



Succession Changes for Businesses – Bill C-208

A CHBA Presentation

September 23, 2021



Wherever business takes you

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Succession Options

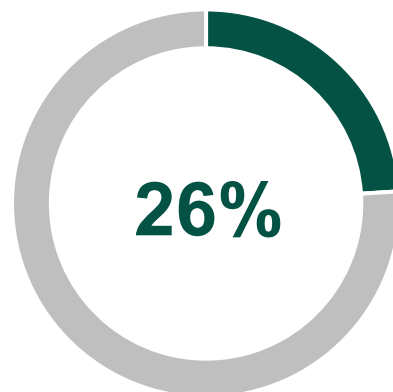
- Family succession (Bill C-208)
- Management Buyout
- Third Party Sale

Tax Rate Overview (Ontario)



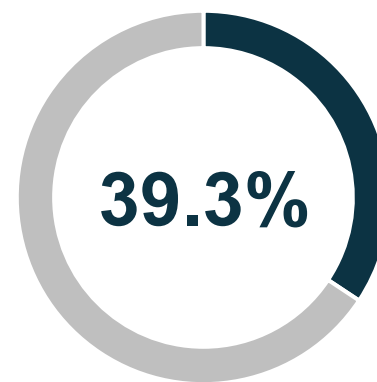
Lifetime Capital Gain Deduction

No tax on the first \$892,218 of capital gains on qualifying small business corporation (QSBC) shares or \$1,000,000 on qualifying farm or fishing property (QFFP)



