

IS YOUR SMALL BUSINESS READY FOR THE NEXT BIG STEP?

Navigating the Section 85 Rollover

“ One of the most common questions I receive from growing small businesses, is about how to transition from Sole Proprietor into a Corporation, and when is it time.

When a Canadian taxpayer wants to move assets like land, buildings, or equipment into a corporation, they often use the Section 85 rollover provisions from the Canadian Income Tax Act (ITA). This article explains how Section 85 rollovers work, including their benefits, drawbacks, and how they interact with Ontario Land Transfer Tax (LTT) exemptions.

What is a Section 85 Rollover?

A Section 85 rollover allows individuals, trusts, partnerships, or corporations to transfer assets to a taxable Canadian corporation without immediately triggering a taxable event. By agreeing on a specific "transfer value" (called the agreed amount), you can defer any taxable gains that would normally apply to the transfer of appreciated assets.



Ontario Land Transfer Tax (LTT) Exemptions for Section 85 Rollovers

Ontario's Land Transfer Tax (LTT) typically applies when land or buildings are transferred. However, under specific circumstances involving Section 85 rollovers, LTT exemptions or deferrals may apply. Below are the types of exemptions available, their conditions, and the implications of not meeting these conditions.

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Here's how it works:

1. **Agreed Amount:** The transferor and transferee corporation agree on a value for the transferred property.
2. **Tax Deferral:** This value becomes the sale price for tax purposes, potentially deferring capital gains or recapture of depreciation.
3. **Shares as Consideration:** The transferor must receive at least one share in the corporation as part of the compensation.

This deferral is particularly useful when assets have appreciated significantly and the transferor wants to avoid paying a large tax bill upfront.

When Can Section 85 Rollover Be Used?

Examples of Common Applications:

1. **Business Incorporation:** A sole proprietor transfers their business assets into a corporation to benefit from lower corporate tax rates.
2. **Family Business Succession:** A business owner transfers assets to a family-owned corporation to share ownership and income with family members.

Eligible Transferors and Transferees

- **Transferor:** Can be an individual, trust, corporation, or partnership (if all partners are Canadian residents).
- **Transferee:** Must be a taxable Canadian corporation.

Eligible Property

Includes depreciable assets (e.g., buildings, equipment), non-depreciable assets (e.g., land), inventory, and certain resource properties.

A Section 85 rollover is a powerful tax planning tool for Canadian small business owners. Whether incorporating a business or planning for succession, it offers significant tax deferral benefits.

Ontario Land Transfer Tax (LTT)

Exemptions for Section 85 Rollovers

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Corporate Group Transfers

When land is transferred between affiliated corporations, a deferral of LTT may be granted.

Key Conditions:

1. **Affiliation Requirement:** Both the transferor and transferee corporations must be affiliated (as defined by the Income Tax Act). Affiliation typically means one corporation controls the other, or both are controlled by the same entity.
2. **Continued Control:** The underlying control of the corporate group must remain unchanged for at least three years after the transfer.
3. **Land Retention:** The property must stay within the corporate group for the same three-year period.

What Happens if Conditions are Breached?

- If the property is sold or control of the corporation changes within the three-year period, the deferred LTT becomes payable retroactively, with possible penalties and interest.

Family Business Transfers

Transfers of land to a family business corporation may also qualify for an LTT exemption.

Key Conditions:

1. **Family Business Corporation:** The corporation receiving the land must meet the definition of a family business corporation, where shareholders are limited to members of the transferor's family. This includes:
 - Spouse or common-law partner (including same-sex partners).
 - Children or grandchildren of the transferor.
 - Siblings or parents of the transferor.
2. **Shareholding Requirement:** The transferor must receive shares in the family business corporation as part of the transaction.
3. **Land Use:** The transferred property must be used by the family business for business purposes (not solely held for investment).
4. **Continued Ownership:** Shareholders must retain their shares, and the corporation must continue to use the land for business purposes for three years after the transfer.

Special Considerations

- **Multi-Use Properties:** If the transferred property has both personal and business use, only the portion used for business may qualify for the exemption.
- **Anti-Avoidance Provisions:** The Ministry of Finance scrutinizes transactions to ensure they are not structured solely to avoid LTT. Proper documentation demonstrating legitimate business intent is critical.
- **Audit Risk:** Exemptions are subject to audit, and discrepancies can lead to reassessment, penalties, or denial of the exemption.