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Legislative Summary

BILL C-208: AN ACT TO AMEND THE INCOME TAX ACT (TRANSFER OF SMALL BUSINESS OR FAMILY FARM OR FISHING CORPORATION)

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LEGISLATIVE SUMMARY OF BILL C-208: AN ACT TO AMEND THE INCOME TAX ACT (TRANSFER OF SMALL BUSINESS OR FAMILY FARM OR FISHING CORPORATION)

1 BACKGROUND

1.1 STATUS OF THE BILL

Bill C-208, An Act to amend the Income Tax Act (transfer of small business or family farm or fishing corporation),¹ was reinstated from a previous session of Parliament in the House of Commons on 23 September 2020 and sponsored by Larry Maguire (Brandon—Souris). It passed second reading on 3 February 2021 and was referred for study to the House of Commons Standing Committee on Finance (FINA). Bill C-208 was reported back to the House of Commons without amendment by FINA on 23 March 2021 and passed third reading on 12 May 2021. It was referred for study to the Standing Senate Committee on Agriculture and Forestry on 27 May 2021 and was reported back to the Senate without amendment on 10 June 2021. Bill C-208 was passed by the Senate without amendment on 22 June 2021 and received Royal Assent on 29 June 2021.

1.2 TAXATION OF QUALIFIED SMALL BUSINESS CORPORATIONS AND QUALIFIED FAMILY FARM OR FISHING CORPORATIONS

A taxpayer realizes a capital gain when they sell a capital asset and the proceeds of the sale (the disposition) exceed the adjusted cost base (ACB).² The ACB is generally the cost of a property plus any expenses incurred to acquire it, such as commissions and/or legal fees. Examples of capital assets subject to this tax include buildings, land, shares, bonds, and mutual fund trust units.

The capital gains inclusion rate is 50%, which means that a taxpayer will include 50% of the amount that the disposition exceeds the ACB as income on their tax return. Unique rules apply to qualified farm or fishing property, which includes the following assets:

- shares of the capital stock of a family-farm or fishing corporation;
- an interest in a family-farm or fishing partnership;
- real property, such as land, buildings, and fishing vessels; and
- property included in capital cost allowance Class 14.1, such as milk and egg quotas, or fishing licences.³

If a Canadian resident taxpayer realizes a capital gain when they sell a qualified farm or fishing property or qualified small business corporation, they may be eligible for the lifetime capital gains deduction.⁴ The lifetime capital gains deduction from 2016 to 2020 was \$1,000,000 for dispositions of a qualified farm or fishing property or \$883,384 for dispositions of a qualified small business corporation. Because a taxpayer can only include one-half of the capital gains from these properties in their taxable income, the cumulative capital gains deduction is \$500,000 or \$441,692, respectively (half of \$1,000,000 or \$883,384).

In order to prevent certain abuses of Canada's tax system, "anti-avoidance" rules may apply to sales of qualified small business corporations and qualified farm or fishing properties that occur between non-arm's length individuals. Arm's length transactions refer to those between persons who act in their separate interests and generally reflect ordinary commercial dealings between parties. "Related persons" are not considered to deal with each other at arm's length. Related persons include individuals connected by blood relationship, marriage, common law partnership or adoption. A corporation and another person, or two corporations, may also be related persons.

Bill C-208 seeks to exempt qualified small business corporations and qualified family farm or fishing corporations from the application of certain anti-avoidance rules, making certain intercorporate dividend transfers tax free, provide for the tax-free splitting of these corporations, as well as allow for corporate intergenerational sales of such businesses to be treated as capital gains that are eligible for the lifetime capital gains deduction.

2 DESCRIPTION AND ANALYSIS

2.1 CAPITAL GAIN STRIPS AND EXCEPTIONS (CLAUSE 1)

Section 55 of the *Income Tax Act* (ITA)⁵ addresses tax avoidance transactions known as "capital gain strips," which were made possible because of the tax-free status of certain intercorporate dividends. For example, where a corporation plans to sell its shares in another corporation, it could first receive a tax-free dividend from that corporation. It would then sell its shares at a price reduced by the amount of the dividend, thereby decreasing the capital gain that would otherwise have been realized. Pursuant to section 55(2) of the ITA, the proceeds of a disposition of intercorporate shares are generally be deemed to be a capital gain, and not taxed as an intercorporate dividend.

