Ministry of Small Business and Revenue

BRITISH COLUMBIA

Bulletin SST 092

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Transfer of Business Assets Between Closely Related Parties

Social Service Tax Act

Sections 3.14 to 3.14.3 of the regulations to the *Social Service Tax Act* provide an exemption from tax on transfers of tangible personal property between parent and subsidiary corporations where specific conditions are met. They also allow for the continuity of business through a change in the organizational structure, such as the incorporation of a proprietorship, without attracting a social service tax liability.

The regulations do not provide an exemption on transfers of tangible personal property among two or more partnerships, among corporations that are related only by common shareholders, or among unrelated corporations.

This bulletin outlines conditions under which transfers of tax-paid assets between related business entities may be made without payment of tax. The bulletin is intended as a general guide and is not a substitute for the legislation.

The information in this bulletin is provided for your convenience and guidance and is not a replacement for the legislation. The *Social Service Tax Act* and Regulations can be found on the web at **www.gov.bc.ca/sbr**

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DEFINITIONS

For the purposes of this bulletin, the following definitions apply.

Beneficial Ownership

The ability to exercise any or all of the rights and privileges inherent in the ownership of shares.

Business Assets

Tangible personal property as defined in the *Social Service Tax Act*.

Parent Corporation

A corporation that beneficially owns at least 95% of the outstanding shares of each class of share capital of its subsidiary corporation.

Tax-Paid Assets

Business assets on which social service tax was paid when initially purchased, or which were acquired prior to the enactment of the *Social Service Tax Act* in June 1948, or which, with the exception of the barrier to exemption under section 3.14.2 of the regulations, were not subject to tax

under the Act at the time they were acquired. This includes assets previously acquired exempt under section 3.14 provided all other criteria for exemption were met at the time of acquisition. It **does not** include assets acquired by the seller through self-manufacture.

Barrier to Exemption

Under section 3.14.2, "Barrier to Exemption", assets initially acquired without payment of tax because they were purchased for a specific use which qualified for exemption, cannot be subsequently transferred exempt unless the transferee also qualifies for that specific exemption. For example, a company that qualifies for exemption as a bona fide farmer cannot transfer exempt farm equipment to a subsidiary company that does not also qualify as a bona fide farmer.

Similarly, goods initially purchased without payment of tax because they were acquired for sale or lease cannot be subsequently transferred exempt, unless the transferee also acquires them for sale or lease.

Related Corporation

A corporation associated with another corporation because that other corporation is:

- its parent corporation, or
- its wholly-owned subsidiary, or
- another wholly-owned subsidiary of the same parent corporation.

Wholly-Owned Subsidiary

A corporation where at least 95% of the outstanding shares of each class of its share capital are beneficially owned by another corporation referred to as its parent corporation.

Transfers Among Parent Corporations and Wholly-Owned Subsidiaries

Exemption

Sections 3.14(2) and 3.14(3) of the regulations provide an exemption on the transfer, by sale or lease, of tax-paid business assets from a:

- parent corporation to its wholly-owned subsidiary corporation, or
- wholly-owned subsidiary corporation to its parent corporation, or
- wholly-owned subsidiary corporation to another wholly-owned subsidiary of the same parent corporation.

Sections 2.47(b) and 8.7 of the regulations provide an exemption from tax on purchases of taxable services and of legal services where a corporation purchases these services from a related corporation as defined in section 3.14 of the regulations.

Eligibility Criteria

To qualify for the exemption, the following criteria must be met.

- The business assets being transferred qualify as tax-paid assets by a related corporation.
- Where the transfer is by way of a purchase, the relationship between the corporations must be maintained for a period of at least eight months after the date of the transfer, except in the case of a wind-up or dissolution of a company (see pages 4–5 "Transfers on Wind-up or Dissolution").
- Where the transfer is by way of a lease, no tax is payable on lease payments as long as the relationship between the corporations is maintained. If the relationship between the corporations ceases, tax becomes payable by the lessee on all lease payments subsequent to the cessation of the relationship.

