OFFICE OF THE
PARLIAMENTARY
BUDGET OFFICER

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BUDGET

Cost Estimate for Bill C-274 An Act to amend the Income Tax Act (transfer of small business or family farm or fishing corporation)

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The mandate of the Parliamentary Budget Officer (PBO) is to provide independent analysis to Parliament on the state of the nation's finances, the Government's estimates and trends in the Canadian economy; and, upon request from a committee or parliamentarian, to estimate the financial cost of any proposal for matters over which Parliament has jurisdiction.

The Finance Committee of the House of Commons has directed the PBO to prepare cost estimates of all private member's bills placed on the order of precedence, that have been deemed fiscally material by the PBO.

This report was prepared by the staff of the Parliamentary Budget Officer. Mark Mahabir wrote the report. Jason Jacques provided comments. Jocelyne Scrim and Nancy Beauchamp assisted with the preparation of the report for publication. Please contact pbo-dpb@parl.gc.ca for further information.

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Executive Summary

Bill C-274 was a private member's bill that sought to facilitate the transfer of small businesses or family farms, or fishing operations, between members of the same family, by amending the *Income Tax Act* (ITA). It would have allowed owners and buyers in the same family to enjoy the same rights and privileges as those for a transaction between non-related individuals.

The bill was defeated in the House of Commons on 8 February 2017 on second reading. This report estimates costs of the bill had it been enacted.

Bill C-274 would have amended two sections of the ITA: section 55 and section 84.1. Both apply to transactions between related corporations that involve the transfer or sale of shares and/or the issuance of dividends for the purposes of transferring a business from a parent to a child on a tax-free basis.

In particular, pursuant to paragraph 55(3)(a) of the ITA, the bill would have allowed a corporation to receive tax-free intercorporate dividends on a redemption, acquisition, or cancellation of a share from a related party that was a qualified small business corporation, or a family farm or fishing corporation.

The amendment to subsection 84.1(2) of the ITA would have allowed an individual to claim the capital gains exemption in section 110.6 of the ITA on the sale of shares of a qualified small business corporation, or a family farm or fishing corporation.

There were two key provisions: the shares were purchased by a corporation controlled by a child or grandchild of the taxpayer, and the shares were not disposed of by that corporation (purchaser corporation) within 60 months of their purchase.

Summary Table 1 provides the estimated and projected foregone tax revenue of the section 55 and section 84.1 amendments to the *Income Tax Act* contained in the bill.

Summary Table 1 Estimated and Projected Foregone Tax Revenue of Sections 55 and 84.1 Amendments ($), 2014 - 2018

Year	Section 55	Section 84.1
2014	126,000,000	249,000,000
2015	137,000,000	255,000,000
2016	150,000,000	268,000,000
2017	163,000,000	273,000,000
2018	178,000,000	279,000,000

Notes: Data for 2014 are estimates, while data for 2015-2018 are projections.

Year for section 55 denotes the year in which the corporation's fiscal year ends, while for section 84.1, the year refers to the calendar year.

Source: Parliamentary Budget Officer.

As shown in Summary Table 1, the foregone tax revenue of the bill would have ranged from $126 million to $249 million for 2014 if the measure had been implemented for that taxation year.

Since the foregone tax revenue is based on whether a taxpayer chooses to issue dividends to a related company or to sell shares to a related company, the overall foregone tax revenue for the year would have been between the amounts calculated for section 55 and section 84.1, respectively.

Furthermore, the number of business transfers involving the creation of a new related corporation and the issuance of dividends under section 55 or the sales of shares to a related company is unknown. That makes it difficult to determine the total aggregate cost for any particular year.

1. Introduction

Bill C-274 was a private member's bill that sought to facilitate the transfer of small businesses or family farms, or fishing operations, between members of the same family by amending the *Income Tax Act* (ITA). It would have allowed owners and buyers in the same family to enjoy the same rights and privileges as those for a transaction between non-related people.