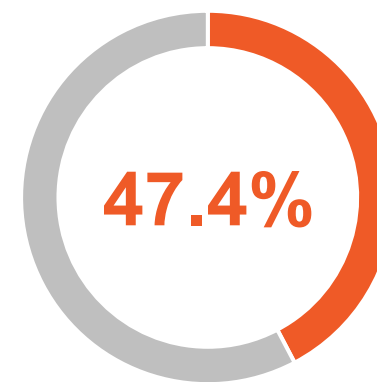
Capital Gain

Combined tax rate on disposition of capital property resulting in capital gain



Eligible Dividend

Combined tax rate on receipt of eligible dividend



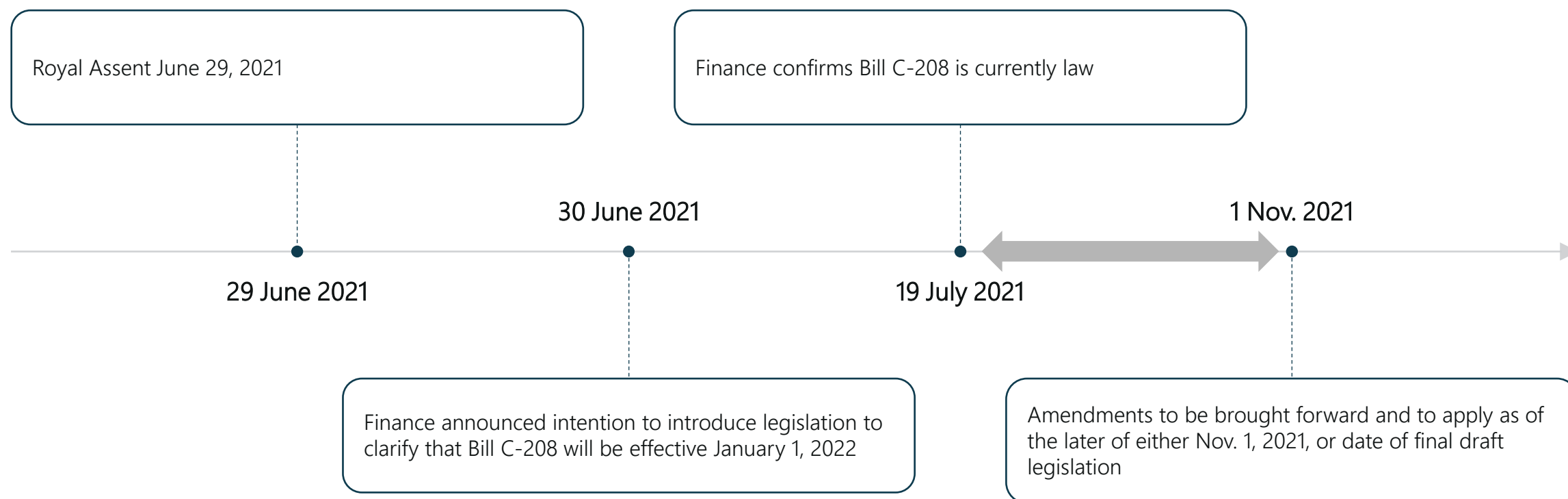
Other than Eligible Dividend

Combined tax rate on receipt of other than eligible dividend

Anti Avoidance

Bias to Reduce Tax Rate

Bill C-208 Timeline



Bill C-208 Timeline

Two main aspects:

- Intergenerational Transfers
 - Specifically deals with succession of business from parent to child/grandchild
- Division of a Family Business
 - Specifically deals with siblings dividing a family business

July 19, 2021 Department of Finance News Release

The Government of Canada is also committed to protecting the integrity of the tax system. As such, the government is clarifying that it does intend to bring forward amendments to the *Income Tax Act* that honour the spirit of Bill C-208 while safeguarding against any unintended tax avoidance loopholes that may have been created by Bill C-208. One loophole that Bill C-208 may inadvertently permit is the opportunity for “surplus stripping,” in which dividends are converted to capital gains to take advantage of the lower tax rate, without any genuine transfer of the business actually taking place, thereby compromising the integrity of the tax system. Below is an illustrative list of the issues the amendments to Bill C-208 would address.

- The requirement to transfer legal and factual control of the corporation carrying on the business from 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.

At a Glance – Division of a Family Business

Division of Family Business - Overview

- ✓ Expanded availability for siblings to implement reorganization transactions involving redemptions to fit within related party exemption
- ✓ The share being redeemed is a share of a QSBC or QFFP



Division of Family Business - Situations

- Opco held by siblings
- Siblings want to go their separate ways
- Siblings want to split up Opco



In Depth – Intergenerational Transfers

Intergenerational Transfers – Requirements

New Rules to Apply when the following are met:

- ✓ Subject shares must be QSBC or QFFP
- ✓ Taxable capital of associated group <\$15M
- ✓ Purchaser corporation must be controlled by one or more children / grandchildren of vendor
- ✓ Children / grandchildren must be 18 or older
- ✓ Purchaser corporation must retain shares of Subject corporation for 60 months after purchase

Intergenerational Transfers - Technical

Qualified Small Business Corporation (QSBC)

- Specific requirements to meet this test
 - A) shares held for at least 24 months prior to sale
 - B) in those 24 months 50% of the assets must be used in the active business
 - C) at the time of sale 90% of the assets must be used in the active business
- Likely we can meet the test at the time of sale with some planning but we cannot go back if the 24 months test has not been met

Intergenerational Transfers – Technical Cont'd

Taxable Capital <15M

- Generally total of Shareholders Equity and Loans to the Corp less investments and loans receivable
- Taxable Capital limitation based on associated groups
- Potential “grind” on use of capital gains exemption

Recommendation:

Based on the intent of Bill C-208 planning to be done only for situations where taxable capital of the group of associated corporations is <\$15M

Intergenerational Transfers – Technical Cont'd

Control

- “Control” in this context appears to be only standard de jure control, as “in any manner whatever” language is absent
- Subject corporation likely needs to be QSBC or QFFP at the precise time of the disposition of the shares, but this is not specified

Intergenerational Transfers – Technical Cont'd

Future Disposition

- Intent appears to allow purchaser corp to dispose of shares of subject corporation following the death of one of its shareholders
- No requirement that children / grandchildren are active or are successors
→ (Recommendation - only complete transactions where children are active)
- The 60-month “no disposition” requirement could be tainted if:
 - Share exchange;
 - Amalgamation or windup;
 - S.85 rollover;

