

## Overview of Familial Succession Plan

For a student rental portfolio consisting of 22 buildings (each with 5 units, totaling 110 units) held across 6 Canadian-Controlled Private Corporations in Ontario, Canada, the goal is to create a tax-efficient familial succession structure that minimizes capital gains taxes. This plan assumes the current owner (for example, a parent) wishes to transfer control and future growth to family members (for example, children) while deferring or reducing capital gains tax exposure. Capital gains taxes in Canada are triggered on dispositions (including deemed dispositions at death) at a 50 percent inclusion rate (increasing to 66.67 percent for gains over \$250,000 per year as of June 25, 2024, but subject to ongoing adjustments).

Key challenges drawn from the provided documents:

- Rental properties are often classified as a "specified investment business" under the Income Tax Act, meaning they may not qualify as an "active business" for the Lifetime Capital Gains Exemption unless each Canadian-Controlled Private Corporation employs more than 5 full-time employees year-round. If not, the Lifetime Capital Gains Exemption (up to \$1.25 million per individual as of 2025) cannot be claimed on share dispositions.
- The portfolio's structure in 6 separate Canadian-Controlled Private Corporations adds complexity; consolidation can simplify succession.
- At death, shares are deemed disposed at fair market value, triggering capital gains taxes on accrued gains unless deferred.
- Ontario-specific considerations include probate fees (1.5 percent on estate assets over \$50,000) and potential land transfer tax if properties are moved.
- Trusts face a 21-year deemed disposition rule, which triggers capital gains taxes on unrealized gains unless mitigated through strategies like distributions or wind-ups.

The most tax-efficient structure, based on the documents, uses an estate freeze combined with a family discretionary trust and a holding company to consolidate ownership. This defers capital gains taxes on future growth to beneficiaries, caps the owner's capital gains tax liability at current fair market value, and allows control retention. Life insurance can fund any unavoidable death taxes. This aligns with Canadian tax rules (for example, sections 85, 86 for rollovers; section 107(2) for trust distributions; amended section 84.1 under the intergenerational business transfer rules, originally from Bill C-208 but updated effective January 1, 2024, for intergenerational transfers).

**Important Disclaimer:** This is a high-level overview based on the provided documents and general Canadian tax principles as of October 2025. Tax laws evolve (for example, recent Tax on Split Income rules, capital gains inclusion rate changes, and amendments to intergenerational transfer rules), and implementation requires personalized advice from a qualified tax advisor, accountant, and lawyer to address valuation, attribution rules, and family dynamics. Costs include legal and accounting fees (\$10,000 to \$50,000 or more), valuations, and annual compliance (\$2,000 to \$5,000 per year for trust filings).

**Recommended Structure: Estate Freeze with Holding Company and Family Trust**

This structure minimizes capital gains taxes by:

- Freezing the owner's interest at current fair market value, shifting future appreciation (for example, from property value increases or rental income) to family members.
- Deferring immediate capital gains taxes via tax rollovers.
- Avoiding or reducing death taxes on growth.
- Potentially qualifying for the Lifetime Capital Gains Exemption if the business can be "purified" and meets active business tests (for example, by ensuring more than 5 full-time employees across operations or transferring rentals to an operating company).
- Mitigating the 21-year trust rule through proactive distributions or wind-ups to avoid deemed dispositions.
- Leveraging intergenerational business transfer rules (amended from Bill C-208) for sales to family members while claiming the Lifetime Capital Gains Exemption, provided strict conditions are met to prevent surplus stripping.

### Step-by-Step Implementation

#### 1. Pre-Planning and Valuation (1 to 3 Months):

- Engage professionals: Tax advisor, lawyer, and business valuator to assess the 6 Canadian-Controlled Private Corporations' fair market value (for example, based on property appraisals, rental income capitalization). Include a price adjustment clause to handle Canada Revenue Agency disputes.
- Determine if rentals qualify as active: If the portfolio employs more than 5 full-time staff (for example, for maintenance, leasing, student management), it may avoid specified investment business status. If not, consider hiring or restructuring operations (such as transferring properties to an operating company) to qualify for qualified small business corporation status and the Lifetime Capital Gains Exemption.
- **Detailed Lifetime Capital Gains Exemption Purification Steps:** To claim the Lifetime Capital Gains Exemption on qualified small business corporation shares, the corporation must meet strict tests: (1) It must be a Canadian-Controlled Private Corporation; (2) At least 90 percent of the fair market value of assets must be used principally in an active business carried on primarily in Canada at the time of disposition; (3) Over the 24 months prior to disposition, more than 50 percent of assets must have been used in an active business, and the shares must have been owned by the individual or related persons throughout that period. For passive rental properties (classified as specified investment business), purification is essential to remove or restructure non-qualifying assets. Steps include: a) Conduct an asset audit to identify passive elements (e.g., excess cash, investments, or rental properties not meeting active criteria); b) Hire or restructure to employ more than 5 full-time employees year-round for property management (e.g., leasing, maintenance, student services) to reclassify as active business—document employment contracts and payroll; c) If hiring is insufficient, transfer passive assets (e.g.,