The bill was defeated in the House of Commons on 8 February 2017 on second reading.

Bill C-274 would have amended two sections of the ITA: section 55 and section 84.1. Both apply to transactions between related corporations that involve the transfer or sale of shares and/or the issuance of dividends for the purposes of transferring a business from a parent to a child on a tax-free basis.

Section 55

Section 55 of ITA treats intercorporate dividends that would normally be tax-free for the recipient as proceeds of disposition of shares or as a capital gain. The purpose of the section is to prevent a reduction in the capital gain upon the sale of a share as a consequence of a prior tax-free intercorporate dividend.

The bill would have amended paragraph 55(5)(e) of the ITA to treat inter-corporate dividends received as a consequence of certain corporate reorganizations and related party transactions as tax-free, and not as a capital gain.

In particular, pursuant to paragraph 55(3)(a) of the ITA, the bill would have allowed a corporation to receive tax-free intercorporate dividends on a redemption, acquisition, or cancellation of a share from a related party that was a qualified small business corporation, or a family farm or fishing corporation.

Moreover, pursuant to paragraph 55(3)(b) of the ITA, the bill would have provided for the tax-free splitting of a qualified small business corporation, or a family farm or fishing corporation owned by a parent into two corporations, each controlled by a separate child.

Intercorporate dividends issued by the original corporation to the corporation controlled by a child would not be treated as proceeds of distribution or a capital gain, thus reducing the tax consequences for the recipient corporation.

Section 84.1

Section 84.1 of the ITA prevents an individual from converting a corporate surplus (that is, retained earnings) into a capital gain as a consequence of a sale of shares to another corporation with which the individual does not deal at arm's length.[1]

One purpose of section 84.1 is to prevent an individual from claiming the capital gains exemption in section 110.6 of the ITA for the capital gain on the sale of shares in a qualified small business corporation, or a family farm or fishing corporation, to a related taxpayer. In these cases, the capital gain is deemed to be a dividend and is thus fully included in taxable income of the individual/vendor.

Bill C-274 would have amended subsection 84.1(2) of the ITA to allow an individual to claim the capital gains exemption in section 110.6 of the ITA on the sale of shares of a qualified small business corporation, or a family farm or fishing corporation. There were two key provisions: the shares were purchased by a corporation controlled by a child or grandchild of the taxpayer, and the shares were not disposed of by that corporation (purchaser corporation) within 60 months of their purchase.

The bill would also have provided for a limited capital gains exemption based on the amount found in subsection 110.6(2) of the ITA for shares of a qualified small business corporation, or a family farm or fishing corporation that were subsequently disposed of by the purchaser corporation within 60 months of their initial purchase.

In particular, the capital gains exemption would be reduced if the taxable capital employed in Canada by the qualified small business corporation, or a family farm or fishing corporation was more than $10 million.

The capital gains exemption would be reduced to zero for shares of a qualified small business corporation, or a family farm or fishing corporation with taxable capital employed in Canada of more than $15 million.

Section 110.6

Section 110.6 of the ITA provides an individual with a lifetime $824,176 exemption in respect of capital gains realized on the disposition of shares in a qualified small business corporation, or a $1,000,000 exemption on the sale of shares in a farming corporation or fishing corporation.[2]

2. Methodology

2.1. Canadian-Controlled Private Corporations

A qualified small business corporation, family farm corporation or a family fishing corporation is defined as a Canadian-controlled private corporation (CCPC) in the ITA.[3]

For practical purposes, a CCPC is a corporation that is not controlled directly or indirectly by: a publicly-traded corporation with shares listed on a designated exchange; a non-resident; or any combination of publicly-traded corporations and non-residents.[4]

Pursuant to 110.6 of the ITA, to be eligible for the capital gains exemption, a small business corporation, family farm corporation or family fishing corporation must have more than 50 per cent of the fair market value of the assets of the corporation attributable to assets used principally in an active business in Canada throughout the 24-month period prior to the sale.