Examples of Exempt Transfers

Examples of exempt transfers between parent and subsidiary corporations are illustrated below. In these figures, the lettered boxes represent corporations and the arrows indicate the relationship between the corporations.

Example 1: In figure 1, A is a parent corporation; B and C are wholly-owned subsidiaries of A. Business assets may be transferred between A, B, and C without attracting tax, provided the business assets are tax paid by either A, B, or C.

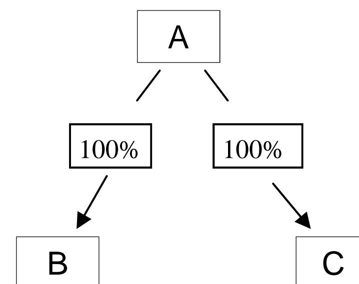


Figure 1

Tax-paid assets may be transferred from A to B and the same assets may later be transferred from B to C without attracting tax because B and C are

wholly-owned subsidiaries of the same parent (A) and the business assets were tax paid by A.

Example 2: In figure 2, D is a wholly-owned subsidiary of B, and B and C are wholly-owned subsidiaries of A, the parent corporation. Companies A, B, and C may transfer tax-paid assets freely among themselves without attracting tax. This is the same situation as in example 1.

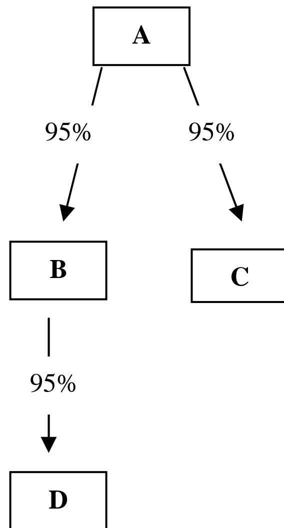


Figure 2

Tax-paid assets may be transferred between A and D without payment of tax because A wholly owns and controls B, the parent corporation of D.

D can transfer tax-paid assets received from A to B because B is D's parent and tax was paid on the assets by A, a related corporation to B.

B can transfer tax-paid assets received from D to C because B and C are wholly-owned subsidiaries of the same parent and tax was paid on the assets by D, a related corporation to B.

D can transfer directly to C because A controls D through B, its wholly owned subsidiary, and C is also a wholly-owned subsidiary of A.

Example 3: In figure 3, Company A, B, and C or B, D, and E may transfer tax-paid assets without payment of tax. Tax -paid assets may be transferred among A, B, C, D, E, F, and H without payment of tax because of the unbroken chain of at least 95% ownership between each of the corporations. This is the same situation as outlined in example 2.

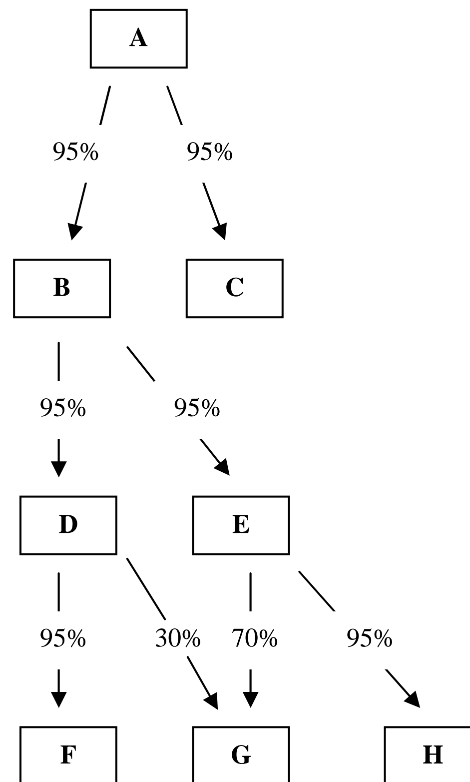


Figure 3

A or B can transfer to G because B wholly owns G through D and E and A wholly owns B. Similarly, G can transfer to A or B.

