



# Enterprise Tax on Demand

## Keeping the business in the family: Tax impacts of intergenerational transfers

### Episode 1: Keeping the business in the family: Tax impacts of intergenerational transfers

Family businesses are built to be passed on. And the dream of many Canadian family business owners, is to hand over the business to their adult children or adult grandchildren when they retire.

In this first episode of Enterprise Tax on Demand, we discuss the income tax treatment of intergenerational transfers under the new rules and compare it with the treatment under the old rules. We also look at how intergenerational transfers are taxed in other jurisdictions, and the lessons we can learn.

*Speaker: Dino Infanti, Partner and National Leader – Enterprise Tax*



With over 15 years of experience, and KPMG's Partner, National Leader KPMG Enterprise™ Tax, Dino Infanti is well known for his insights and guidance on tax technical work in estate and succession planning, corporate restructuring, tax mitigation strategies and divestitures. Dino specializes in owner-managed enterprises primarily in the construction, real estate development, and holdings sectors, in addition to the entertainment sector.

### Episode highlights

Time	Topic
0:00 – 1:53	Introduction
1:53 – 5:35	Canadian application
5:35 – 6:15	Other jurisdictions
5:15 – 9:22	Summary and conclusion

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## Dino Infanti

Family businesses are built to be passed on and the dream of many Canadian family business owners is to hand over the business to their adult children or adult grandchildren when they retire.

I recall a Canadian immigrant family that started a manufacturing business in the construction sector some years ago. Worked extremely hard with many long days and nights employing people and investing in equipment. The children worked in the business as they went to university and were eventually employed full-time in the business. The business was successful, and the entrepreneur and the family built the business into what it is today. So now, the entrepreneur owner is ready for retirement and has a decision to make. Pass on the legacy to the adult children, or two, sell the business to an arm's length third party.

The federal government recently passed new income tax relief for intergenerational transfers of family businesses and also introduced legislation that provides greater flexibility for restructuring family businesses involving siblings.

In this first episode of Enterprise Tax on Demand, we will discuss the income tax treatment of intergenerational transfers under the new rules and compare it with the treatment under the old rules. We'll also look at how intergenerational transfers are taxed in other jurisdictions, and the lessons we can learn from them.

Historically, a parent who operated a family business through a company was discouraged from selling the shares of that company to a company controlled by their adult child or adult grandchild. The reason being is that any gain on those shares would have been taxed in the parent's hands as a dividend. Whereas any gain on a similar sale of shares to an arm's length third party would have been taxed in the parent's hands as a capital gain. This is a concern because of the different tax rates on a dividend compared to a capital gain.

Depending on the parents, province, or territory of residents and the type of dividend, the dividend tax rate could be as high as 49%, whereas the capital gains tax rate could be as low as 22%. This is a significant difference of 27%.

Here's the other thing. On an arm's length sale, the parent can potentially utilize their lifetime capital gains exemption to shelter the gain from income tax subject to something called alternative minimum tax.

The lifetime capital gains exemption is lucrative and could allow for sheltering of a gain of up to approximately \$915,000 on the sale of qualified small business corporation shares, or up to 1,000,000 on the sale of qualified farm or fishing property. So, it's for these reasons the parent was better off selling their shares to a third party, as they could potentially save a significant amount of income tax.

Well, in June 2021, welcome income tax relief was introduced for intergenerational transfers of family businesses. Under these rules, a parent who operates a family business through a company can now expect the same income tax treatment on the

sale of their shares of that company, regardless of whether that is a sale to a company controlled by their adult child or grandchild, or to an arm's length third party. In order to get this tax treatment on a sale to a company controlled by their adult child or grandchild, certain conditions must exist - and there's four of them.

One, the subject shares are qualified small business corporation shares or shares of the capital stock of a family farm or fishing corporation. Two, the purchaser corporation is controlled by one or more of the taxpayers, children, or grandchildren who are 18 years of age or older. Three, the purchaser corporation does not sell the subject shares within 60 months of their purchase. Four and lastly, taxpayers must provide the Canada Revenue Agency with an independent assessment of the subject shares fair market value and an affidavit signed by both the taxpayer and the third party attesting to the sale of shares. So, on a gain of about \$915,000, the parent's income tax savings could be as high as \$448,000.

Let's think about some other jurisdictions that have similar rules. In Quebec, for example, we've seen similar relief for intergenerational transfers of family businesses but of course, this relief is subject to certain stricter conditions being met.

South of the border in the United States, certain intergenerational transfers of family businesses are on a tax-deferred basis, but there is an election to opt-out of this treatment.

In the United Kingdom, the playing field is level. The tax treatment for intergenerational transfer is the same as that for a sale of shares to an arm's length third party.

It is welcome to see our Canadian tax rules for family business transfers to be on an equal footing as other jurisdictions and countries. The Department of Finance has said, though, that it intends to amend these new rules to ensure they facilitate genuine intergenerational transfers and are not being used for artificial tax planning purposes.

The Department of Finance identified four areas that they intend to address. The first, the requirement to transfer legal and factual control of the corporation carrying on the business from the parent to the child or grandchild. The second item, the level of ownership in the corporation carrying on the business that the parent can maintain for a reasonable period of time after the transfer occurs. Third, the requirement and timeline for the parent to transition their involvement in the business to the next generation. And four, the level of involvement of the child or grandchild in the business after the transfer occurs.

So where does this leave us? By removing the tax advantage of selling outside the family, many Canadian business owners can be spared the difficult choice between a more financially secure retirement or increasing their income tax burden to enable their adult child or grandchild to carry on the family business and legacy. This is a welcomed change for family business owners to help equalize intergenerational and third-party transfers.

Ultimately, this will provide a greater peace of mind when succession planning and preserving the business's legacy and it will also help maintain unique status and identities of our communities. With changes on the horizon here in Canada, it's important if you haven't already to start to plan your business succession to the next generation, that you start to map this out and understand the impacts of these very important changes.

Thank you for joining us today on the first episode of Enterprise Tax on Demand. This video series will include thought leader perspectives on key enterprise tax topics across Canada, the United States, and around the world.

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*Musical outro*