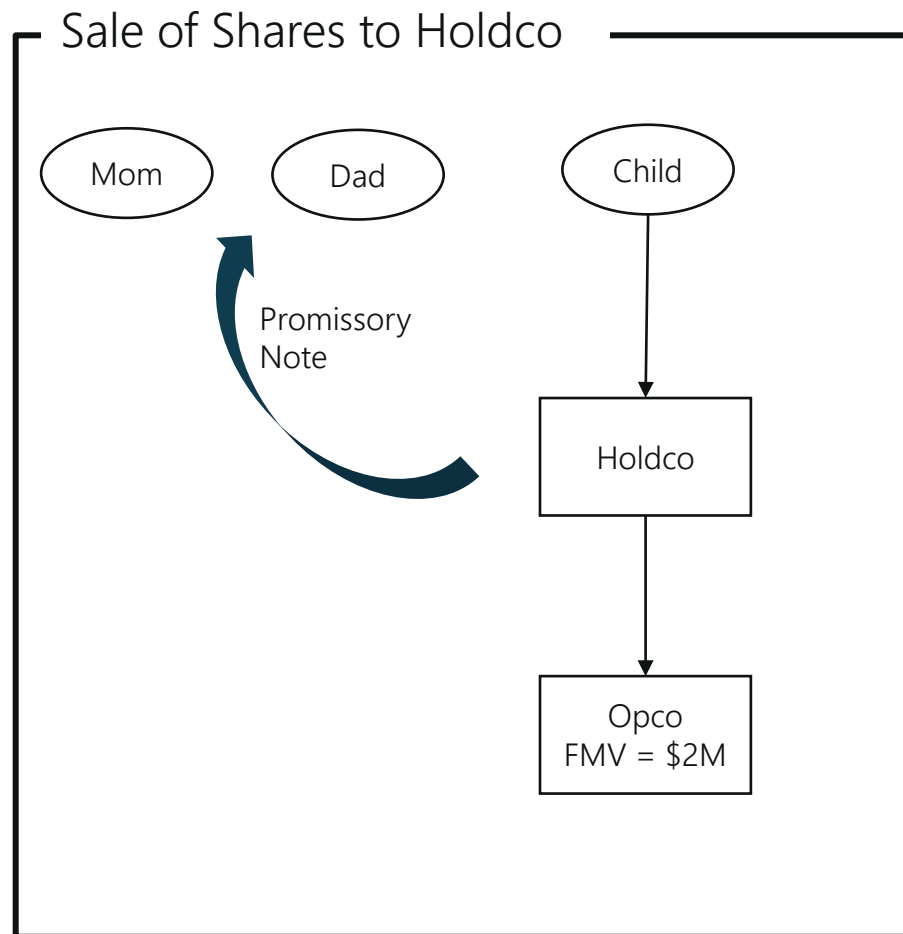
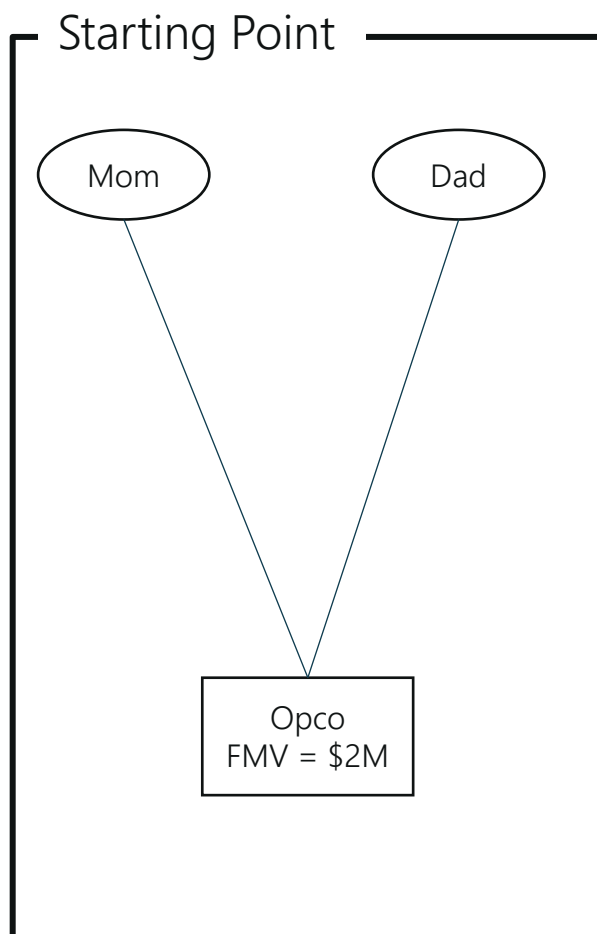
Intergenerational Transfers - Reporting