excess cash or non-essential properties) out via tax-efficient methods like paying bonuses/dividends to shareholders or using a section 85 rollover to move them to a separate investment corporation; d) If the portfolio is purely passive, consider a "butterfly" reorganization (under section 55) to split active management operations into an operating company while isolating passive rentals in the holding company; e) Maintain compliance for at least 24 months prior to any claim (e.g., disposition or 21-year trust event)—track asset usage with financial statements; f) Obtain valuations to confirm asset thresholds and file Form T657 with the tax return when claiming.

- **Detailed Butterfly Reorganization:** A butterfly reorganization, exempt under section 55(3)(b) of the Income Tax Act, is a tax-deferred corporate restructuring that divides a corporation's assets among shareholders proportionally, often used for purification by separating active and passive assets. It is named for the diagram of steps resembling a butterfly. Key requirements (under subsections 55(3) and 55(3.1)): The transaction must not be part of a series to avoid tax or confer benefits; assets are divided pro-rata based on types (business property like equipment/inventory, investment property like rentals, cash-like property); shareholders must deal at arm's length (siblings generally qualify per recent rulings); no pre-butterfly asset acquisitions to manipulate types. Steps: (i) Incorporate new "transferee" corporations (one per shareholder or asset type); (ii) Transfer assets from the original "distributing" corporation to transferees on a tax-deferred basis using section 85 rollover, electing at adjusted cost base; (iii) Cross-issue and redeem shares (e.g., distributing corp receives shares in transferees, then redeems for assets); (iv) Wind up or amalgamate entities as needed. For this portfolio, use to spin off active management (e.g., leasing/student services) into an operating company, leaving passive rentals in the holding company—ensuring qualified small business corporation status for the active portion. Risks include Canada Revenue Agency scrutiny for general anti-avoidance rule (e.g., outside/inside basis misalignment) or non-genuine splits; obtain advance ruling if complex. This must align with intergenerational rules if involving family.
- Review family goals: Identify beneficiaries (for example, adult children), control needs (for example, owner as trustee), and retirement funding (for example, via preferred share dividends).
- Estimate capital gains tax exposure: If properties have appreciated (for example, from original cost to current fair market value), calculate potential gains. Use life insurance needs analysis to cover death taxes.
- Assess eligibility for intergenerational business transfer rules: Confirm if shares qualify as qualified small business corporation shares and if family members (adult children or grandchildren) can meet the transfer conditions.
- **Cost Breakdown:** Professional fees (tax advisor/lawyer initial consult): \$2,000–\$5,000; Valuations/appraisals: \$5,000–\$15,000; Asset audit for purification: \$3,000–\$7,000;

Butterfly reorganization planning (if pursued): \$10,000–\$20,000 (including CRA ruling fees if sought).

## 2. Incorporate a Holding Company (1 to 2 Months):

- Form a new Canadian-Controlled Private Corporation (holding company) owned by the current owner under Ontario's Business Corporations Act.
- Transfer shares of the 6 Canadian-Controlled Private Corporations to the holding company using a Section 85 rollover: Elect to transfer at adjusted cost base to defer capital gains taxes. This consolidates the portfolio under one entity, simplifying management and succession.
- Benefits: Provides creditor protection for properties, allows tax-free intercorporate dividends from rentals to the holding company, and facilitates purification (for example, move excess cash or non-essential assets out to maintain qualified small business corporation status if applicable). It also defers gains on the transfer, with the elected amount setting the cost base for the holding company.
- If rentals are passive (specified investment business), holding company shares will not qualify for the Lifetime Capital Gains Exemption, but the structure still defers growth taxes.
- **Cost Breakdown:** Incorporation fees (Ontario registration, articles): \$500–\$2,000; Section 85 rollover documentation and filing (Form T2057): \$2,000–\$5,000; Legal/accounting for transfers: \$3,000–\$8,000.

