

Income Tax

IMP. 521.2-1/R1 **Disposition of Property to a Taxable Canadian Corporation: General Rules
Concerning Tax-Deferred Transfers**

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Reference(s): *Taxation Act* (CQLR, c. I-3), sections 1, 41.0.1, 93.3.1, 99, 105, 107, 130.1, 194,
238, 518 to 533, 570 and 614
Regulation respecting the Taxation Act (CQLR, c. I-3, r. 1), sections 99R1, 570R1
and 1027R9

This version of interpretation bulletin IMP. 521.2-1 supersedes that of July 31, 2001. The text was completely reworked and now incorporates bulletin IMP. 518-3.

This bulletin presents Revenu Québec's interpretation of the rules provided for in sections 518 to 533 of the *Taxation Act* (TA), hereinafter the "rules for tax-deferred transfers," in respect of a disposition of property made after March 25, 1997, to which section 518 of the TA applies.

GENERAL

1. The rules provided for in sections 518 to 533 of the TA allow a taxpayer¹ (hereinafter the "Transferor") to defer or limit tax at the time of the transfer of property to a taxable Canadian corporation² (hereinafter the "Corporation").
2. Section 518 of the TA provides that the rules for tax-deferred transfers apply where a Transferor disposes of any of the Transferor's property to a Corporation for consideration that includes a share of the capital stock of the Corporation and where a valid election is made for the purposes of subsection 85(1) of the ITA. These rules generally provide that an election made for the purposes of the ITA is deemed to have been made for the purposes of the TA. Conversely, where no valid election is made for the purposes of federal legislation, no election can be made for the purposes

¹ This interpretation bulletin also applies, with the necessary adjustments, to partnerships that make a valid election for the purposes of subsection 85(2) of the *Income Tax Act* (R.S.C., 1985, c. 1 (5th Supp.)) (ITA) in respect of a disposition of property to a taxable Canadian corporation for consideration that includes a share of the capital stock of the corporation, in accordance with section 529 of the TA.

² This bulletin also applies, with the necessary adjustments provided for in the second paragraph of section 614 of the TA, to a Canadian partnership that acquires from a taxpayer (the Transferor) a property referred to in that paragraph. The Transferor and all the members of the partnership must make a valid election in order for the provisions of subsection 97(2) of the ITA to apply in respect of the acquisition of the property.

of the TA.³ The same principle applies in the case of a late or an amended election made under subsection 85(7) or subsection 85(7.1) of the ITA for federal income tax purposes.

APPLICABILITY CONDITIONS

3. The following conditions must be met for the Transferor and the Corporation to benefit from the rules for tax-deferred transfers.

Conditions relating to the Transferor and the Corporation

4. The Transferor must be a taxpayer within the meaning of section 1 of the TA, that is, any person whether or not liable to pay tax. That section also provides that the term “person” includes any corporation and any entity exempt from tax under Part I of the TA, and the legal representatives of such a person, according to the law of that part of Canada to which the context extends.

5. The Corporation must be a “taxable Canadian corporation” within the meaning of section 1 of the TA (which refers to paragraph (m) of section 570 of the TA), that is, a corporation that, at the time of disposition, is a Canadian corporation that is not, by virtue of a statutory provision, exempt from tax under Part I of the TA.

Conditions regarding the consideration received by the Transferor

6. The Transferor must receive at least one share⁴ or fraction of a share of the capital stock of the Corporation as consideration for the property disposed of. The Transferor may therefore receive one or more shares or a combination of shares and any other type of property. Where more than one property is transferred by the Transferor to the Corporation, the Transferor needs to receive only one share of the capital stock of the Corporation for the election to be valid.

Documentary requirements

7. The Transferor must send Revenu Québec a duly completed copy of the prescribed form (form TP-518-V), along with a copy of any document sent to the Canada Revenue Agency in respect of the election made for federal purposes, within a specified period and separately from any other fiscal return. Failure to comply with these requirements does not preclude the application of the rules for tax-deferred transfers where a valid election was made under subsection 85(1) of the ITA. However, failure to send the required documents to Revenu Québec within the period provided for under section 520.1 of the TA may give rise to penalties (see the current version of interpretation bulletin IMP. 520.1-1).

³ See the exception mentioned in point 15.

⁴ Under section 1 of the TA, a “share” means a share or a fraction of a share of the capital stock of a corporation and includes, for the purposes of all the rules for tax-deferred transfers, a share or fraction of a share of the capital of a prescribed cooperative or of a savings and credit union.

