

Navigating the New Tax Rules for Intergenerational Business Transfers



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"Is your family business ready for its next chapter?"

For many [family-owned enterprises](#), the dream is clear—passing a thriving business onto the next generation. This transition is more than an inheritance; it is a legacy, a symbol of shared values, and a route to sustained success across generations. However, the process of intergenerational business transfers has long been fraught with financial and regulatory challenges, often resulting in significant tax burdens when transferring ownership.

Enter the revised Section 84.1 of Canada's Income Tax Act (ITA), which offers family business owners new tax-efficient pathways to fulfill these dreams. Whether you're a first-generation founder looking to retire or a second-generation executive eager to take the reins, understanding these new tax rules is critical to a seamless transition.

In this article, our [trusted advisors](#) at [Crowe MacKay](#) explain the importance of Intergenerational Business Transfers, the new rules and conditions, and how to go from theory to practice.

The Importance of Intergenerational Business Transfers

Family businesses are a pillar of the Canadian economy, generating roughly 50% of the country's private sector gross domestic product (GDP). Yet, studies reveal that many family businesses have been unsuccessful in transitioning to the second generation, while even fewer continue into the third. Why? Challenges often arise in balancing financial considerations, succession planning, and family dynamics.

Until recently, the Canadian income tax system worked against family business owners choosing to sell or transfer the family business corporation to a corporation owned by their child(ren), leading many to contemplate selling to third parties instead. With updates to [ITA Section 84.1](#), however, family businesses finally have practical solutions to retain ownership within the family without facing an unfair tax result.

This change isn't just about new tax rules—it's a fantastic opportunity for family businesses to grow and succeed across generations.

The New Rules for Intergenerational Business Transfers

The updated ITA Section 84.1 introduces flexibility and fairness to the transfer process, explicitly addressing challenges with tax during ownership changes from one generation (G1) to the next (G2). Here's what you need to know about the two primary transfer types available under the new updated rules:



Immediate Business Transfer (IBT)

The IBT option allows parents to transfer complete business ownership and management within **three years**. This option delivers a streamlined process, ideal for families with well-prepared successors ready to assume complete control and management (almost) immediately.



Gradual Business Transfer (GBT)

Conditions for Intergenerational Business Transfers

Careful preparation and planning are essential to leverage these new tax-efficient options. The ITA changes outline **five specific conditions** families must meet before, during, and after the initial transfer of the company's shares.

Before Disposition

- The transferred shares must qualify as **Qualified Small Business Corporation (QSBC) shares** or **Family Farm or Family Fishing Corporation (FFFC) shares**.
- The child(ren) must be at least **18 years old** and directly own the purchaser corporation.

For clarity, note that under these rules, a "child" can include an adult niece, nephew, grandniece, and grandnephew.

At the Time of Disposition

To ensure genuine transfer of control:

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Parents must relinquish **legal** and **factual control** over the business for an IBT.

- Parents giving up control under a GBT need only meet the standard for **legal control** at the disposition time.

Additionally:

- Parents must transfer their **economic interest**, retaining no more than 50% ownership of the corporation's shares post-disposition.

After the Disposition

The remaining transition process enforces the following timelines:

- For an IBT, parents must complete the entire transfer of management and ownership within **36 months**.
- For a GBT, the above transfer must happen within **60 months**, with extensions granted if deemed "reasonable in the circumstances."

An added condition applies to a GBT: The parent(s) must divest any remaining debt or equity tied to QSBC or FFFC shares within ten years from the disposition date.