Clause 1 of Bill C-208 amends section 55(5)(e)(i) of the ITA to create exceptions – to the section 55(2) anti-avoidance rule – for transactions concerning the purchases of capital stock of a qualified small business corporation or of a qualified farm or fishing property. In particular, the amendment allows a corporation to receive tax-free intercorporate dividends on the redemption, acquisition, or cancellation of a share from a related party that was a qualified small business corporation, or a family farm or fishing corporation.

In addition, the amendments brought about by clause 1 – in conjunction with section 55(3)(b) of the ITA – provide for the tax-free splitting of a qualified small business corporation, or a family farm or fishing corporation owned by a parent into two corporations, each controlled by a separate child. As a result, intercorporate dividends that are issued by the original corporation to the corporation controlled by a child will not be treated as proceeds of distribution or as a capital gain, therefore reducing the tax consequences for the recipient corporation.

2.2 SURPLUS STRIPPING AND NON-ARM'S LENGTH TRANSFERS (CLAUSE 2)

Section 84.1 of the ITA aims to prevent the “stripping” of taxable corporate surpluses in certain circumstances where shares of a Canadian resident corporation have been the subject of a non-arm's length transfer. Section 84.1 applies, for example, when family members buy a business from another family member and – in order to facilitate the transaction – a new corporation is formed to borrow the required funds to finance the acquisition. Section 84.1 provides that when a taxpayer sells the shares of one corporation to another non-arm's length corporation – for example, a sale between a corporation owned by a parent to another owned by their child – the proceeds of the disposition are treated as a taxable dividend rather than a capital gain. Therefore, when a farmer's child (or other non-arm's length individual) purchases their parents' qualified farm or fishing property through a corporation, they would not be permitted to utilize the lifetime capital gains deduction. Notably, this deduction remains permissible if the sale does not take place through a corporation.

Clause 2(1) of Bill C-208 adds section 84.1(2)(e) to the ITA in order to provide an exception to the application of section 84.1 for transactions involving shares of a qualified small business corporation or a qualified farm or fishing property where the purchaser's corporation is owned by the adult child or grandchild of the seller's corporation.

Clause 2(2) also adds section 84.1(2.3) to specify special capital gains calculations if the child or grandchild's corporation subsequently sold or disposed of those shares within five years of their purchase by providing a limited capital gains exemption

based on the amount found in subsection 110.6(2) of the ITA. In addition, the capital gains exemption is reduced if the taxable capital employed in Canada by the qualified small business corporation, or a family farm or fishing corporation was more than \$10 million. The capital gains exemption is reduced to zero for shares of a qualified small business corporation, or a family farm or fishing corporation with taxable capital employed in Canada of more than \$15 million.

3 COMMENTARY

3.1 HISTORY AND PARLIAMENTARY DISCUSSIONS

The federal government's position with respect to intergenerational transfers of qualified farm or fishing properties was noted in the 2019 Budget:

The Government understands the importance Canadian farmers, fishers and other business owners place on being able to pass their businesses on to their children. The Government will continue its outreach to farmers, fishers and other business owners throughout 2019 to develop new proposals to better accommodate intergenerational transfers of businesses while protecting the integrity and fairness of the tax system.⁶

In addition, the Prime Minister's 13 December 2019 mandate letter to the Minister of Finance listed a "top priority" of the minister as "[working] with the Minister of Agriculture and Agri-Food on tax measures to facilitate the intergenerational transfer of farms."⁷

During Bill C-208's study before the House of Commons Standing Committee on Finance⁸ and the Standing Senate Committee on Agriculture and Forestry,⁹ the Department of Finance expressed concerns that the exceptions to anti-avoidance rules created by Bill C-208 in respect of intergenerational transfers of small businesses, farms or fishing property lack safeguards to ensure that these exceptions are used solely for genuine intergenerational transfers. According to the Department of Finance, these exceptions could be used by high-net worth individuals to avoid paying taxes without intergenerational transfers taking place.