PROCEEDS OF DISPOSITION AND COST OF THE PROPERTY TRANSFERRED

General rule

8. As a rule, where the Transferor and the Corporation have made a valid election under subsection 85(1) of the ITA in respect of the disposition of property, section 521.2 of the TA provides that the Transferor's proceeds of disposition of the property and the cost to the Corporation of the property are deemed to be equal to such amount as is established in respect of the property under the ITA. However, for the purposes of paragraphs (b) and (c) of section 528 of the TA (rules establishing the cost of the shares received as consideration), the proceeds of disposition of the property are deemed to be equal to the amount established under subsection 85(1) of the ITA without reference to paragraph 85(1)(e.2). Paragraph 85(1)(e.2) applies where a Transferor transfers property to a Corporation under subsection 85(1) of the ITA and the fair market value of the property transferred to the Corporation exceeds the greater of the fair market value of the entire consideration (including the shares of the Corporation) received by the Transferor and the amount agreed on, and where it is reasonable to regard any part of the excess as a benefit that the Transferor desired to have conferred on a person related to the Transferor. The rules provided for under paragraph 85(1)(e.2) have for effect to increase the amount of the benefit otherwise agreed on.

9. As regards the disposition of property, the amount agreed on for federal income tax purposes, as established according to the upper limit and the lower limits provided for under subsection 85(1) of the ITA, constitutes the Transferor's proceeds of disposition of the property and the Corporation's cost of the property for the purposes of the TA. As a result, for the purposes of the TA, the Transferor may realize income or incur a loss that is greater than that realized or incurred for the purposes of the ITA.

Example

10. A Transferor disposed of the Transferor's sole class 10 depreciable property to a Corporation for consideration composed exclusively of shares of the Corporation's capital stock. The property had been acquired for \$10,000 and at the time of disposition its fair market value was \$2,500. Immediately before its disposition the undepreciated capital cost (UCC) of the property determined under subsection 13(21) of the ITA was \$2,040 and the undepreciated capital cost (UCC) of the property for the purposes of paragraph (e) of section 93 of the TA was \$4,000. A valid election in respect of the disposition of the depreciable property was made under subsection 85(1) of the ITA for federal income tax purposes and the amount agreed on was \$2,040, which corresponds to the amount of the UCC determined under the ITA. The Transferor's proceeds of disposition of the property and the cost to the Corporation of the property were determined as follows:

Amount agreed on for federal income tax purposes (pars. 85(1)(a), (b), (c), (e) and (e.3) ITA)	\$2,040
Transferor's proceeds of disposition and cost to the Corporation (s. 521.2 TA)	\$2,040

11. By reason of the agreed-on amount set at \$2,040, the Transferor did not, for the purposes of the ITA, realize any capital gain or recover any capital cost allowance, nor did the Transferor incur a terminal loss as a result of the proceeds of disposition that were determined to be \$2,040 for federal purposes.

12. However, for the purposes of the TA, the Transferor incurred, pursuant to the second paragraph of section 130.1 of the TA, a terminal loss of \$1,960 as shown in the following calculation:

UCC		\$4,000
minus the lower of the following amounts:		
• capital cost	\$10,000	
• net proceeds of disposition	\$2,040	– \$2,040
Terminal loss		\$1,960

13. Where depreciable property is transferred to an affiliated person, the rules provided for under sections 518 to 533 of the TA no longer apply in respect of the disposition and any loss recognized in respect of the disposition is carried over until the occurrence of the earliest of the events indicated in subparagraph (iii) of subparagraph (b) of the second paragraph of section 93.3.1 of the TA (see point 29 below).

SITUATIONS WHERE AN AMOUNT AGREED ON FOR QUÉBEC INCOME TAX PURPOSES MAY DIFFER FROM THE AMOUNT AGREED ON FOR FEDERAL INCOME TAX PURPOSES

14. The proceeds of disposition of a property and its cost as agreed on for Québec income tax purposes may differ from the amount so established for federal income tax purposes where the parties to the transfer agree on an amount in respect of the property under section 522 of the TA and meet the conditions given in the second paragraph of that section (more specifically, the proportion of business carried on in Québec by each party to the transfer must be at least 90% for the year of the transfer; furthermore, if an individual is involved, that individual must also be resident in Québec at the end of the individual's taxation year in which the disposition is made (see the current version of interpretation bulletin IMP. 522-1)). The amount thus agreed on is deemed to be the Transferor's proceeds of disposition of the property and the cost to the Corporation of the property, in accordance with subparagraph (a) of the first paragraph of section 522 of the TA.