Ongoing Conditions

During and after the transition period:

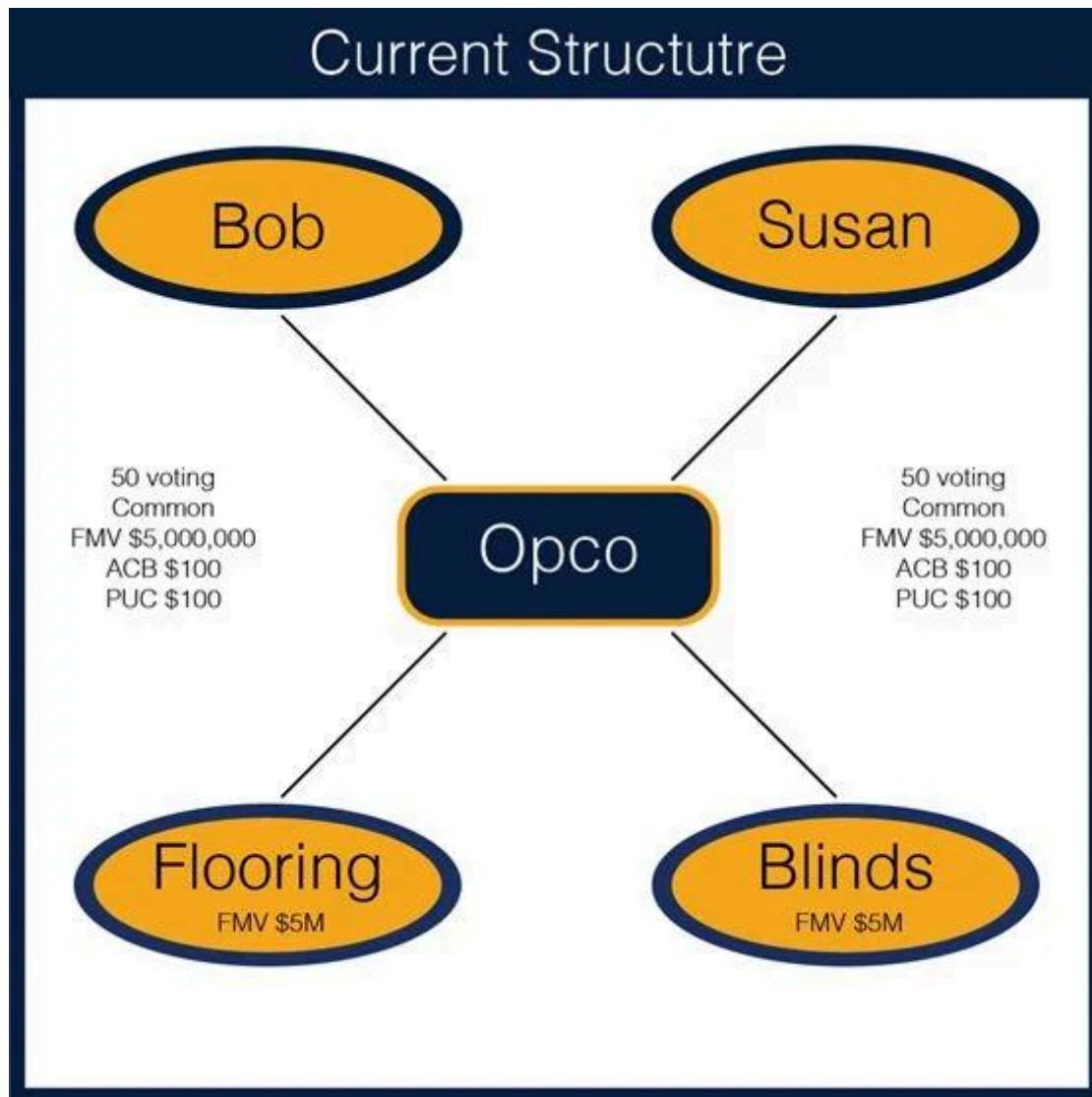
- The child(ren) must actively run the business while maintaining control.
- The business itself must remain active and operational.

Tax-Specific Obligations

- Both parent(s) and child(ren) must file a **joint tax election**, the child(ren) agreeing to become jointly and severally liable for the parents tax liabilities in respect of the business transfer.
- Relieving provisions to deem the IBT or GBT conditions to have been met in circumstances where the child(ren) subsequently sells the shares to an arm's length party or to another sibling, or there is a death or incapacity of a child engaged in the business.

