change the contract to have it explicitly state that "the payment of the lump sum amount represents payment for the part of my clientele that it is possible for me to transfer on the date hereof." VMD refused to amend the wording, which, at least in the judge's opinion, demonstrated the "absence of any intention on its part to acquire Desmarais' client list."

Desmarais' employment contract also provided that he would have to reimburse VMD the full \$350,000 if he were to leave during his first year.

If it was truly VMD's goal to purchase the goodwill associated with Desmarais' client list, surely the contract would have provided that such a reimbursement would be based on whether or not the clients of Desmarais stuck around.

In fact, Desmarais did receive other compensation in respect of his clients being transferred over.

Desmarais joined VMD as a branch manager. Consequently, he brought over another Nesbitt advisor, Martin Bernier, to whom he sold his client list. According to his testimony, "(Mr.) Bernier... gives me a share of his commissions to purchase my clientele."

Thus, it's hard to see how the \$350,000 payment from VMD represented payment for Desmarais' clients since he was already being compensated by Bernier.

The judge concluded that the \$350,000 was simply paid as an incentive for Desmarais to leave Nesbitt Burns to join VMD and not to acquire Desmarais' clientele and thus was properly fully taxable as employment income.

As the judge wrote, it was unrealistic to expect VMD to acquire Desmarais' goodwill "because it is recognized in the field that there is a close relationship of trust between an investment advisor and his or her clients, especially if he or she has given them advice over several years." **AER**

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