15. Where the parties are unable to make the election provided for under subparagraph 85(1) of the ITA because certain rules provided for under subsection 13(21.2) of the ITA apply that preclude a loss from being incurred in respect of a transfer of depreciable property between affiliated persons, those persons may, under certain conditions, make an election to make a tax-deferred transfer in respect of the depreciable property for the purposes of the TA (see the current version of interpretation bulletin IMP. 522-1).

COST OF THE CONSIDERATION THE TRANSFEROR RECEIVES FROM THE CORPORATION

16. A Transferor that disposes of property to a Corporation and that makes the election referred to in section 518 of the TA may receive as consideration preferred shares and common shares, as well as property other than shares or rights to receive shares. Paragraphs (a), (b) and (c) of section 528 of the TA specify the rules used to determine the tax cost of each property the Transferor receives as consideration.

Property other than shares

17. Under paragraph (a) of section 528 of the TA, the cost of property received, other than a share of the capital stock of the Corporation or a right to receive such a share, is deemed to be equal to the lesser of the two following amounts:

- the fair market value (FMV) of the particular property received by the Transferor;
- the FMV of the property disposed of by the Transferor; if two or more properties other than shares of the capital stock of the Corporation are received as consideration for the property disposed of, that amount is equal to the product obtained by multiplying the FMV of the property disposed of by the proportion that the FMV of the particular property received is of the FMV of all the properties received, other than shares of the capital stock of the corporation.

Preferred shares⁵

18. Under paragraph (b) of section 528 of the TA, the cost of a preferred share of a given class of the capital stock of the Corporation that is received by the Transferor is deemed to be equal to the lesser of the two following amounts:

- the FMV of the preferred share immediately after the disposition;
- the proportion of the excess of the proceeds of disposition (amount agreed on at the federal level or amount agreed on under section 522 of the TA, as the case may be) of the property over the FMV of any non-share consideration received, that the FMV, immediately after the disposition, of that preferred share of that class is, at the same time, of all the preferred shares of the capital stock of the Corporation that the Transferor receives or has a right to receive as consideration for such disposition.

Common shares⁶

19. Under paragraph (c) of section 528 of the TA, the cost of a common share received by the Transferor corresponds to the excess of the proceeds of disposition described in point 18 over the aggregate of the FMV of any non-share consideration (see point 17 above) and the cost

⁵ Under section 1 of the TA, the term “preferred share” means a share other than a common share.

⁶ Under section 1 of the TA, the term “common share” means a share the holder of which is not precluded, upon the reduction or redemption of the capital stock, from participating in the assets of the corporation beyond the amount then paid for that share plus a fixed premium and a defined rate of dividend.

attributable to preferred shares (see point 18 above) that the Transferor received for that disposition.

Paid-up capital of the shares received

20. Under paragraph (a) of section 570 of the TA and section 570R1 of the *Regulation respecting the Taxation Act* (RTA), the paid-up capital in respect of the shares of the capital-stock of a Corporation means an amount equal to the amount so determined in respect of those shares for the same purposes under the ITA. Where subsection 85(1) of the ITA applies to a disposition of property to a Corporation (other than a disposition of property to which section 84.1 or 212.1 of the ITA applies) subsection 85(2.1) of the ITA provides for an adjustment to the paid-up capital of the shares the Corporation issued to the Transferor.

SPECIFIC RULES

Order of disposition of property

21. Section 525 of the TA provides that where two or more incorporeal capital properties or depreciable properties are disposed of at the same time as part of a tax-deferred transfer, each of those properties is deemed to have been separately disposed of, in the order designated by the Transferor in the prescribed form (form TP-518-V) or, if the Transferor does not so designate any such order, in the order designated by the Minister.

Property that is part of farm inventory

22. Specific rules, set out in section 524.1 of the TA, apply where the Transferor carries on a farming business and uses the cash method of accounting. These rules apply for purposes of computing the income from that business of the Transferor, where the property subject to a tax-deferred transfer is property that was inventory owned by the Transferor in connection with that business immediately before the time the property was disposed of.