G can also transfer exempt to D, E, F, and H because G is 95% wholly-owned by B through D and E, and F and H are subsidiaries of D and E, respectively.

G can also transfer exempt to C because A wholly owns G through B, and C is another wholly-owned subsidiary of A.

95% Ownership

To qualify for exemption in the above examples, it is essential that a relationship of at least 95% beneficial ownership can be traced through a chain of parent/ subsidiary relationships and that the assets qualify as tax-paid by a related corporation.

Transfers of Assets Acquired From a Company That is No Longer Related

Relationship Between Companies Ceases

Where an asset is initially acquired exempt from tax under section 3.14 of the regulations and, at least eight months following the transfer, the relationship between the companies ceases, the asset retains its tax-paid status on future transfers under section 3.14 of the regulations.

Example:
Company A pays tax on its purchase of equipment and subsequently transfers the equipment exempt to its wholly-owned subsidiary, Company B. The parent/subsidiary relationship between A and B is maintained for a period of at least eight months. The shares of Company B are then sold by Company A to unrelated Company C. Company B then transfers the equipment to Company C, which is now its parent.

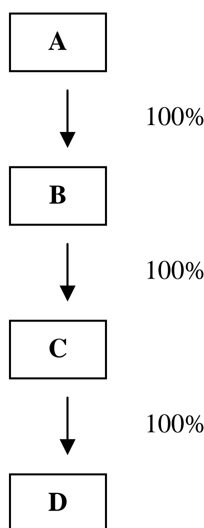
The transfer from Company B to Company C qualifies for exemption under section 3.14(2) (b) of the regulations because no tax was payable by B at the time it acquired the equipment. However, for this exemption to apply, the relationship between A and B had to be maintained for at least eight months after the initial transfer. Furthermore, the relationship between B and C must be retained for a period of at least eight months after the subsequent transfer.

Change in How Companies are Related Within Eight Months

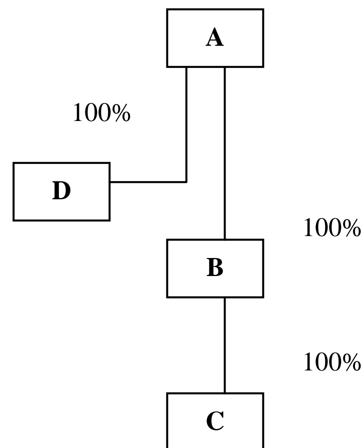
Where there is a sale of company ownership among related corporations, the transfer of tax-paid assets is eligible for exemption as long as the seller and purchaser always remain related corporations, as defined in the regulation, throughout the eight-month period.

Example

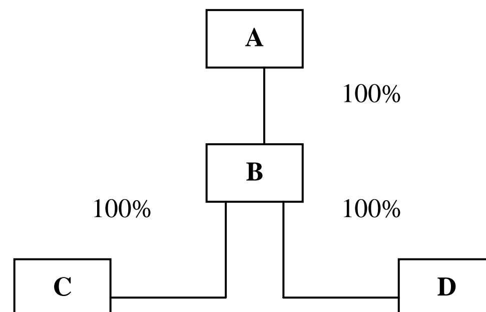
Step 1: C transferred tax-paid assets to D. At the time of transfer, C and D qualified as related companies as follows.



Step 2: Before eight months passed, C sold its shares in D to A. Under the resulting structure, C and D remained related corporations for the purposes of section 3.14.



Step 3: A then sold its shares in D to B. This sale also occurred within eight months after the transfer of tax-paid assets from C to D. Under the resulting structure, C and D remained related corporations.



In this situation, the transfer of tax-paid assets from C to D under step 1 retains its exempt status.