- The capital gains reserve is extended from 5 to 10 years for qualifying transfers, allowing for the payment of the tax liability to be spread over a period of up to 10 years.

Intergenerational Business Transfer Example



Current Business Structure

Bob and Susan jointly own a business, Opco, which operates two distinct divisions:

- **Flooring Business** with a fair market value (FMV) of \$5 million
- **Blinds Business** with a FMV of \$5 million

Ownership details:

- Bob: 50 voting common shares (FMV: \$5,000,000; adjusted cost base (ACB): \$100; paid-up capital (PUC): \$100)
 - Susan: 50 voting common shares (FMV: \$5,000,000; ACB: \$100; PUC: \$100)
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Proposed Plan

Separate the businesses into two entities: Flooring Inc. and Blinds Inc.

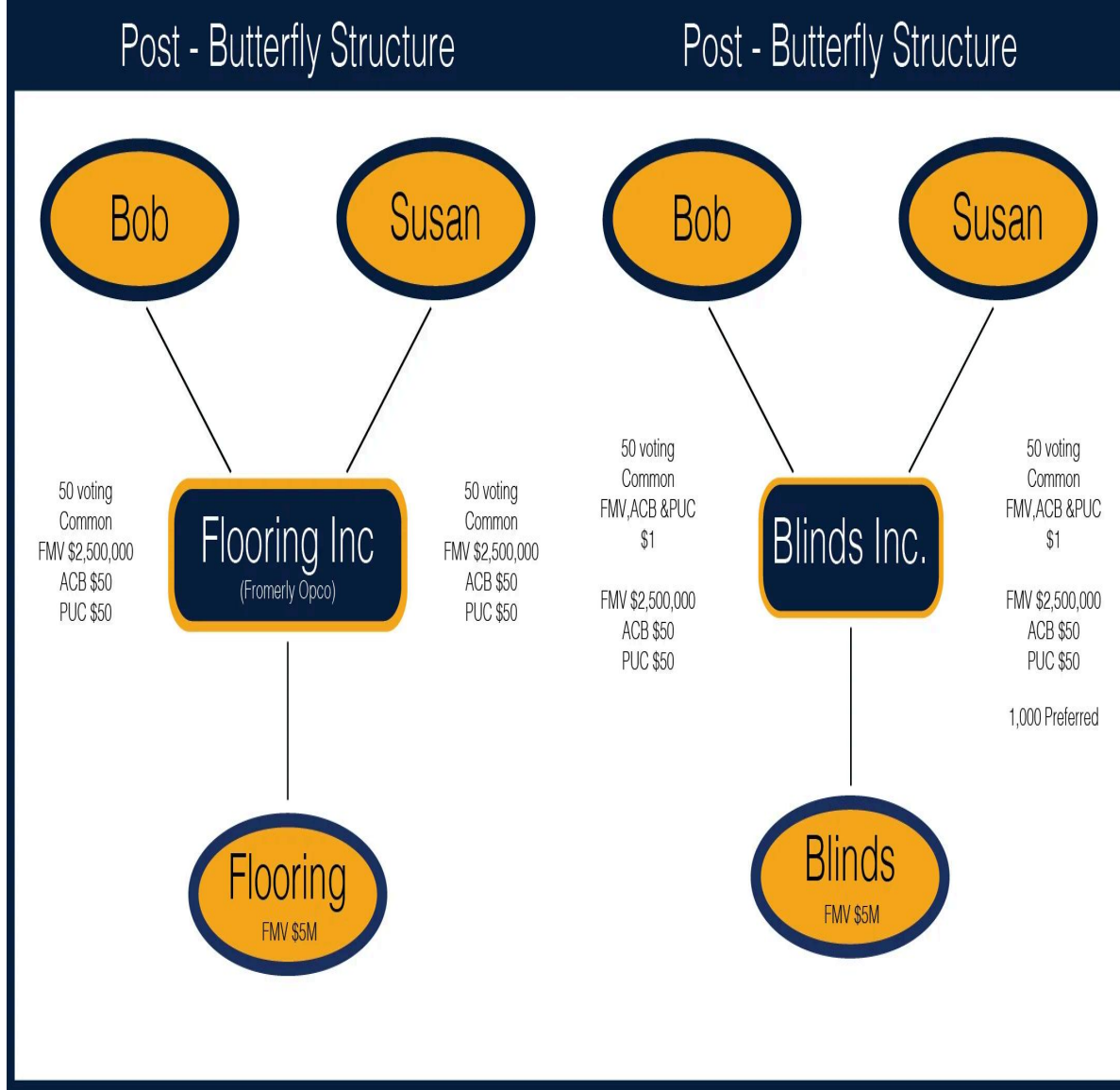
Sell one business to each of their adult children:

- Sally (active in the flooring business) will purchase Flooring Inc. immediately.
- John (not active in either business) will purchase Blinds Inc. after completing his education.

Challenge: Sally and John lack the funds to purchase the businesses outright. To complete the transfer, they plan to use the businesses' operational income to repay loans issued.

Solution: Use the new intergenerational transfer rules to structure the sale efficiently, leveraging the Lifetime Capital Gains Exemption (LCGE).

Post-Butterfly Structure



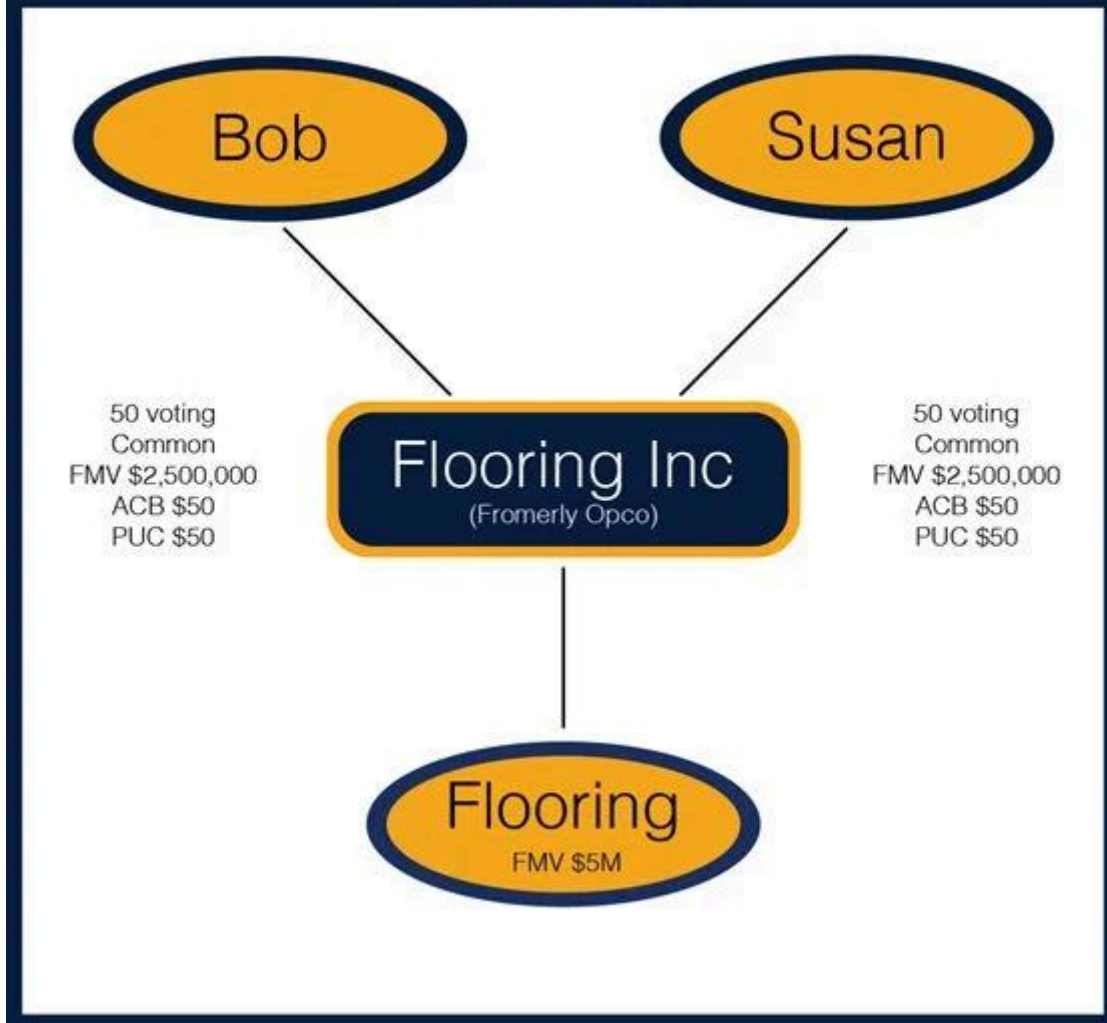
The businesses are separated into two corporations:

- **Flooring Inc.** (formerly Opco) owns the flooring business (FMV: \$5 million).
- **Blinds Inc.** owns the blinds business (FMV: \$5 million).

Bob and Susan's ownership structure:

- Flooring Inc.: 50 voting common shares each (FMV: \$2.5 million; ACB: \$50; PUC: \$50).
- Blinds Inc.: 50 voting common shares each (FMV: \$1; ACB: \$1; PUC: \$1) and 1,000 preferred shares each (FMV: \$2.5 million; ACB: \$50; PUC: \$50).

Sale to Sally



Sale to Sally

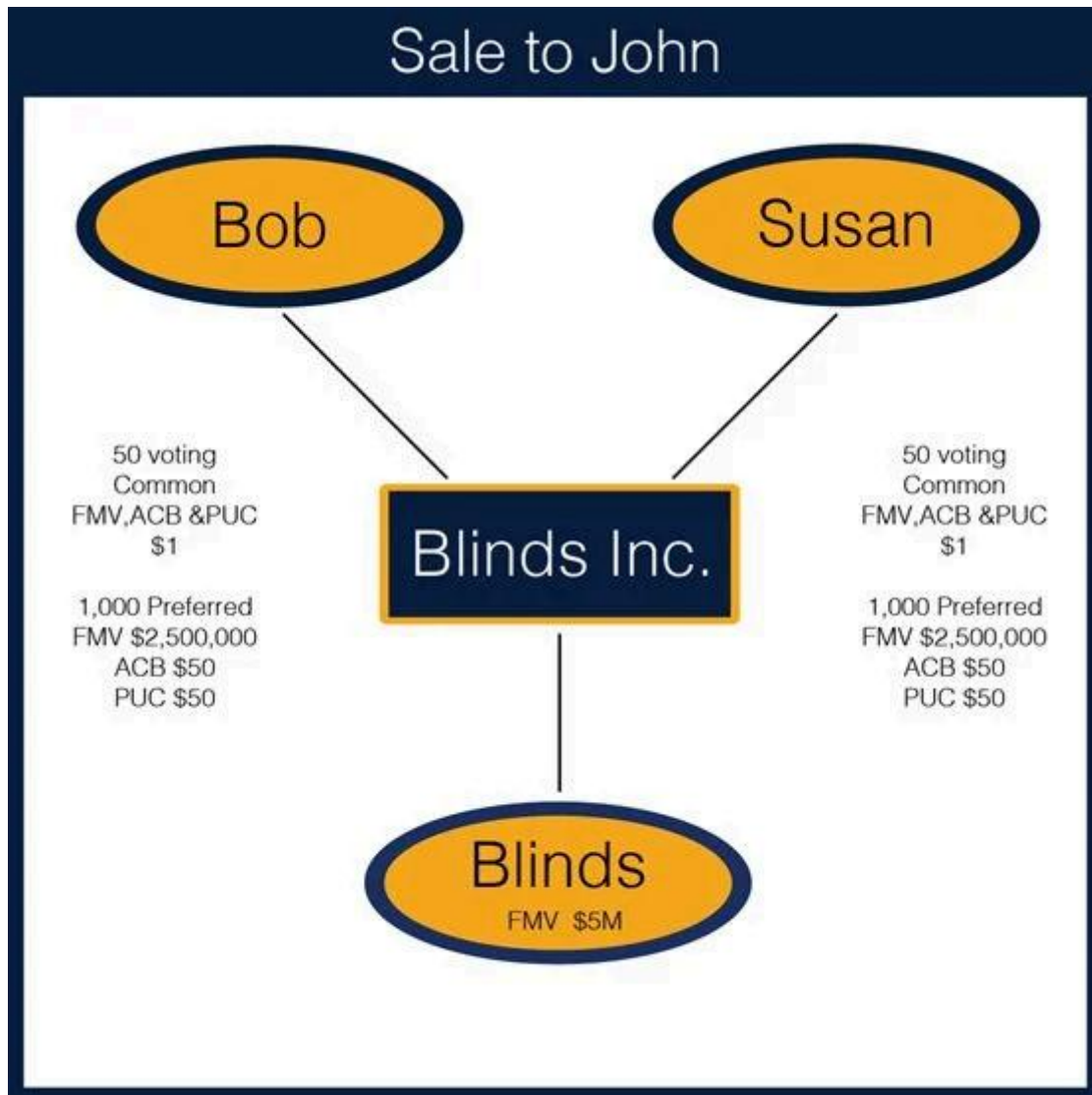
Sally creates a new corporation, Sallyco, to purchase Flooring Inc.