Thus, a corporation with more than 50 per cent of its assets not used in the active business during the two-year period prior to the sale, such as financial investments, would not qualify. Before that 24-month period, a small business corporation must have more than 90 per cent of the fair market value of its assets in assets used principally in an active business carried on primarily in Canada by the particular corporation or a related corporation.[5]

According to section 123.3 of the ITA, CCPCs that earn investment income are also liable for an additional tax that is refundable when dividends are paid to a shareholder.

In our determination of the number of eligible CCPCs, CCPCs that earn investment income subject to the section 123.3 refundable tax are assumed to be ineligible as a qualified small business corporation, family farm corporation, or fishing corporation. This is because the primary source of income for a small business corporation is from an active business, and not from passive investments.

Number of eligible CCPCs

According to data provided by the Canada Revenue Agency (CRA), there were 1,943,830 CCPCs in 2014. Of these, 50,340 (2.6 per cent) were farming corporations and 4,180 (0.2 per cent) were fishing corporations.[6] The number of CCPCs that are qualified small business corporations (QSBC) can be estimated through the calculations in Table 2-1.

Table 2-1 Estimated Number of Qualified Small Business Corporations, 2014

	Amount
Total number of CCPCs	1,943,830
-number of farming CCPCs	50,340
-number of fishing CCPCs	4,180
-number of CCPCs that pay section 123.3 investment tax[7]	215,000
Total qualified small business corporations	**1,674,310**

Sources: Canada Revenue Agency, Finance Canada and Parliamentary Budget Officer.

Number of CCPCs controlled by an individual and associated CCPCs

The number of associated corporations is important in determining the level of retained earnings held by a group of corporations. These data can be used to estimate the fair market value of the corporation that is being sold by eliminating the corporations that do not have active business income.

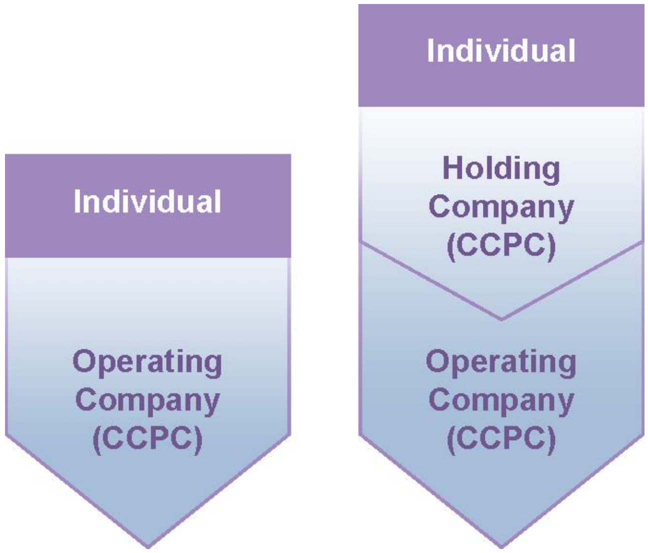
According to *Wolfson et. al*, 2016, in 2010 there were roughly 1,719,000 individuals who had at least 10 per cent ownership of the voting shares of a CCPC.[8] According to CRA data, there were 1,839,520 CCPCs in 2010.

The number of CCPCs is higher than the number of individuals reporting 10 per cent ownership since an individual may control more than one CCPC and a CCPC may be controlled by another CCPC. For example, an individual may own a CCPC that is the operating company through another CCPC that is the holding company (see Figure 1).

In general, a holding company is used to protect the income generated by the operating company by transferring the income earned by the operating company through dividends issued to the holding company.

Moreover, the dividend income received by the holding company from the operating company is usually the sole source of revenue of the holding company. Holding companies can be used for many other purposes, such as income splitting to allocate the income of private corporations to shareholders.