## 3. Establish a Family Discretionary Trust (Concurrent with Step 2):

- Create an irrevocable discretionary family trust with the owner (or a neutral party) as settlor (contributing nominal \$10 to \$100 to avoid attribution). Beneficiaries: Spouse, children, and possibly grandchildren.
- Owner can be a trustee for control, but include independent trustees to mitigate risks. Draft a trust deed outlining discretionary powers, beneficiaries, termination date, and asset protection clauses.
- Benefits: Allows flexible allocation of income and gains to lower-tax-bracket beneficiaries, multiplies potential Lifetime Capital Gains Exemption claims (each beneficiary has their own \$1.25 million limit), and supports income splitting (subject to Tax on Split Income rules—ensure beneficiaries aged 25 or older are involved or meet exclusions).
- Tax note: Trusts face a 21-year deemed disposition rule (gains taxed at top rates, up to approximately 53.53 percent in Ontario for 2025); plan distributions before then to defer taxes.
- **Cost Breakdown:** Legal drafting of trust deed: \$1,500–\$5,000; Tax advisory for setup: \$500–\$1,500; CRA registration and initial filings: \$500–\$1,000; Total for trust: \$1,500–\$10,000.

#### 4. Execute the Estate Freeze on the Holding Company (1 to 2 Months):

- Amend the holding company's articles to create "freeze" preferred shares: Non-participating, redeemable and retractable at current fair market value, with voting rights and dividend entitlements for the owner.
- Exchange the owner's common shares in the holding company for these preferred shares using Section 86 (share-for-share exchange) or Section 85 rollover. Elect at adjusted cost base to defer immediate capital gains taxes (no tax triggered now).
- Issue new "growth" common shares (nominal value, for example, \$1 each) to the family trust. Future portfolio growth (for example, property appreciation, rental profits) accrues to these shares.
- Result: Owner's capital gains taxes are capped at the frozen fair market value (taxed only on future disposition, for example, death or redemption). Growth is taxed to beneficiaries at potentially lower rates or deferred.
- **Cost Breakdown:** Corporate amendments and share exchanges: \$2,000–\$5,000; Section 85/86 filings and elections: \$2,000–\$5,000; Valuations for freeze value: \$3,000–\$10,000; Total for freeze: \$5,000–\$15,000.

#### 5. Post-Freeze Management and Succession (Ongoing):

- **Control and Income:** Owner retains control via voting preferred shares or trusteeship. Draw tax-efficient income via dividends on preferred shares or salary if active.
- **Gradual Transfer:** Redeem preferred shares over time (for example, "wasting freeze") to extract value tax-efficiently, using a 10-year capital gains tax reserve for intergenerational transfers. Gift or sell growth shares to children, claiming the Lifetime Capital Gains Exemption if qualified. For sales, leverage the intergenerational business transfer rules (amended from Bill C-208, effective January 1, 2024): Sell shares to a corporation controlled by adult children (or grandchildren/nieces/nephews) without anti-surplus stripping rules applying, allowing capital gains treatment and Lifetime Capital Gains Exemption access. Choose between Immediate (transfer legal control immediately, relinquish management within 36-60 months, no economic interest after 10 years) or Gradual (transfer over 5-10 years with ongoing mentoring). File Form T2066 to elect. This requires the business to be a qualified small business corporation, genuine transfer (no reacquisition), and joint election. This is particularly useful for the student rental portfolio if purified to active status.
- **At Death:** Deemed disposition of preferred shares at fair market value (capital gains taxes on frozen gain: fair market value minus adjusted cost base). Growth shares in trust avoid this. Use corporate-owned life insurance (proceeds tax-free via capital dividend account) to fund taxes—place in holding company for efficiency.
- **Flexibility Options:** If value drops, "refreeze" at lower fair market value. If needed, "thaw" by converting shares back (may trigger gains).

