(other than prescribed shares). A prescribed share is defined by reference to s. 6205 of the Income Tax Regulations, C.R.C., c. 945. In general terms, a prescribed share is a common share or a preferred share issued to a "freezor" on an estate freeze where, as part of the freeze, common shares were issued to persons with whom the freezor did not deal at arm's length. Estate freezes are discussed in detail in chapter 14 (Estate Planning for Private Businesses).

In addition, s. 110.6(7)(a) prevents the exemption being claimed as part of a series of transactions or events which includes a "butterfly" reorganization. "Butterfly" reorganizations are divisive reorganizations by which corporate assets are divided amongst companies owned by the shareholders on a proportional basis in a tax-deferred manner. The rules relating to butterfly reorganizations are extremely complex and are found in s. 55.

In certain circumstances, a taxpayer does not need to hold shares for 24 months before claiming the capital gains exemption. Section 110.6(14) will abridge or prevent the 24-month hold period from being restarted on specific types of reorganizations by deeming the taxpayer to be related to certain corporations, partnerships, and personal trusts. (Without the latter deeming rule, a taxpayer might have to hold shares for an additional 24 months after their acquisition from a related party before qualifying for the QSBCS exemption.) Among other things, this permits a proprietor to transfer (on a rollover basis) all or substantially all of the assets used in their active business to a controlled corporation and then claim the QSBCS exemption on an immediate sale of shares of that corporation.

2. TAX DISADVANTAGES OF INCORPORATION [§8.28]

There are several disadvantages associated with incorporation, most of which can be minimized by setting up a structure which specifically addresses the proprietor's particular circumstances.

a. Carrying on Business in Partnership or as an Employee [§8.29]

One of the most significant advantages of incorporation is the preferential tax rate of 11.0% that applies to the first $500,000 of Canadian-source business income; however, using a partnership structure undermines this advantage. It will not be as advantageous to incorporate if a person carries on business in partnership, because the $500,000 small business limit associated with partnership income

must be shared among all of the partners of the partnership. Each partner, whether or not incorporated, will notionally have assigned to it a percentage of the small business limit determined by multiplying the partner's percentage entitlement to partnership income by the $500,000 small business limit. The corporate partner's business income from the partnership, in excess of this reduced small business limit, is subject to the full corporate tax rate of 27%.

Tax practitioners employed various strategies to mitigate or avoid the foregoing tax consequences. However, these strategies were largely shut down by legislative amendments first proposed in the 2016 Federal Budget.

Even when the corporation's partnership income is taxed at the full rate of 27%, there is still a deferral advantage, as discussed above, and income splitting remains possible (though, as discussed below, in narrower circumstances than before).

Notwithstanding the above, as a result of 2018 amendments to the *ITA* there is generally little to no advantage (and likely a significant disadvantage) to earning PSB income through a corporation. Specifically, PSB income is excluded from the general rate reduction applicable to ordinary corporate income (though PSB income is still added to a corporation's GRIP balance). Also, as of 2016 an additional tax of 5% is imposed on PSB income (s. 123.5). This means that a corporate tax rate of 44% applies to PSB income.

Although this may present a very slight deferral advantage when compared to the tax payable by a top rate individual, s. 18(1)(p) severely limits the deductibility of expenses incurred in connection with a PSB. In addition, PSB income no longer integrates properly. For example, suppose $100 of PSB income is earned. If the after-tax corporate income of $56 is paid as an eligible dividend to a top-rate shareholder, an additional $20.46 of personal tax will be paid on the dividend amount. The fully integrated tax payable on PSB income is therefore nearly 64.5%.

b. Attribution Rules [§8.30]

The *ITA* contains a number of "attribution rules" intended to prevent a high-rate taxpayer from arranging their affairs so that their income is decreased and the income of related low-rate individuals (usually a spouse and/or minor children) is increased, with the result that their combined tax liability is reduced. See "The Attribution Rules" in this

chapter. The attribution rules are separate from the TOSI provisions (see "Income Splitting" in this chapter), which limit the opportunity to income split through incorporation (though there remain acceptable ways to avoid the application of those rules). The attribution rules are complex and minimizing or avoiding their application requires careful consideration.