Subsequent disposition of incorporeal capital property by the Corporation

23. Where incorporeal capital property in respect of the Transferor's business was disposed of by the Transferor to a Corporation and the election referred to in section 518 of the TA was made in respect of the property, for the purpose of determining, after the time of the disposition, the amount to be included under paragraph (b) of section 105 of the TA in computing the income of the Corporation, the Corporation must add the amount determined by the formula provided for under section 524.0.1 of the TA to the amount otherwise determined under subparagraph (ii) of paragraph (a) of the second paragraph of section 107 of the TA. The purpose of this rule is to take into account the change in the inclusion rate in respect of income and expenses, which has increased from $\frac{1}{2}$ to $\frac{3}{4}$, and to prevent the overestimation of the amount to be included in computing the income of the Corporation under paragraph (b) of section 105 of the TA.

Passenger vehicle the cost of which exceeds \$20,000 or any other prescribed amount

24. Under the first paragraph of section 525.1 of the TA, where property of the Transferor in respect of the disposition of which section 518 of the TA applies is depreciable property of a prescribed class that is a passenger vehicle the cost to the Transferor of which exceeds \$20,000 or such other amount as may be prescribed for the purposes of paragraph (d.3) of section 99 of the TA, as the case may be, and the Transferor and the Corporation to which the property is disposed of do not deal with each other at arm's length, the amount referred to in section 521.2 of the TA in respect of the property, or, where section 522 of the TA applies thereto, the amount agreed on in respect of the property in the prescribed form, is deemed to be equal to the undepreciated capital cost to the Transferor of the class immediately before the disposition minus, where applicable, the amount deducted by the Transferor under paragraph (a) of section 130 of the TA, in respect of the passenger vehicle in computing the Transferor's income for the taxation year in which the passenger vehicle was disposed of by the Transferor.

25. The second paragraph of section 525.1 of the TA stipulates that, for the purposes of section 41.0.1 of the TA, the cost to the Corporation of the passenger vehicle is deemed to be an amount equal to its fair market value immediately before the disposition.

26. Section 99R1 of the RTA prescribes the following amounts for the purposes of paragraph (d.3) of section 99 of the TA:

- a) for a passenger vehicle acquired after August 1989 and before 1991, \$24,000;
- b) for a passenger vehicle acquired after 1990, the amount determined by the formula

$$A + B,$$

in which

A is

- \$24,000 if the passenger vehicle was acquired before 1997,
- \$25,000 if the passenger vehicle was acquired in 1997,
- \$26,000 if the passenger vehicle was acquired in 1998 or 1999,
- \$27,000 if the passenger vehicle was acquired in 2000,
- \$30,000 if the passenger vehicle was acquired after 2000;

B is the sum that would have been payable in respect of federal and provincial sales taxes on the acquisition of the passenger vehicle if it had been acquired at a cost equal to amount A before taxes at the time of the acquisition.

Exchange of shares and reorganization of capital

27. The rules provided for in the case of an exchange of shares (ss. 536 to 539 TA) or a reorganization of capital (ss. 541 to 543.2 TA) do not apply if the Transferor and the Corporation made the valid election referred to in section 518 of the TA.

Taxable Québec property or taxable Canadian property

28. Section 521 of the TA provides that, where a property that is disposed of is Québec taxable property or Canadian taxable property, a share received as consideration is also deemed to be taxable Québec property or taxable Canadian property, as the case may be.

Tax-deferred transfer impossible to make where section 93.3.1 of the TA applies (depreciable property loss between affiliated persons)

29. Under section 93.3.1 of the TA, sections 518 to 533 of the TA do not apply where a person or partnership disposes, otherwise than in a disposition described in any of paragraphs (a) to (e) of section 238 of the TA, of depreciable property of a prescribed class, and the proceeds of disposition are lower than both the capital cost of the property and a proportional fraction of the UCC of the class to which the property belongs. Where these conditions are met and, 30 days after the disposition, the Transferor, or a person affiliated with the Transferor, owns or has a right to acquire the property, no loss can be recognized in respect of the disposition. Rather, that loss is carried over until the occurrence of the earliest of the events indicated in subparagraph (iii) of subparagraph (b) of the second paragraph of section 93.3.1 of the TA.