Transfers on Wind-up or Dissolution

Where a corporation is to be wound up or dissolved, it may transfer its tax-paid assets to a related corporation exempt of tax provided the transfer otherwise qualifies for exemption and meets the following conditions

- The seller and the purchaser were related corporations for a period of not less than eight months before the date of purchase.
- At or after the time of the purchase, the seller is dissolved or wound up under the *Business Corporations Act,* the *Canada Business Corporations Act* (Canada), the *Bank Act* (Canada), or the *Winding-up and Restructuring Act* (Canada).
- The seller and the purchaser remain related corporations until such time as the seller is dissolved or wound up.

If these criteria are met, it is not necessary for the companies to remain related for eight months after the transfer.

Example:
Subsidiary B transfers assets to its parent company A. B is subsequently wound-up, and the same assets are transferred by A to another wholly owned subsidiary C. The transfer between A and C is exempt if B and A were related until B's winding-up and the relationship between A and C is maintained for a period of at least eight months following the transfer from A to C.

Transfer of Assets to New Companies Wholly-Owned and Controlled by the Transferors

Exemption

Section 3.14.1(2) of the regulations provides exemption from tax on the transfer of tax-paid business assets when a new company is incorporated by a person, partnership, or corporation that wholly owns and controls the new corporation and the intention is to have the same principals operate the business. Wholly owns and controls means that the transferor beneficially owns at least 95% of the outstanding shares of each class of the share capital of the new company.

Eligibility Criteria

To qualify for exemption, the following conditions must be met.

- The person(s), partnership, or corporation incorporating the new company wholly owns and controls it.
- The business assets being transferred qualify as tax-paid assets by the transferor.
- The transferor continues to wholly own and control the new corporation for a period of at least eight months after the date of the transfer.
- The business assets being transferred are available to the newly incorporated company on the first day that it commences to carry on business – for example, by marketing, manufacturing, or producing products, or providing services.

Examples of Exempt Transfers

Following are examples illustrating situations in which tax-paid business assets may be transferred exempt, provided the above conditions are met.

Example 4: In figure 4, A is a proprietorship and incorporates A Ltd., which it wholly owns and controls.

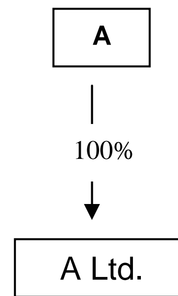


Figure 4

A may transfer tax-paid assets to A Ltd. without payment of tax provided all other conditions for exemption are met.

Example 5: In figure 5, A, B, and C are in partnership. They incorporate ABC Ltd., which they wholly own and control.

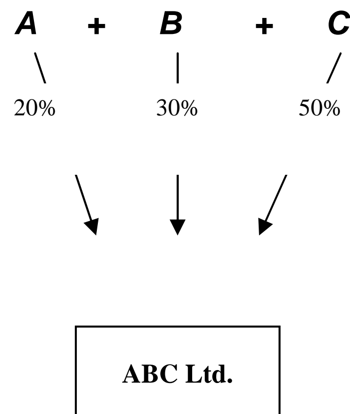


Figure 5

A + B + C may transfer their tax-paid assets to ABC Ltd. without payment of tax, provided all other conditions for exemption are met.

When the Transfer of Assets Qualifies for Exemption

Transfers of assets under this section will qualify for exemption when the accounting entries are recorded in the company's books of account after the company has begun its intended business, provided that the effective date of the transfer is no later than the date when the firm first commenced to carry on business, for example, by marketing, manufacturing, or producing products, or providing services. Transfers of assets after the date the corporation began carrying on business, for

example, where the assets could not effectively be transferred by that date because the transferor continued to use the assets, would not qualify for exemption under section 3.14.1 of the regulations.

For the purposes of section 3.14.1 of the regulations, activities such as arranging financing for a business or selling share capital will not in themselves be considered carrying on a business.

Transfers of Assets to a New Company the Transferor does not Wholly Own or Control

Criteria for Exemption

Section 3.14.1(3) and (4) of the regulations exempt transfers of business assets from a person(s), partnership, or corporation to a new corporation, which the transferor does not wholly own or control, provided that ALL the following criteria are met.