Figure 2-1 **Examples of Ownership Structures of Canadian-Controlled Private Corporations**



Source: Parliamentary Budget Officer.

According to *Wolfson et. al.*, 2016, 81 per cent of those individuals who had at least 10 per cent ownership of the voting shares of a CCPC were associated with only one CCPC for 2010 (the structure on the left of Figure 2-1).

Number of individuals with 10 per cent ownership of more than 1 CCPC = 1,943,830 * (1-0.81) = 369,330

A corporation is associated with another corporation if that other corporation owns more than 50 per cent of the shares of the corporation, or if an individual or a third corporation owns more than 50 per cent of the shares of both corporations. Therefore, the number of associated CCPCs for 2014 could be as high as 369,330.[9]

According to the Department of Finance, between 2005 and 2008 an annual average of 362,500 corporations were part of a corporate group in which there was common ownership ranging from 50 per cent to 100 per cent. This annual average is similar to the number of corporations with the same individual owner as calculated above, although the common owner as determined by the Department of Finance could be a corporation or an individual.

Moreover, the number of corporate groups in which there was a corporation that was wholly-owned by another corporation in that group was on average 111,500 for that period.

We have used a range of holding companies of 100,000, 200,000 and 300,000 in our analysis to determine the average retained earnings of a QSBC with active business income (see Table 2-4).

Total amount of dividends that could be distributed by a CCPC

The provisions in Bill C-274 applied to shares of a qualified small business corporation, family farm corporation or a family fishing corporation that are transferred to a corporation controlled by a child of the owner of the qualified small business or family farm or fishing corporation. The dividends that could be paid as a result of such transactions are assumed to be limited to the cumulative retained earnings of the corporation whose shares are being transferred.[10]

The amount of dividends that can be distributed by a corporation to a shareholder for a fiscal year is limited in most cases to its retained earnings at the beginning of its fiscal year and the income earned by the corporation for the fiscal year.[11]

The end-of-year balance of a corporation's retained earnings for tax purposes is the amount of retained earnings at the start of the fiscal year, plus any additional income, and minus any dividends that were distributed to shareholders.[12]

Thus, the end-of-year balance of the retained earnings account contains the total funds that could be distributed in the subsequent year to a shareholder as a dividend.[13]

According to CRA data, in 2014 the aggregate closing balance of all CCPCs amounted to just under $1,157 billion. Of this total, just over $37.5 billion belonged to farming corporations and nearly $1.4 billion belonged to fishing corporations (see Table 2-2).

Table 2-2 Retained Earnings Closing Balance ($millions) of Controlled Private Corporations, 2014

Qualified Small Businesses	Farming Corporations	Fishing Corporations	**Total**
1,118,863	37,528	1,383	**1,157,775**

Notes: The aggregate retained earnings of qualified small businesses is assumed to be the amount remaining after deducting the retained earnings of all farming corporations and all fishing corporations from the total amount of retained earnings of all CCPCs.

Sources: Canada Revenue Agency and Parliamentary Budget Officer.

Table 2-3 shows the average retained earnings of farming corporations and a fishing corporations.

Table 2-3 **Average Retained Earnings (RE in $) of Farming Corporations and Fishing Corporations, 2014**

	Farming Corporations	Fishing Corporations
RE ($1000s)	37,528,827	1,383,445
CCPCs	50,340	4,180
Average RE	**$745,507**	**$330,967**

Sources: Canada Revenue Agency and Parliamentary Budget Officer.

The retained earnings of a holding corporation are obtained from its associated operating company. Thus, the average retained earnings of all qualified small business corporations must take into account that the total number of QSBCs, as reported by the Canada Revenue Agency, contains a number of companies in which their retained earnings have been shifted to the holding company. The average retained earnings of a QSBC can be estimated by using the formula below.