c. Property Transfer Tax [§8.31]

Property transfer tax at a base rate of 1% on the first $200,000, 2% on the next $1,800,000 (up to $2,000,000), and 3% is payable on the fair market value greater than $2,000,000 when a transfer of title is registered under the *Land Title Act*, R.S.B.C. 1996, c. 250. For residential property, a further 2% (i.e., 5% in total) is payable on the portion of the fair market value greater than $3,000,000. This tax is payable pursuant to the *Property Transfer Tax Act*, R.S.B.C. 1996, c. 378 (the "*PTTA*"). Several exemptions to the tax exist, including for the transfer of personally used residential property between related individuals, and some limited exemptions for corporate transfers, such as statutory amalgamations. For further discussion, see "Property Transfer Tax" in chapter 11.

The *PTTA* also provides that foreign entities acquiring residential real property located in certain areas of British Columbia (Capital Regional District, Fraser Valley Regional District, Metro Vancouver Regional District, Regional District of Central Okanagan, and the Regional District of Nanaimo) are subject to an additional property transfer tax equal to 20% of the entire fair market value of the real estate purchased (that is, in addition to the rates set forth above). A "foreign entity" is generally either:

(1) an individual who is neither a Canadian citizen nor a permanent resident; or

(2) a private corporation that is controlled by one or more such individuals or incorporated outside of Canada.

Trusts of which a foreign entity is either the trustee or a beneficiary may also be subject to the additional tax. Certain exemptions ordinarily applicable to taxable transactions are not available in respect to this additional 20% tax.

Thus, a foreign national who (for example) purchases a $4,500,000 residential property in British Columbia is now subject to aggregate property transfer tax of $1,043,000 (being 1% of $200,000 + 2%

of $1,800,000 + 3% of $2,500,000 + 2% of $1,500,000 + 20% of $4,500,000).

There are disclosure rules under the *PTTA*'s Information Collection Regulation, B.C. Reg. 166/2018. Upon registration of a taxable transfer (as defined in the *PTTA*) by a corporation, these rules require identification of any individual with a "significant" interest in the corporation. Where the transferee is a trust, the Property Transfer Tax form requires disclosure of all beneficiaries of the trust. The regulation creates requirements in addition to the existing disclosure rules for bare trusts, and may be supplemented by the *Land Owner Transparency Act*, S.B.C. 2019, c. 23.

III. TAX ISSUES AFFECTING CORPORATE OPERATIONS [§8.32]

Almost every transaction, activity, or event involving a receipt or payment, an acquisition or disposition of property, or an assumption or reduction of liabilities will deliver some tax consequence to the corporation and/or its shareholder. As well, virtually every supply of property or a service will attract GST (see "Goods and Services Tax" in this chapter) unless a specific exemption or zero-rating provision is applicable, and some transactions will attract PST (see "Provincial Sales Tax" in this chapter). It is beyond the scope of this chapter to discuss these issues comprehensively. The discussion below is a summary of some of the key income tax issues affecting the operations of a closely held corporation.

A. TRANSFERRING PROPERTY TO A CORPORATION UNDER *INCOME TAX ACT* SECTION 85 [§8.33]

1. OVERVIEW OF TAX CONSEQUENCES UNDER *INCOME TAX ACT* SECTION 85 [§8.34]

"Incorporation" of a business involves a transfer of business assets to a corporation by a proprietor. The proprietor usually receives fixed-value preferred shares (and sometimes a promissory note) having an aggregate value equal to the fair market value of the transferred assets. So as to retain control over the corporation, the proprietor is usually issued voting shares. Transferring property to a corporation under s. 85(1) of the *ITA* is one of the most common transactions between a company and its shareholder and is available for most kinds