Reporting to CRA

- Independent assessment of the fair market value of the subject shares (Valuation)
- Affidavit signed by the taxpayer and by a third party attesting to the disposal of the shares.

Intergenerational Transfer Examples

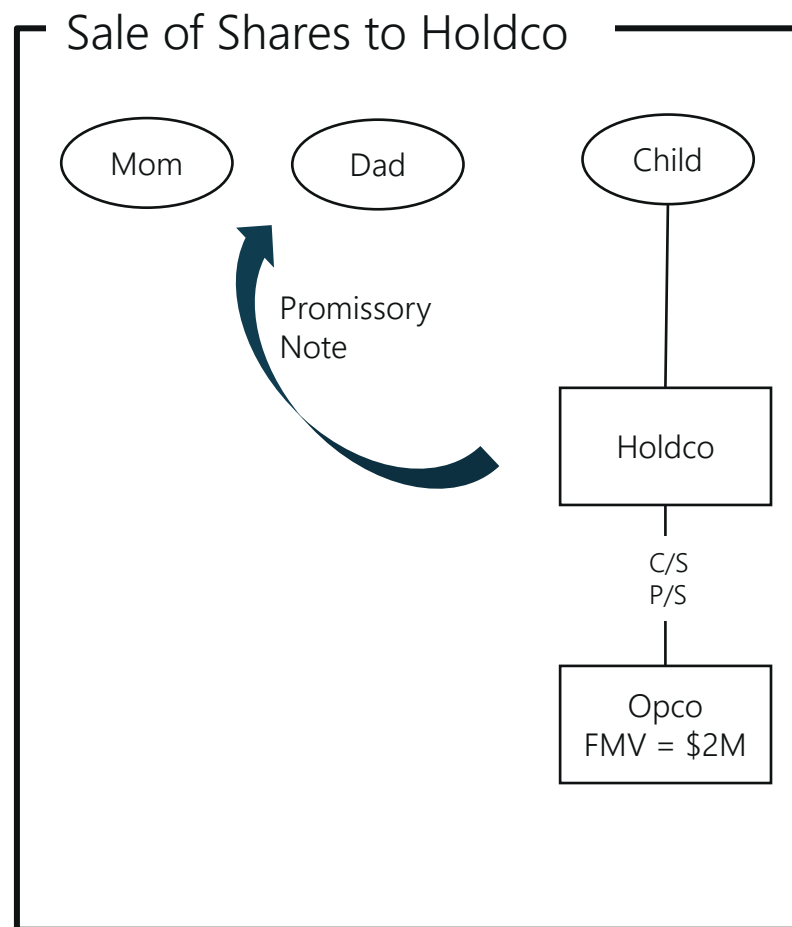
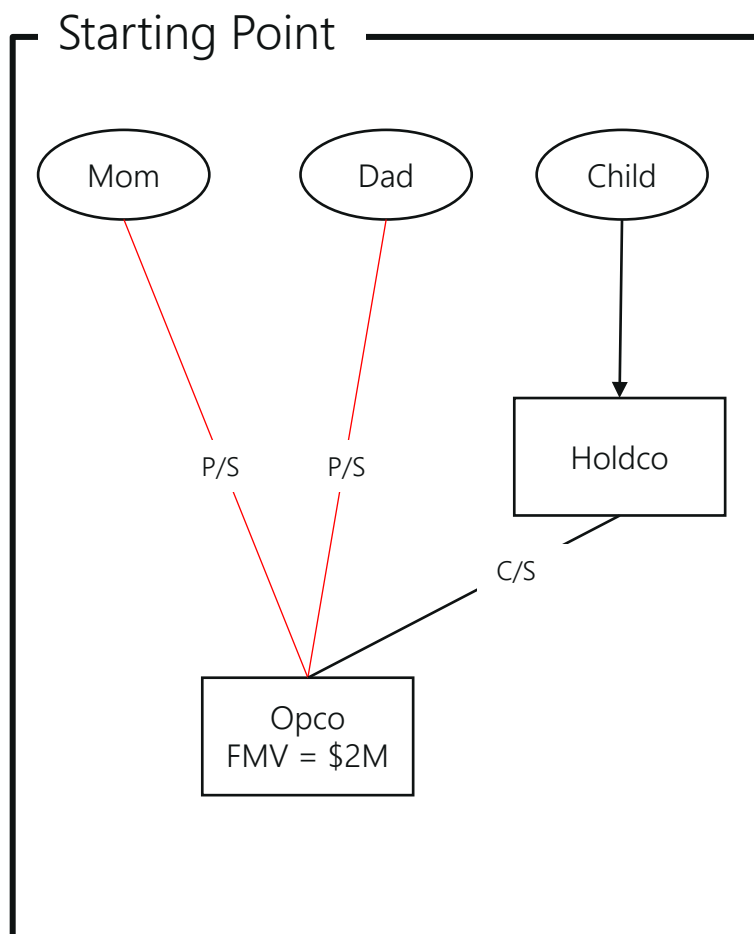
Transition Example - Simple