Avg RE = Total RE for all QSBC / (total QSBCs – QSBC holding companies)

Table 2-4 provides an estimate of the average retained earnings of a small business corporation based on an estimated range of the number of holding companies that are CCPCs.[14]

Table 2-4 **Average Retained Earnings (RE in $) of a Qualified Small Business Corporation (excluding Holding Companies), 2014**

	Low	Medium	High
RE ($1000s)	$1,118,863,028	$1,118,863,028	$1,118,863,028
Total QSBCs (from Table 2-1)	1,674,310	1,674,310	1,674,310
-Holding companies	100,000	200,000	300,000
Average RE	**$710,700**	**$758,906**	**$814,127**

Sources: Canada Revenue Agency and Parliamentary Budget Officer.

Amount of capital gain during the sale of shares of a CCPC

Shareholders who sell a share of a CCPC are permitted to claim a deduction on his or her tax return for the capital gains on the sale of those shares up to a limit known as the lifetime capital gains exemption.

Tables 2-5 and 2-6 provide the average capital gains claimed on the sale of shares of a farming and fishing corporation and a QSBC, respectively.

Table 2-5 Average Capital Gain ($) claimed by Taxpayers on the Sale of a Share of a Farming and Fishing Corporation, 2009 - 2015

Year	Number of Taxpayers	Average Capital Gain
2009	25,620	125,105
2010	27,140	123,010
2011	27,030	151,394
2012	28,460	166,841
2013	28,150	181,686
2014	27,940	196,643
2015	26,030	218,746

Sources: Canada Revenue Agency and Parliamentary Budget Officer.

Table 2-6 Average Capital Gain ($) claimed by Taxpayers on the Sale of a Share of a QSBC, 2009 - 2015

Year	Number of Taxpayers	Average Capital Gain
2009	30,040	184,778
2010	32,150	199,072
2011	33,220	216,382
2012	32,270	228,461
2013	32,890	215,535
2014	37,230	230,279
2015	34,130	270,100

Sources: Canada Revenue Agency and Parliamentary Budget Officer.

When comparing Tables 2-5 and 2-6 to Tables 2-3 and 2-4, the average capital gain claimed by taxpayers on the sale of shares of a farming and fishing corporation or a QSBC is $100,000 to $500,000 lower than the average retained earnings in such corporations.

On the sale of shares of a CCPC, the total capital gain on all shares should be equal or greater than the retained earnings in the business, since the fair market value of a corporation includes the retained earnings as well as the value of any future income and the goodwill of the business.

The lower amount of capital gains claimed by an individual taxpayer indicates one or more of the following scenarios:

- The majority of the sale of shares of a CCPC are sales of a minority of outstanding shares.

- The fair market value of the CCPCs that are sold is lower than other CCPCs.
- Taxpayer has prior losses that reduce the capital gains deduction on the sale of shares of a CCPC.
- Taxpayer has claimed a reserve on the capital gains rather than full amount of the gain.[15]

For the reasons above, we will be estimating the fair market value of the various types of CCPC by using the average retained earnings of each type of CCPC (see section 2.3).

Number of CCPCs sold in a year

A business may be sold through the sale of its assets, or if the business is incorporated, through the sale of the shares of the business. The number of CCPCs that are sold each year can be estimated using various methods.

For example, taxpayers who sell a farm or fishing property, which includes shares in a farm or fishing corporation, or shares in a QSBC, to a to a child, grandchild or great-grandchild are able to claim a reserve on the capital gain so that only 10 per cent of the total gain is recognized in a particular tax year.

According to the CRA, in 2014, 1,940 taxpayers claimed a new reserve on the sale of a qualified farm or fishing property, while 2,630 taxpayers claimed a new reserve on the sale of shares in a QSBC.[16] Each taxpayer who sells shares in a farm or fishing corporation or a QSBC can claim a reserve. Thus, the number of CCPCs that are sold could be lower than the number of taxpayers claiming a reserve on the sale of such shares.