3.2 COMING INTO FORCE

Once a bill has been adopted by the Senate and the House of Commons and has been given Royal Assent by the Governor General, it becomes an Act of Parliament and, as such, part of the Laws of Canada. An Act, however, is not binding unless it has commenced.¹⁰ There is a distinction between the enactment of an Act and its

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commencement. The former relates to the time it receives Royal Assent,¹¹ and the latter to the time when it becomes binding and capable of producing legal effects.¹²

The *Interpretation Act*¹³ provides for default and general rules pertaining to the commencement of federal legislation, though an Act may provide for its own coming into force mechanism. In particular, section 5(2) of the *Interpretation Act* specifies that, “If no date of commencement is provided for in an Act, the date of commencement of that Act is the date of assent to the Act.” As such, Acts of Parliament may come into force on Royal Assent, on a day specified in the Act itself, or by order of the Governor in Council. Bill C-208 did not contain a commencement date.

On 30 June 2021, a news release from the Department of Finance noted that “Bill C-208 makes amendments to the *Income Tax Act* but does not include an application date” and that “[t]he government proposes to introduce legislation to clarify that these amendments would apply at the beginning of the next taxation year, starting on January 1, 2022.”¹⁴

On 19 July 2021, a news release from the Department of Finance explained that the provisions of Bill C-208 “now apply in law” and that the government intends to put forward legislative amendments to ensure the provisions of the bill are “not used for artificial tax planning purposes.”¹⁵ While appearing before the House of Commons Standing Committee on Finance on 20 July 2021 to explain its position on the commencement of the Act, the Department of Finance clarified that the 30 June news release was intended to announce that the government would be proposing amendments to the ITA related to the bill that would apply as of 1 January 2022, and that Bill C-208 became binding and capable of producing legal effects as of that day.¹⁶

NOTES

1. [Bill C-208, An Act to amend the Income Tax Act \(transfer of small business or family farm or fishing corporation\)](#), 43rd Parliament, 1st Session.
2. For more information, see Government of Canada, [Capital Gains – 2020](#); and Government of Canada, [Adjusted cost base \(ACB\)](#).
3. See definition of “Qualified farm or fishing property” in Government of Canada, [Capital Gains – 2020](#).
4. See Government of Canada, “[What is the capital gains deduction limit?](#),” *Capital Gains – 2020*.
5. [Income Tax Act](#), R.S.C. 1985, c. 1 (5th Supp.).
6. Government of Canada, [Investing in the Middle Class](#), Budget 2019, p. 207.
7. Prime Minister of Canada, Justin Trudeau, [Minister of Finance Mandate Letter](#), 13 December 2019.
8. House of Commons, Standing Committee on Finance, [Evidence](#), 11 March 2021, 1750 (Trevor McGowan, Senior Director, Tax Legislation Division, Tax Policy Branch, Department of Finance).

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9. Senate, Standing Committee on Agriculture and Forestry, [Evidence](#), 10 June 2021 (Trevor McGowan, Director General, Tax Legislation Division, Tax Policy Branch, Department of Finance).
10. “Commencement” and “coming into force” are synonymous and are used interchangeably in this text.
11. In Canada, the Governor General gives Royal Assent, in the Queen’s name, to bills that have been passed by both houses of Parliament. See [Constitution Act, 1867](#), 30 & 31 Victoria, c. 3 (U.K.), s. 55.
12. See Michel Bédard, [Coming into Force of Federal Legislation](#), Publication no. 2009-03-E, Library of Parliament, 25 August 2015.
13. [Interpretation Act](#), R.S.C. 1985, c. I-21.
14. Department of Finance Canada, [Government of Canada provides details on next steps for Private Member’s Bill C-208](#), News release, 30 June 2021.
15. Department of Finance Canada, [Government of Canada clarifies taxation for intergenerational transfers of small business shares](#), News release, 19 July 2021.
16. House of Commons, Standing Committee on Finance, [Evidence](#), 20 July 2021, 1415 (Trevor McGowan, Director General, Tax Legislation Division, Tax Policy Branch, Department of Finance).