SASKATCHEWAN CHAMBER of COMMERCE

Policy Position

April 2015

Amend Section 84.1 of the Federal Income Tax Act

Background

Section 84.1 of Canada's federal Income Tax Act (ITA) applies when an individual sells shares of a Canadian corporation (the subject corporation) to another individual or corporation (the purchaser corporation) with which the transferor does not deal at arm's length, and immediately after the sale, the subject corporation is connected with the purchaser or purchaser's corporation.

The rationale behind section 84.1 is to prevent the tax-free removal of taxable corporate assets through a non-arm's-length transfer of shares by an individual to a corporation, but this can sometimes result in problems for people wishing to sell their business to individuals within their immediate family.

A business can be transferred by selling the company's shares to a third party, by integrating key employees, or by transferring the business to family members, but section 84.1 of the ITA suggests that it is more favourable to sell a business to a third party instead of to immediate family members.

Section 84.1 considers capital gains to be a dividend when an individual sells the shares of a Canadian-based corporation to an immediate family member, but does not consider them a dividend if the shares are sold to an arm's length purchaser. This tax rule prevents the individual from benefitting from the capital gains exemption if they sell their business to an immediate family member, which often encourages a sale to people outside of their family, even though they may have a family member interested in continuing the business.

This issue is of concern to anyone wanting to sell their business to an immediate family member, people that are looking to sell shares to a son or daughter for example, even if those shares are being sold at fair market value.

Capital gains exemptions are a key component of the financial structuring of a business transfer, so it is important to remove this impediment in order to help alleviate the succession planning concerns that many Canadian businesses are facing.

Issue

Section 84.1 of the federal Income Tax Act disadvantages the sale of businesses between non-arm's length parties, even if the transaction occurs at fair market value. This means that the tax system currently encourages business transfers to third parties instead of to family members, which creates challenges to succession planning if the more logical exit strategy for the owner is to sell the business to his children or other immediate family members.

Saskatchewan Chamber of Commerce Recommendations

1) That the Saskatchewan Chamber of Commerce work with the Canadian Chamber of Commerce and other concerned advocacy groups to encourage the Government of Canada to make appropriate amendments to section 84.1 of the Income Tax Act so that it no longer disadvantages the intergenerational transfers of businesses the sale of businesses to family members at fair market value.