As well, not all taxpayers who sell shares in a farming or fishing corporation or a QSBC choose to claim a reserve. For example, a reserve may not be utilized if the taxpayer has business losses from other tax years to offset the gain on the shares. Data on new reserves are only available for 2014.

Estimating the number of businesses that could be sold to a child or grandchild

The number of business owners nearing retirement age can be used to estimate the total number of businesses that could be transferred to a child or grandchild. According to Statistics Canada's *Survey on Financing and Growth of Small and Medium Enterprises 2014*, there were 73,242 business owners over the age of 65 in 2014.[17]

According to the Canadian Federation of Independent Business, in 2011, 36.8 per cent of business owners planned to sell or transfer their business to a family member, while 28.8 per cent planned to exit the business in the next six to 10 years.[18]

Using Statistics Canada's data for 2014 for small and medium enterprises, and applying the percentage of business owners who planned to transfer a business to a family member, we can estimate the total number of businesses that could be transferred to a family member, either through a sale of the business or a transfer of ownership in the following formula.[19]

> Total number of businesses that could be transferred = business owners over the age of 65 * % of business owners that plan to sell or transfer their business to a family member
>
> Total number of businesses that could be transferred = 73,242 * 36.8% = 26,953

According to the Canadian Federation of Independent Business, two-thirds (66.5 per cent) of business owners planned to exit the business in the next one to 10 years. If the businesses that could be transferred in the next 10 years are averaged over that period, about 2,695 businesses could be transferred in a year.

Estimating the value of assets held by a CCPC

According to Statistics Canada's *Survey on Financing and Growth of Small and Medium Enterprises*, 2011, less than 0.5 per cent (or about 2,849) of all privately-owned corporations with 100 to 499 employees have assets greater $7 million.[20]

The number of CCPCs with assets greate than $10 million is assumed to be less than this percentage. Consequently, given the low number of CCPCs that have assets greater than $10 million, the sale of shares in such businesses by owners wishing to tranfer their business to a family member would not have a material impact on the foregone tax revenue of the section 84.1 amendment.

2.2. Amendments to Section 55 of the ITA

The amendments in Bill C-274 to Section 55 of the ITA would have permitted a corporation to receive an intercorporate dividend from a related corporation without such dividends being treated as a capital gain for the dividend recipient.

Since a new corporation is being created when a parent transfers a business to a one controlled by a child, the amount of the dividend is limited to the retained earnings of the parent's corporation. For owners with multiple tiered CCPCs, retained earnings are likely held only by one CCPC.

The annual foregone tax revenue for the federal government from such dividends being treated as tax-free rather than a capital gain, in which 50 per cent are taxable, can be determined by the following formula.

Annual Foregone Tax Revenue = retained earnings of corporation/2 * corporate income tax rate * annual number of business sales or transfers

Furthermore, various percentages of the retained earnings of the parent corporation could be distributed as a dividend. The average retained earnings for each type of corporation (that is, farming, fishing and QSBC) will be used to calculate the fiscal impact. The corporate income tax rate is an effective rate of 13 per cent calculated for all CCPCs.[21]

The number of business sales or transfers will be based on the proportion of total CCPCs: farm (2.6 per cent), fishing (0.2 per cent) or QSBCs (86.1 per cent). These proportions will be applied to the annual business sales and potential transfer of the 2,695 businesses.

In the splitting of a corporation into two new entities, we assume that 100 per cent of the original retained earnings is transferred to the two new entities.

2.3. Amendments to Section 84.1 of the ITA

The amount of capital gains that could be claimed for the capital gains exemption can be estimated by using the average fair market value (FMV) of CCPCs. One method of calculating the fair market value of a corporation is to assume that the retained earnings in the corporation is a proportion of its FMV.

The fair market value of a corporation can be estimated using the market value to book value ratio for equity, and applying that ratio to the retained earnings, which is the largest proportion of the book value of an established corporation.[22]

According to Statistics Canada's CANSIM Table 376-0142, the ratio of average market value to book value for Canadian businesses was 1.62 for the period from Q4 2011 to Q3 2016.