Assumptions

- Opco is a QSBC
- Taxable capital is <\$15M
- Parents sell common shares of Opco to Holdco
- Holdco issues a promissory note to parents
- Sale to be completed by November 1, 2021

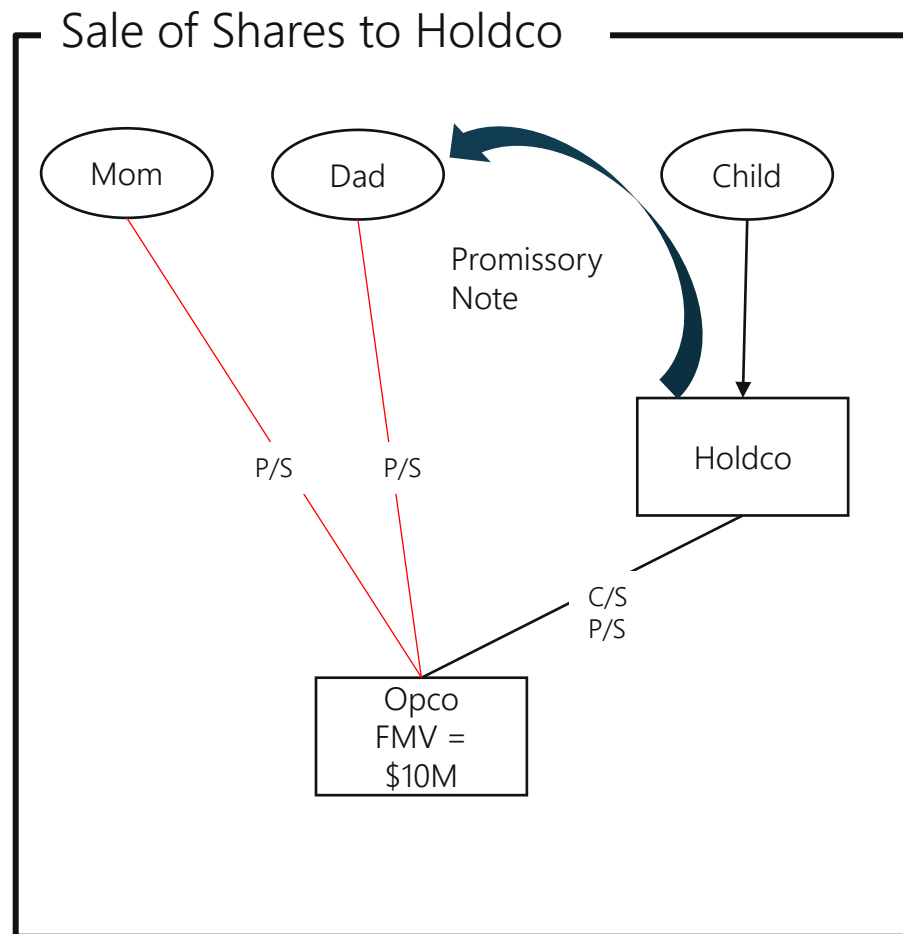
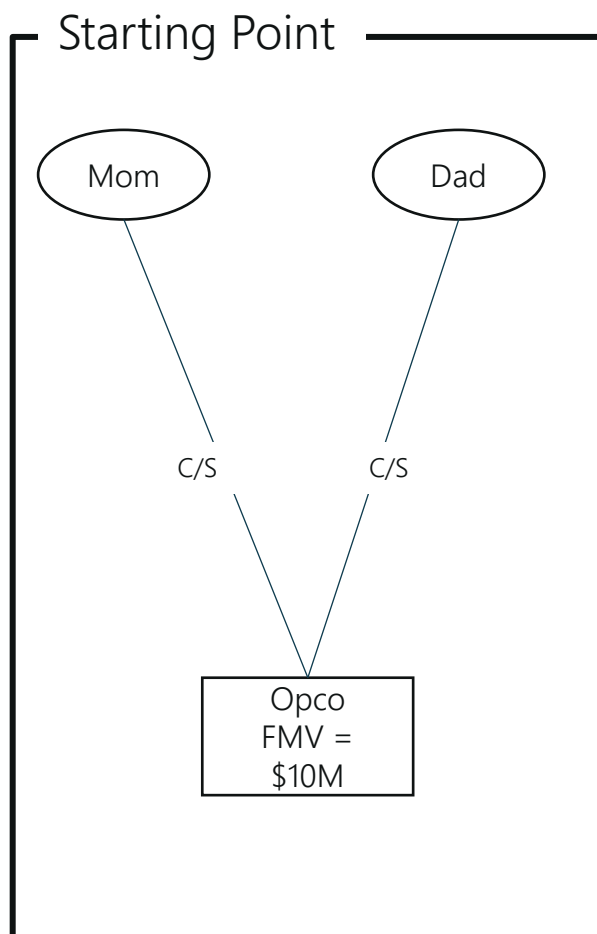
Transition Example – Historical Freeze



Assumptions

- Opco is a QSBC
- Taxable capital is <\$15M
- Parents previously froze Opco in favour of Child / Child's Holdco
