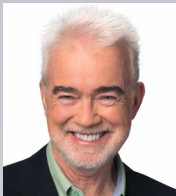


Can you transfer your business to your family tax free?



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The capital gains exemption is not dying completely, but there is a broader way to use it now than there has been before, or likely, ever will be again. Canadian-resident individuals have long faced an unfair scenario when trying to pass along their family business to the next generation. In some instances, it was more favourable to sell to a stranger than your own kin or alternatively, a difficult decision of who would be footing the tax bill had to be made. That said, the tax playing field seems to have been levelled... for the time being.

THE PROBLEM

Every Canadian-resident individual has a lifetime capital gains exemption, currently up to \$892,218. It is available on the sale of private corporate shares that meet certain requirements. This represents up to \$214,000 of tax savings on a share sale for each capital gains exemption that can be used. That's the good news.

The problem is it is not always available on the transfer of a business to another family member. The issue is exemplified by a client situation I had several years ago. Dad was close to retirement and wanted to sell his trucking business to Son. Son was involved in the business and had some cash in his own company (Holdco) to start paying Dad. Dad wanted to sell the business to Son for \$1,000,000, use his and Mom's capital gains exemption, and pay little or no tax.

Son did not mind paying as long as he was able to use money in his Holdco, and money from future tax-free dividends paid to his Holdco from the business. The problem was that for Mom and Dad to access their capital gains exemption, Son would need to buy the shares personally and not through his Holdco. If Son's Holdco bought the shares, Mom and Dad would be denied the use of the lifetime capital gains exemption and taxed as either a deemed dividend, a capital gain, or some combination of the two, because of an anti-avoidance rule (section 84.1 of the *Income Tax Act*). Mom and Dad could pay upwards of \$240,000 of tax (or higher if the transaction was not structured properly). On the other hand, if Son were to pay from his personal funds as his Dad wished, he would have to pay personal tax of about \$500,000 to pay himself the cash out of his Holdco, to in turn pay Mom and Dad. In effect, the cost to Son would be \$1.5 million instead of \$1 million. Although Son was happy to pay for the business, from his point of view, why should he pay a pile of tax so that Mom and Dad could save some? If allowed to use his Holdco to buy the shares, he would be using tax-paid corporate dollars, saving him \$500,000.

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THE SOLUTION

A private member's bill amends the *Income Tax Act* to allow for the use of a capital gains exemption on the sale to a corporation owned by an adult child or grandchild. The good news is that the bill has received Royal Assent in late June and is now law. The bad news is that the Department of Finance is concerned about abuses that may result from this relieving provision. While the Federal Government accepts that the amendment is currently law, and transactions may be completed on that basis for the time being, they have expressed their intention to change this. We do not yet know what changes the Department of Finance will propose, but it can be expected that they will limit the scope, or craft a complex set of rules that make it more difficult to access the tax benefit that the new legislation intends to create.

CURRENT IMPACT ON SUCCESSION OF THE FAMILY BUSINESS

There is a narrow window of opportunity to access the capital gains exemption on a family business succession plan between now and November 1. It can take anywhere from a month to a year or longer to plan and implement a tax-efficient strategy, depending on the complexity and family dynamics involved. At the very least, it is worthwhile to have a conversation in the next month or two to determine whether the new legislation has advantages for the succession of a particular family business.

If you have clients who are considering selling their business to a family member in the near future and would like to discuss the potential tax implications, please reach out!

Cheers,

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