Tables 2-7 and 2-8 provide the average fair market values for farming and fishing corporations and for QSBCs, respectively, for 2014.

Table 2-7

Estimated Average Fair Market Value (FMV) of a Farming Corporation and a Fishing Corporation, 2014

	Farming Corporations	Fishing Corporations
Retained Earnings (RE) ($1000s)	$37,528,827	$1,383,445
CCPCs	50,340	4,180
Average RE	**$745,507**	**$330,967**
Market Value to Book Value Ratio	1.62	1.62
Average FMV	**$1,207,721**	**$536,166**

Sources: Canada Revenue Agency and Parliamentary Budget Officer.

Table 2-8

Estimated Average Fair Market Value (FMV) of a Qualified Small Business Corporation (excluding Holding Companies), 2014

Retained Earnings (RE) ($1000s)	$1,118,863,028
Total QSBCs (from Table 2-1)	1,674,310
-Holding companies	300,000
Average RE	**$814,127**
Market Value to Book Value Ratio	1.62
Average FMV	**$1,318,886**

Sources: Canada Revenue Agency and Parliamentary Budget Officer.

The annual foregone tax revenue for the federal government for permitting an individual to sell shares of a CCPC to a family member for purposes of the capital gains exemption is as follows:

Annual Foregone Tax Revenue = (the greater of the Capital Gains Exemption or the average FMV of the CCPC)/2 * composite individual tax rate * annual number of business sales of that type of CCPC

A composite individual tax rate of 26 per cent is used for our calculations for the 2014 and 2015 and a tax rate of 27 per cent is used for 2016-2018 to account for the new 33 per cent tax rate. Again, the number of business sales or transfers will be based on the proportion of total CCPCs: farm (2.6 per cent), fishing (0.2 per cent) or QSBC (86.1 per cent). The proportions will be applied to the annual business sales and potential transfer of the 2,695 businesses.

2.4. Combined effects of Amendments to Sections 55 and 84.1 of the ITA

This report considers two methods to transfer a business: the creation of another corporation and the issuance of dividends to that corporation; and the sale of shares in a corporation to another entity. There are other methods, such as the creation of a trust or other legal entity to transfer ownership from one beneficiary to another beneficiary of the trust.

The combined fiscal effect of the amendments to sections 55 and 84.1 is not a simple summation of the individual fiscal effect of each amendment. That is because the amount of dividends that could be issued and the capital gains that accrue from the sale of the business are both linked to the retained earnings of the CCPC that is being transferred, or in which the shares are being sold.

For example, if a CCPC issues a dividend to a related corporation, the fair market value of the CCPC will decrease. Therefore, the overall fiscal cost of the bill is limited to the number of transactions involving the issuance of dividends and the number of businesses that are sold through the sale of shares.

For our estimated fiscal cost, a range will be provided based on 100 per cent of all transfers involving an issuance of dividends or a sale of shares.

3. Results

Table 3-1 below provides the estimated and projected foregone tax revenue of the section 55 and section 84.1 amendments to the *Income Tax Act* contained in Bill C-274.

Table 3-1 **Estimated and Projected Foregone Tax Revenue of the Section 55 and 84.1 Amendments ($), 2014 - 2018**

Year	Section 55	Section 84.1
2014	126,000,000	249,000,000
2015	137,000,000	255,000,000
2016	150,000,000	268,000,000
2017	163,000,000	273,000,000
2018	178,000,000	279,000,000

Notes: Data for 2014 are estimates, while data for 2015-2018 are projections.

Year for section 55 denotes the year in which the corporation's fiscal year ends, while for section 84.1, the year refers to the calendar year.

Source: Parliamentary Budget Officer.

As can be seen from Table 3-1, the foregone tax revenue of the bill would have ranged from $126 million to $249 million for 2014 if the measure had been implemented for that taxation year.

