



700 - 9990 Jasper Avenue,  
WORLD TRADE CENTRE EDMONTON  
Edmonton, Alberta Canada T5J 1P7  
tel 780.426.4620 fax 780.424.7946

## Intergenerational Transfer of Qualified Small Business Shares

February 2007

### Background

The current business and tax environment has not fostered a climate where family businesses can plan with certainty into successive generations. Although it is often the expressed wishes of the founder of the family enterprise to have the family business continue on for generations to come, the discouraging reality is that few survive to the second generation. Statistics suggest that 70% are either liquidated or sold soon after the founder's retirement or death and less than 13% last through the third generation. Although sound management and the ability to manage change through intergenerational transition is often a contributing factor, there is an absence of a provision in the *Income Tax Act* that would allow for a tax-deferred intergenerational rollover of the shares of a qualifying family-owned small business corporation is a significant contributing factor. Such a provision currently exists for family-owned farm enterprises to ensure the sustainability of the farming industry. However, despite the breadth of the impact that small business has on the Canadian economy, the Act fails to provide similar treatment for those family enterprises outside of the farming industry. This impact cannot be understated when the influence of family business in Canada is considered statistically.

There are approximately 1,000,000 family businesses in Canada that range in size and scope from the very small "hobby" business to large-sized corporations.

- more than 80% of all businesses in Canada are family businesses;
- over 180,000 have revenues over \$5 million;
- more than 50% of Canada's workforce is employed in family business;
- family business generates over 45% of GDP; and,
- family business generates over 80% of new job growth.

Family-owned small businesses should enjoy income tax treatment on the intergenerational transfer of the shares of the corporation similar to that currently available to family farm corporations for no other reason than to ensure the sustainability of successful family businesses beyond the first generation. The immediate benefit to successive generations would lie in a deferral of income tax on the transfer of shares of the corporation from one

generation to the next, thus eliminating the need for costly and complex planning or the potential for liquidation of the corporation to address income issues surrounding disposition of the shares on the death or retirement of the founder.

The lack of such a provision has created an environment that is costly, complicating and mitigates rather than defers tax on such transfers.

#### Review of Legislative Background

The concept of an inter-vivos or testamentary transfer of the shares of the capital stock of a family-owned corporation is not new to the Act. In 1977, Parliament introduced subsection 73(5) to address the issue of inter-vivos transfers of shares of a “small business corporation” as defined, at that time, under the provisions of subsection 248(1) of the Act. In addition, subsections 70(9.4) through 70(9.7) addressed the issue of a tax deferred rollover of the shares of a small-business corporation at death. In both instances, the legislation provided an effective mechanism for the transfer of shares to a successive generation without the current incidence of income tax. At this time, parallel provisions were introduced in subsections 70(9.2) and 70(9.3) to allow for the tax deferred transfer of the shares of a family farm corporation to a child or spouse of the shareholder. In addition, a parallel provision was also introduced in 1977, under subsection 73(4) to allow for the inter-vivos transfer of the shares of a family farm corporation to a child of the shareholder. Although the provisions relating to the tax deferred transfer of the shares of family farm corporations survived the introduction of the enhanced capital gains deduction in 1985, the provisions relating to the intergenerational transfer of the shares of a small business corporation were repealed for transfers and dispositions made after 1987. Speculation exists that the repeal of the small business provisions was principally motivated by the introduction of the enhanced capital gains deduction under subsection 110.6(2.1). However, this argument is inherently flawed as provisions introducing the enhanced capital gains deduction for shares of a family farm corporation were also introduced in 1985 under subsection 110.6(2). Comments by income tax practitioners who were well versed with the small-business rollover at the time have suggested that the repeal reflected the tightening of rules that were seldom used and such amendment was, at the time, met with little resistance. It has also been suggested that a large proportion of the family businesses in Canada at that time had not reached a level of economic maturity that would have dictated an inter-generational transfer. Quite simply, many of the founders of post-WW II businesses were not yet ready to relinquish their businesses to the next generation. What is clear today, however, is that the demographic make-up of the business community has changed dramatically from 1987.

The Canadian economy will experience an unprecedented transfer of ownership of closely held businesses, and other property, from the post-war era to the next generation. As part of this transfer, Canada's aging entrepreneurs will look to the next generation to continue the family business – with startling and disturbing statistics of success.

### **Recommendation**

That the Government of Canada:

1. Introduce amendments to the Income Tax Act, fiscal conditions permitting, to allow for the tax-deferred intergenerational transfer of the shares of a "family-owned small business corporation" on both an inter-vivos and a testamentary basis in a manner consistent with the existing legislation that applies to such transfers of the shares of a family farm corporation.