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# Intergenerational transfers of family businesses

Private member's bill C-208 to provide some relief

**Bill C-208 was introduced by Mr. Maguire, MP, as a private member's bill which has made its way through Parliament and received royal assent on June 29, 2021. The rules outlined in the bill became effective immediately on this date. The legislation amends the Income Tax Act (ITA) to provide that, in the case of a reorganization of a business involving qualified small business corporation shares and shares of the capital stock of a family farm or fishing corporation, siblings are related, and that, under certain conditions, the transfer of those shares by a taxpayer to the taxpayer's child or grandchild who is 18 years of age or older is excluded from a long-standing anti-avoidance rule contained in the ITA.**

## Siblings involved in the reorganization of a family business

Existing rules in the ITA may convert an otherwise tax-free intercorporate dividend into a taxable capital gain in certain circumstances. However, there is an exception to these rules where related parties are involved. Although, siblings are generally considered related for most provisions of the ITA, they are considered unrelated under these particular rules. As a result, they cannot rely on this exception and reorganizations of a family business where siblings are involved can be extremely complex.

Bill C-208 provides a new exception so that siblings will be considered related in the case where the dividend was received or paid, as part of a transaction or event or a series of transactions or events, by a qualified small business corporation or family farm or fishing corporation.

As a result of these new rules, reorganizations involving siblings may be much less cumbersome.

## Sale of family business to your adult children or grandchildren

An existing anti-avoidance rule in the ITA provides that, where you transfer shares of a qualified small business corporation or shares of a family farm or fishing corporation to a corporation controlled by your adult (at least 18 years of age) children or grandchildren, the transfer may result in a deemed dividend instead of a capital gain. As a result, you may pay much more tax as the rate of tax on a dividend is generally much higher than a capital gain. In addition, you would not be able to claim the capital gains exemption on the sale of your shares. This conversion of a capital gain to a deemed dividend would not occur if you sold the shares of your corporation to an arm's length third party.

Bill C-208 attempts to fix this issue by providing exceptions to this anti-avoidance rule which may provide you with the same tax treatment that would apply if you sold the shares to an arm's-length party. The new rules would apply if the following conditions are met:

- The shares being sold are qualified small business corporation shares or shares of the capital stock of a family farm or fishing corporation;
- The purchaser corporation is controlled by one or more of your children or grandchildren who are 18 years of age or older; and
- The purchaser corporation does not dispose of the shares within 60 months of their purchase.

In addition, you must provide the Canada Revenue Agency (CRA) with an independent assessment of the fair market value of the shares and an affidavit signed by you and by a third party attesting to the disposal of the shares.

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In effect, these new rules may allow you to transfer your family business to a corporation controlled by your adult children or grandchildren and realize a capital gain instead of a deemed dividend, which likely results in much less tax payable by you. In addition, you may potentially utilize your lifetime capital gains exemption on the resulting capital gain, further reducing your taxes on the sale. However, the new rules do provide for a grind down of your capital gains exemption where the corporation (or, the associated group of corporations, if applicable) has taxable capital employed in Canada in excess of $10 million, and is eliminated where taxable capital is $15 million or more.

## Unfinished business – potential clarifications and changes to the rules

Although this is great news for family businesses, it may not be the end of this story. Some tax professionals have commented that there are certain aspects of the new legislation that need clarification. In addition, they have also pointed out that Finance may not be satisfied with these rules as drafted since they are too broad and may apply in situations where they are not intended to apply.

In addition, on June 30, 2021, the federal government announced their intention to introduce legislation to clarify that the rules in Bill C-208 would apply at the beginning of the next taxation year, starting on January 1, 2022, instead of June 29, 2021.

The federal government also confirmed that it is committed to facilitating genuine intergenerational share transfers, while preventing tax avoidance that undermines the equity of Canada's tax system. This may imply that they may also propose other amendments to the rules in Bill C-208 to narrow its scope. If you a have a qualified small business corporation or a family farm or fishing corporation that you intend to transfer to the next generation, or where you are contemplating a reorganization involving siblings, you should consult with your qualified tax advisor to see if you can benefit from these new rules. Based on the government's June 30, 2021 news release, you may want to proceed with extreme caution.

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