- The business assets being transferred qualify as tax-paid assets.
- The transferor receives shares of the purchasing corporation equal in value to the tax-paid assets transferred.
- The transfer of tax-paid assets to the purchasing corporation is concurrent with the transfer of shares to the transferor.
- The transfer takes place no later than the first day the new company commences business, for example, by marketing, manufacturing or producing products, or providing services.
- The transferor retains all the shares accepted as payment for a period of at least eight months after the date of their issue or transfer.

Example of An Exempt Transfer

An example of an exempt transfer is as follows.

- A, a proprietorship, wishes to incorporate its business and bring B into the new company to form AB Ltd.
- Proprietor A transfers $50,000 in tax-paid assets to AB Ltd. and receives $50,000 in shares of AB Ltd. in return.
- B transfers $30,000 in tax-paid assets to AB Ltd. and receives $30,000 in shares of AB Ltd. in return.
- A and B receive shares equal in value to the tax-paid assets which they each transferred to AB Ltd., therefore no tax is due.

In this example, if either A or B received share capital of lower value than the value of the assets transferred, then tax would be payable by AB Ltd. on the difference in value.

Application of the Tax to Other Transfers

Amalgamation

When companies amalgamate through a formal amalgamation in accordance with the *Business Corporations Act* (British Columbia) or under similar provisions of an enactment of Canada or of another province, the transfer of assets to the newly amalgamated company is not considered to be a sale of tangible personal property. Therefore, social service tax does not apply to the transaction.

Where tax was previously paid on the assets by either of the parties to the amalgamation, or if the assets were acquired by either party prior to June 1948, or were acquired during a period when they were not subject to tax under the legislation, the assets will be considered tax-paid by the amalgamated company. This is important for future transfers to wholly-owned subsidiaries or further amalgamations.

Where the amalgamation involves two wholly-owned subsidiaries of the same parent corporation, any assets either subsidiary acquired exempt under section 3.14 of the regulations from the parent corporation retain their exempt status on amalgamation if the amalgamated company remains a wholly-owned subsidiary of the same parent. This applies even if the amalgamation occurs within eight months of the transfer of assets. However, if the parent/subsidiary relationship ends within eight months of the transfer, the amalgamated company is liable for tax on any assets received exempt from the parent within the eight-month period.

Where amalgamating companies are wholly-owned subsidiaries of different parent corporations, any assets received exempt under section 3.14 of the regulations from the respective parent corporations at least eight months prior to the amalgamation will retain their exempt status upon amalgamation. The amalgamating companies are liable for tax on any assets received exempt from the respective parent corporations within eight months prior to the date of amalgamation.

An amalgamation procedure does not absolve the parties to the amalgamation from any tax liability incurred prior to the amalgamation.

Partnerships

With the exception of transfers to a new corporation as described above, transfers among partnerships do not qualify for exemption under section 3.14 of the regulations.

With respect to partnerships, the Consumer Taxation Branch follows the *Seven Mile Dam Contractors* decision of the British Columbia Court of Appeal (1980). That is, each partner in a partnership has a proprietary interest in all of the assets of the partnership.

The application of social service tax is based on each partner individually owning a pro-rata share of the partnership's assets in relation to the equity interest in the partnership. Thus, a transfer of assets to a partnership is, in effect, a transfer to each partner.

Other Transfers

Transfers of business assets as part of a winding-up, dissolution, or liquidation of a business, as a dividend in kind, or as a return of capital are subject to social service tax. For further information on such transactions, please refer to **Bulletin SST 091**, *Transfers of Business Assets as Part of a Winding Up, as a Dividend in Kind, or as a Return of Capital.*

NEED MORE INFO?

This bulletin is provided for convenience and guidance. If you still have questions call us at 604 660-4524 in Vancouver or toll-free at 1 877 388-4440 elsewhere in Canada or refer to the legislation.

Information is also on the web at www.gov.bc.ca/sbr While there, you can subscribe to our free electronic update service.

References: *Social Service Tax Act,* Regulations 3.14, 3.14.1, 3.14.2 and 3.14.3