- Sale of preferred shares to Holdco
- Holdco issues a promissory note to parents
- Sale to be completed by November 1, 2021

Transition Example – Mom/Dad Remain in Corp



Assumptions

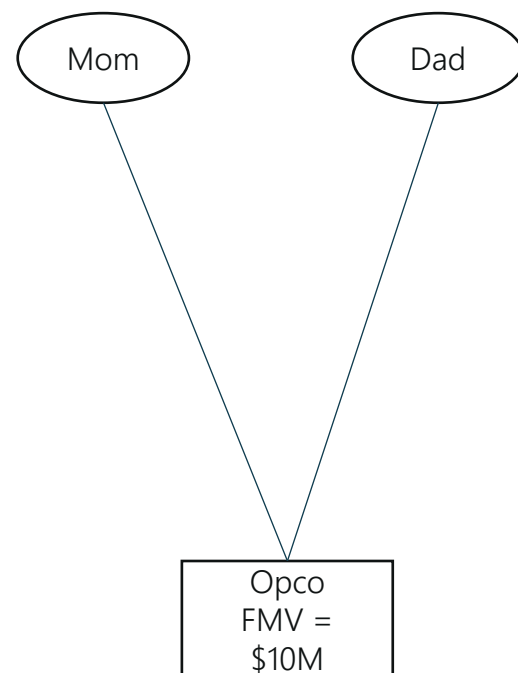
- Opco is a QSBC
- Taxable capital is <\$15M
- Freeze of Opco in Favour of Holdco
- Parents sell some preferred shares of Opco to Holdco for promissory note
- Remaining preferred shares redeemed or sold over time