- **Ontario-Specific Probate Fee Strategies:** Ontario probate fees are 1.5 percent on estate assets over \$50,000. To minimize: (1) Use multiple wills—one "primary" will for non-corporate assets (probated) and a "secondary" will for corporate shares (non-probated, as shares pass via corporate mechanisms); (2) Hold growth shares in the family trust, which bypasses the estate entirely, avoiding probate on those assets; (3) Transfer shares (not properties) to avoid land transfer tax. For example, on \$5 million in trust-held shares, this avoids approximately \$75,000 in probate fees.
- **21-Year Rule Mitigation:** The 21-year deemed disposition triggers capital gains on unrealized gains (for example, growth shares' fair market value minus nominal adjusted cost base, taxed at up to 35.67 percent effective rate for gains over \$250,000). To minimize: (1) Tax-deferred rollout: Distribute growth shares to Canadian-resident beneficiaries (section 107(2)) before year 21 (e.g., years 19-20) at adjusted cost base, deferring taxes until they sell; (2) Wind up the trust: Dissolve before year 21, distributing assets tax-deferred; (3) Leverage Lifetime Capital Gains Exemption: Purify for qualified small business corporation status (e.g., employ >5 staff, maintain 24 months prior), allocate gains to beneficiaries for \$1.25 million exemption each; (4) Trigger partial gains early: Redeem/sell portions incrementally using lower brackets or capital dividend account; (5) Extend trust life: Transfer to a new trust (section 107(2)) to reset the clock; (6) Spousal rollover: If spouse is beneficiary, roll shares to them (section 73(1)) deferring to their death. Plan by years 15-18; costs \$5,000-\$15,000 for rollout/wind-up.
  - **Detailed Example:** A couple in Ontario establishes a family trust in 2005, holding growth shares (adjusted cost base \$1) of a Canadian-Controlled Private Corporation with \$5 million in rental properties (adjusted cost base \$2 million) post-estate freeze. By 2026 (21st year), properties are worth \$10 million, and growth shares' fair market value is \$5 million. Deemed gain: \$5 million – \$1 = approximately \$5 million. Taxable gain (66.67 percent) = \$3.33 million. Tax at 53.53 percent = approximately \$1.78 million (assuming no Lifetime Capital Gains Exemption). With Lifetime Capital Gains Exemption (if qualified small business corporation-qualified): Allocate \$1.25 million to each of four beneficiaries (parents, two kids), sheltering \$5 million—no tax owed, saving \$1.78 million. Mitigation (rollout): In 2024, roll out shares to children at \$1 adjusted cost base—no tax in trust; children's future sale triggers capital gains taxes, potentially using Lifetime Capital Gains Exemption. Probate: Trust avoids 1.5 percent Ontario probate (approximately \$75,000 on \$5 million), regardless of 21-year rule.
- **Cost Breakdown:** Annual compliance (T2/T3 filings, accounting): \$2,000–\$5,000 per year; Gradual transfers/intergenerational elections (Form T2066): \$1,000–\$3,000 per transaction; 21-year mitigation (rollout/wind-up): \$5,000–\$15,000; Life insurance setup: \$1,000–\$5,000 (plus premiums); Refreeze/thaw if needed: \$2,000–\$5,000.

## Tax Efficiency Breakdown

Aspect	Strategy	Benefit
<b>Immediate Transfer</b>	Section 85/86 rollovers	Defers 100% of gains until disposition.
<b>Future Growth</b>	Shifted to trust/beneficiaries	Taxes at lower rates; defers owner's liability.
<b>Lifetime Capital Gains Exemption</b>	Purification; >5 employees	Up to \$1.25M exemption per beneficiary if qualified.
<b>Death Taxes</b>	Freeze caps; life insurance	Limits to frozen amount; insurance funds via tax-free dividends.
<b>Income Splitting</b>	Trust distributions	Reduces family tax; avoids Tax on Split Income with involvement.
<b>21-Year Trust Rule</b>	Distributions/wind-ups/Lifetime Capital Gains Exemption	Defers/eliminates deemed gains via allocations.
<b>Intergenerational Transfers</b>	Amended Bill C-208 (section 84.1)	Capital gains treatment and Lifetime Capital Gains Exemption on family sales.
<b>Attribution/Tax on Split Income</b>	Irrevocable trust; exclusions	Prevents attribution; ensures compliance.

**Estimated Tax Savings:** Without planning, full capital gains taxes at death (e.g., 33% effective on gains >\$250,000). With structure, defer 50-80% of future gains; Lifetime Capital Gains Exemption saves up to \$312,500 per beneficiary. For \$5M gain example, save ~\$1.78M if sheltered.

### Potential Risks and Alternatives

- **Risks:** Canada Revenue Agency valuation challenges (use adjustments); Tax on Split Income on dividends (mitigate with involvement); 21-year trust tax (plan early, by years 15-18); if rentals passive, no Lifetime Capital Gains Exemption; purification costs (\$10,000 to \$50,000); intergenerational transfer scrutiny (must be genuine, or rules don't apply).
- **Alternatives if Freeze Not Ideal:**
  - **Spousal Rollover:** Transfer to spouse first (tax-free under section 73(1)), then to children.
  - **Gradual Gifting:** Gift shares annually, but triggers immediate capital gains taxes (use reserve).
  - **Sale to Family Corporation:** Use amended intergenerational business transfer rules for the Lifetime Capital Gains Exemption on sales, with Immediate or Gradual options.
  - **No Corporation Structure:** If de-incorporating, transfer properties personally (triggers gains, but possible principal residence exemption if applicable—unlikely for rentals).