30. The amount of the loss constitutes the capital cost of a property, belonging to the same class as the original property, that the Transferor acquired before the taxation year of disposition. The new property is deemed to belong to the Transferor until the occurrence of the earliest of the events listed in subparagraph (iii) of subparagraph (b) of the second paragraph of section 93.3.1 of the TA. Consequently, the Transferor may claim a capital cost allowance after the disposition, in respect of the difference between the tax cost of the property that was disposed of and its proceeds of disposition for the Transferor, otherwise determined. In addition, any part of the difference that is not claimed as capital cost allowance may be recognized as a terminal loss when one of the events listed in subparagraph (iii) of subparagraph (b) of the second paragraph of section 93.3.1 of the TA occurs, on the condition that the Transferor does not have any other property of the same class.

Example

31. A Transferor transferred the sole depreciable property the Transferor owned in a given class to a Corporation that was an affiliated person and received common shares of the Corporation as consideration. A valid election for the purposes of subsection 85(1) of the ITA was made. The cost of the property was \$1,000,000 and its FMV at the time of the transfer was \$800,000. The UCC determined under subsection 13(21) of the ITA was \$300,000, while the UCC determined in accordance with section 93 of the TA was \$500,000. Under federal legislation, the amount agreed on corresponded to the UCC, that is, \$300,000. If an amount were agreed on for the purposes of

section 521.2 of the TA, it would also be equal to that amount, and the Transferor would incur a terminal loss of \$200,000.

32. Section 93.3.1 of the TA applies in this situation and, consequently, the rules provided for under sections 518 to 533 of the TA do not apply in respect of the disposition and any loss recognized in respect of the disposition is carried over to the occurrence of the earliest of the events indicated in subparagraph (iii) of subparagraph (b) of the second paragraph of section 93.3.1 of the TA.

33. Under subparagraph (i) of subparagraph (b) of the second paragraph of section 93.3.1 of the TA, the Transferor is deemed to have disposed of the property for proceeds of disposition equal to the lesser of the cost (\$1,000,000) and the UCC (\$500,000).

34. Furthermore, the Transferor is deemed to own depreciable property the capital cost of which corresponds to the amount by which the lesser of the capital cost of the property to the Transferor (\$1,000,000) and the UCC (\$500,000) of the property exceeds the amount that would otherwise constitute the proceeds of disposition of the property for the Transferor (\$300,000). The Transferor is therefore deemed to own property the capital cost of which is \$200,000.

35. Subparagraph (d) of the second paragraph of section 93.3.1 of the TA provides that the capital cost of the property for the Corporation is deemed to be the Transferor's capital cost of that property and that the amount by which the capital cost (\$1,000,000) for the Transferor exceeds the lesser of the FMV (\$800,000) and the amount that would otherwise be the Transferor's proceeds of disposition of the property (\$300,000) at the time of disposition, that is, \$700,000, is deemed to have been allowed to the Corporation as depreciation.

Assessment by the Minister

36. Despite sections 1010 to 1011 of the TA, the Minister will be required to make any reassessment required for any taxation year to give effect to the tax-differed transfer rules provided for under Divisions I, II and III of Chapter IV of Title IX of Book III of Part I of the TA. The purpose of this rule is to ensure that the Minister can assess the persons concerned for tax, interest and penalties in respect of statute-barred years where, in particular, the election under the ITA is only made once the prescribed time limit is reached in respect of the year of disposition, or such an election is amended after the expiry of that time limit.

Provisional accounts

37. Where a Transferor that is a corporation disposes of all or substantially all of its properties to a Corporation with which it was not dealing at arm's length and section 518 or 529 of the TA applies to the disposition of one of those properties, section 1027R9 of the RTA provides that the basic provisional accounts of the two corporations must be added together for the purpose of computing the provisional accounts of the Corporation.

General anti-avoidance rule

38. The Court of Appeal of Québec, in *OGT Holdings Ltd. c. Québec (Sous-ministre du Revenu)*,⁷ mentions that the spirit of the legislative provisions regarding tax-deferred transfers does not allow a taxpayer to use this tool, which is intended for tax deferral, to avoid paying tax completely. The Court states that to use these rules in order to avoid paying tax is to distort and misrepresent section 518 of the TA and constitutes abusive tax avoidance within the meaning of *Lipson v. Canada*.⁸ The Court upheld the application of the general anti-avoidance rule in respect of a taxpayer who had used tax-deferred transfer rules in this manner.

⁷ 2009 QCCA 191. The application for leave to appeal this decision to the Supreme Court of Canada was dismissed on September 10, 2009.

⁸ 2009, CSC 1.