Transition Example – Freeze and Trust

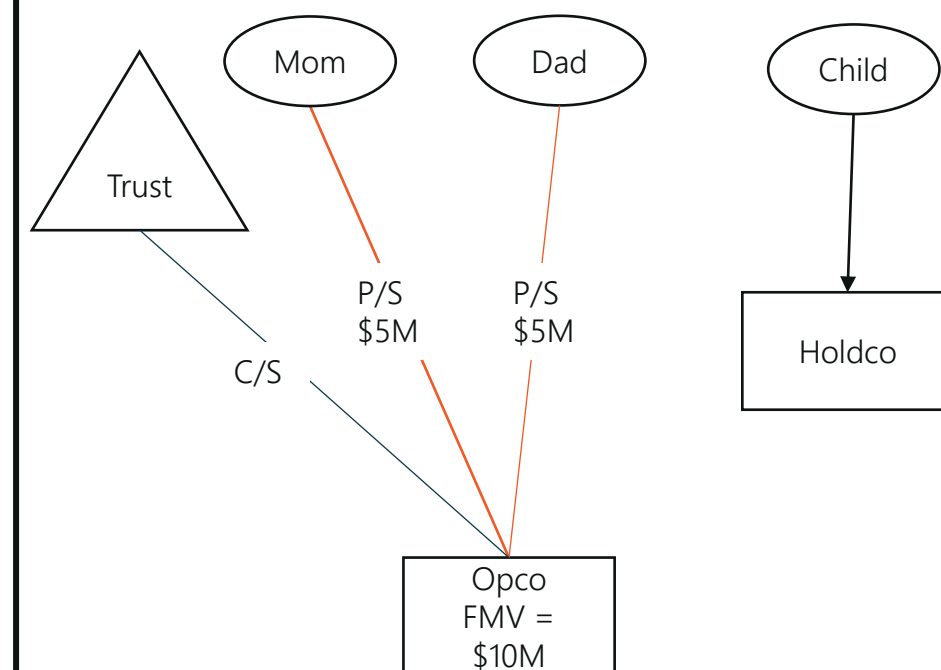
Assumptions

- Opco is a QSBC
- Taxable Capital <\$15M
- Parents will transition Opco to children
- Year 1: Parent freezes opco in favour a Trust (parents are also beneficiaries)
- Year 1: Parents sell shares of Opco to Holdco
- Year 2 – 5: Remaining preferred shares redeemed over time
- Opco advances funds to Holdco to fund payment of Preferred Shares
- After 60 months, companies amalgamate