Conditions:

- Bob and Susan sell all their shares in Flooring Inc. to Sallyco.
- Promissory notes for \$2.5 million each are issued to Bob and Susan.
- Within 36 months, Bob and Susan must cease managing the business (though they can retain advisory roles).
- Sally must actively manage Flooring Inc. and control Sallyco.

Compliance with IBT rules ensures:

- Bob and Susan retain no direct or indirect control of Flooring Inc. or Sallyco.
- The transfer is structured to utilize LCGE to shelter a portion of the capital gains.



Sale to John

John creates a new corporation, Johnco, to purchase Blinds Inc.

Conditions:

- Bob and Susan initially retain 40% of the common shares of Blinds Inc.
- Promissory notes for \$2.5 million each are issued to Bob and Susan.
- To qualify for GBT rules, Bob and Susan's equity interest in Blinds Inc. must be reduced to 30% or less within 10 years.
 - Management transition:

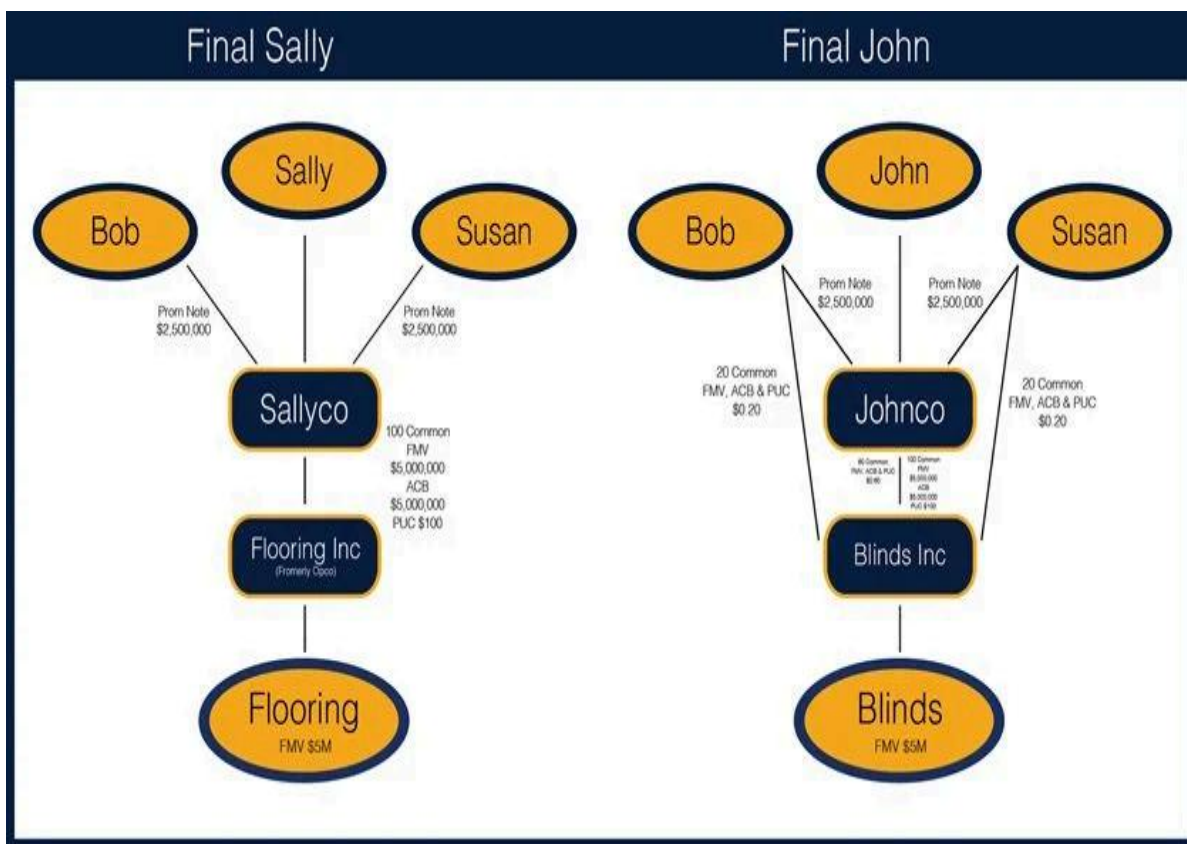
Bob and Susan must cease managing Blinds Inc. within 36 months (IBT) or 60 months (GBT).

- John must take an active managerial role.

Compliance with GBT rules ensures:

- John controls Johnco.
- Blinds Inc. continues as an active business, with John regularly and substantially engaged.

Final Structures



Sally (Year 3):

- Owns 100% of Flooring Inc. through Sallyco.
- Bob and Susan retain no shares but hold promissory notes worth \$2.5 million each.

John (Year 10):

- Owns 100% of Blinds Inc. through Johnco.
- Bob and Susan retain no shares but hold reduced promissory notes worth \$750,000 each.

From Theory to Practice

While the new tax rules lay a solid foundation, every family business is unique. **The Three Circle Model** offers a framework to guide decision-making balancing:

1. **Non-Family Owners** (bringing professional expertise).
2. **Family Owners** (anchored in maintaining values).
3. **Family Employees** (delegating responsibilities for active participation).

By proactively addressing challenges—such as power struggles, valuation disagreements, or succession disputes—family businesses can align all three groups' emotional and financial interests.

To understand the Three Circle Model better, read our article on [family business succession planning](#).

It's Time to Plan

Change is challenging, but with the revisions to ITA Section 84.1, the opportunity to secure your business's future has never been more achievable. Planning effectively for an intergenerational transfer requires strategic conversations today to avoid complications tomorrow.

At Crowe MacKay, our team of tax advisors specializes in guiding family businesses through transitions. Contact us to discuss your unique challenges, discover tax-efficient solutions, and ensure that your legacy endures for future generations.

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