TAXTALK

Bill C-208 – Tax Relief for Intergenerational Transfers of Small Businesses

Bill C-208, which received Royal Assent recently and is now law, has been looked at as a win for owners of small businesses across Canada. It was introduced as a private member's bill and it attempts to address a gap in the Income Tax Act (ITA) that for many years had made it more expensive for small business owners to transfer shares of their business to their children or grandchildren than to sell those same shares to an outside party.

Section 84.1 before rule changes

This previous disadvantage was caused by an anti-avoidance rule in section 84.1 of the ITA, which limits an owner from extracting surplus cash from a corporation (i.e. surplus stripping) in a manner that produces a capital gain rather than a dividend.

The rules contained in section 84.1 can prevent an individual from claiming their Lifetime Capital Gains Exemption (LCGE) when they sell to a corporation controlled by family members, or increase the after-tax cost to family members of funding the acquisition of the shares when the individual does claim the LCGE.

Section 84.1 attempts to limit surplus stripping the value of property from a corporation on a tax-free basis through non-arm's length sales or transfers, by treating what would otherwise be a capital gain on a sale of shares to a purchaser corporation as a dividend.

As a result, a sale of Qualified Small Business Corporation (QSBC) shares to a related party where the LCGE is otherwise available can result in less favourable tax treatment than a sale to an arm's length party.

Section 84.1 amendments

Under the new rules, an individual who sells shares and a controlling interest to a corporation controlled by their children or grandchildren who are at least 18 years of age may be able to benefit from capital gains treatment, including the LCGE provided the purchaser corporation keeps the transferred shares for at least 60 months.

This new legislation will make the sale of a business to a child or grandchild the exact same as if the parent were selling to an arm's length party.

The department of finance has already commented that it will amend the bill's language to limit what may not be proper intergenerational transfers. More specifically, the issues that amendments to Bill C-208 would address are:

- The requirement to transfer legal and factual control of the corporation carrying on the business form the parent to their child or grandchild;
- The level of ownership in the corporation carrying on the business that the parent can maintain for a reasonable time after the transfer;
- The requirements and timeline for the parent to transition their involvement in the business to the next generation; and
- The level of involvement of the child or grandchild in the business after the transfer.

Forthcoming amendments are intended to make sure that this law facilitates genuine intergenerational transfers and is not used for artificial tax planning purposes. The department of finance is expected to introduce further amendments to Bill C-208 by November 2021.

Taxpayers should be cautious in taking immediate action to these rules in Bill C-208 in situations where the related transactions might not be considered to represent a bona fide intergenerational transfer.

A memorandum of this nature cannot be all-encompassing and is not intended to replace professional advice. Its purpose is to highlight tax planning possibilities and identify areas of possible concern. Anyone wishing to discuss the contents or to make any comments or suggestions about this TaxTalk is invited to contact one of our offices.

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