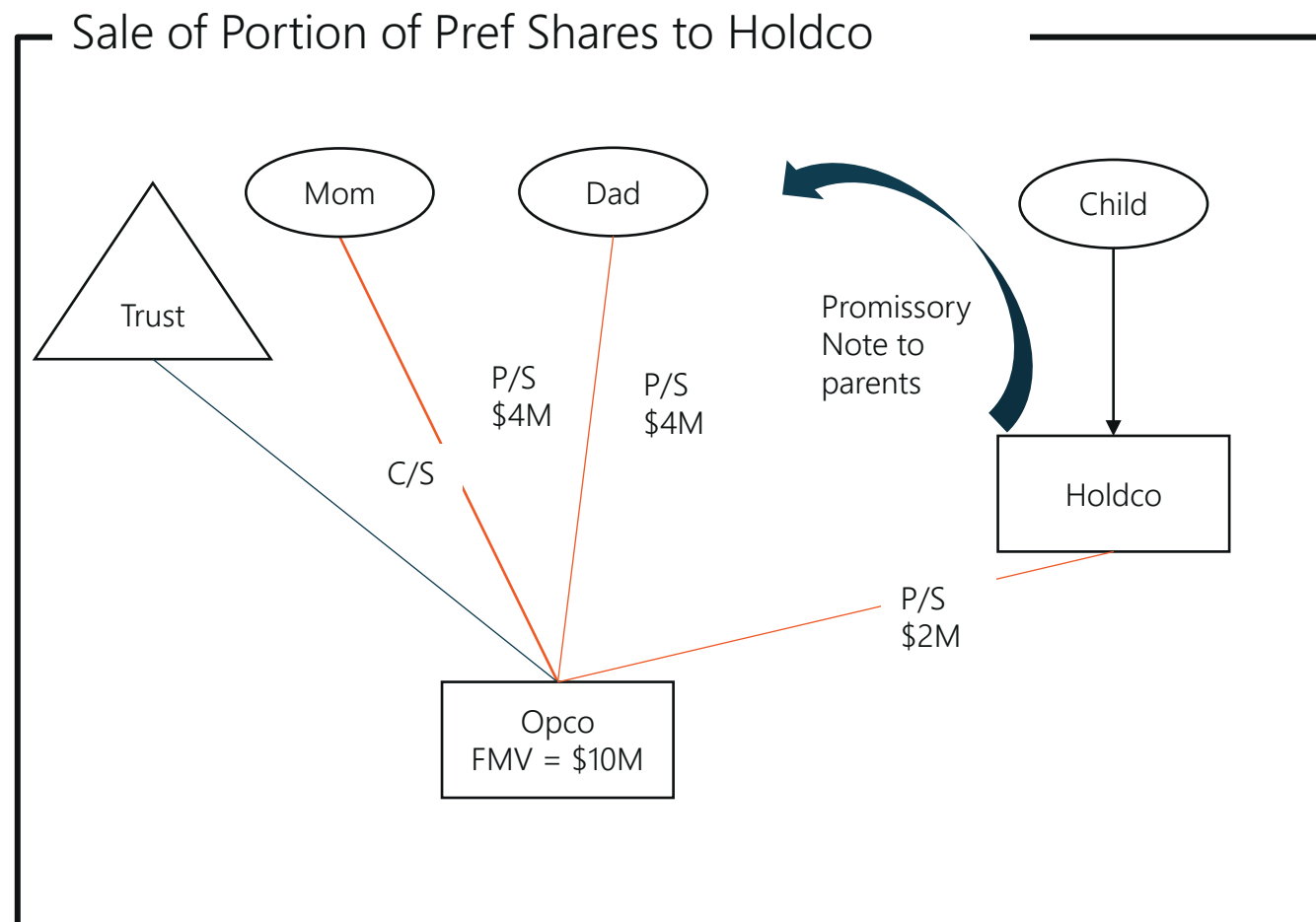
Starting Point



Freeze in Favour of Trust



Transition Example – Freeze and Trust Cont'd



Risk Factors

- Child not active in the business
- Sale of preferred shares to all children but only one active in business
- Roll shares from family trust in advance to parents (didn't need to sell shares to effect transition)
- Intend to sell all or a portion of the business to arm's length persons in future
- Child is 18 -25 years old (is child truly the successor?)
- Child sells shares of Holdco back to parent

Succession

Top 8 Questions to Ask Yourself

1. Do you have clear objectives for the transition of your business?
2. Is your tax and estate plan structured to ensure you retain the max amount?
3. Do you know what your business is currently worth?
4. Have you considered options and are on track for transition on the terms you want?
5. Does your current business plan reflect your retirement goals?
6. Does your business have the appropriate governance structure?
7. Have you identified all key employees for transition and created a retention plan?
8. What would happen to the business if there was an unplanned exit?

Pitfalls to Avoid

- Assuming people are interested...or not
- Eliminating management as a successor because they can't afford it
- Picking wrong successors
- Assuming fair is the same as equal
- Starting too late and losing key people or tax advantages
- Establishing a price without basis
- Not having a Plan B
- Not involving advisors in process

Questions?



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