Since the foregone tax revenue is based on whether a taxpayer chooses to issue dividends to a related company, or to sell shares to a related company, the overall foregone tax revenue for the year would have been between the amounts calculated for section 55 and section 84.1, respectively.

Appendix A: Estimates and Projections

The following tables contain the estimated and projected retained earnings, number of CCPCs, average retained earnings and the average fair market value of farm CCPCs, fishing CCPCs and QSBCs.

The data for 2014 is based on the closing balance as reported on field 3849 on the T2 Form 100 General Index of Financial Information (GIFI) and the number of CCPCs for that year. These data were provided by the Canada Revenue Agency.

The average retained earnings and fair market value are PBO's calculations. The fair market value is based on the ratio of market value to book value of 1.62. It was obtained from Statistics Canada's CANSIM table 376-0142.

The growth in retained earnings is based on the on the average in-year growth in retained earnings for all CCPCs as reported on fields 3660 (opening balance) and 3849 (closing balance) on the T2 Form 100 (GIFI) for the period from 2009 to2014. These data were provided by the Canada Revenue Agency.

The growth in the number of CCPCs is based on the annual average increase or decrease in the number of CCPCs for the period 2009-2014. The number of CCPCs for that period was provided by the Canada Revenue Agency. We assume that the number of farm and fishing CCPCs does not include a significant number of holding companies.

Table A-1 Estimated and Projected Retained Earnings (RE), number of CCPCs and FMV for Farm CCPCs, 2014 - 2018

Year	RE ($millions)	CCPCs	Average RE ($)	Average FMV ($)
2014	37,528	50,340	745,507	1,207,721
2015	41,732	51,468	810,835	1,313,553
2016	46,406	52,596	882,311	1,429,344
2017	51,603	53,724	960,530	1,556,059
2018	57,383	54,852	1,046,144	1,694,754

Notes: Data for 2014 are estimates, while data for 2015-2018 are projections.

Year for section 55 denotes the year in which the corporation's fiscal year ends, while for section 84.1, the year refers to the calendar year.

An annual RE growth rate of 11.2 per cent was used.

A market value to book value ratio of 1.62 was used.

Source: Parliamentary Budget Officer.

Table A-2

Estimated and Projected Retained Earnings (RE), number of CCPCs and FMV for Fishing CCPCs, 2014 - 2018

Year	RE ($millions)	CCPCs	Average RE ($)	Average FMV ($)
2014	1,383	4,180	330,968	536,168
2015	1,538	4,180	368,036	596,218
2016	1,710	4,180	409,256	662,995
2017	1,902	4,180	455,093	737,250
2018	2,115	4,180	506,063	819,822

Notes: Data for 2014 are estimates, while data for 2015-2018 are projections.

Year for section 55 denotes the year in which the corporation's fiscal year ends, while for section 84.1, the year refers to the calendar year.

An annual RE growth rate of 11.2 per cent was used.

A market value to book value ratio of 1.62 was used.

Source: Parliamentary Budget Officer.

Table A-3

Estimated and Projected Retained Earnings (RE), number of CCPCs and FMV for QSBC CCPCs, 2014 - 2018

Year	RE ($millions)	CCPCs	Average RE ($)	Average FMV ($)
2014	1,118,863	1,374,310	814,127	1,318,886
2015	1,244,175	1,403,922	886,214	1,435,667
2016	1,383,523	1,433,534	965,114	1,563,484
2017	1,538,477	1,463,146	1,051,486	1,703,408
2018	1,710,787	1,492,758	1,146,058	1,856,614

Notes: Data for 2014 are estimates, while data for 2015-2018 are projections.

Year for section 55 denotes the year in which the corporation's fiscal year ends, while for section 84.1, the year refers to the calendar year.

An annual RE growth rate of 11.2 per cent was used.

The number of holding companies is fixed at 300,000 for each year.

A market value to book value ratio of 1.62 was used.

Source: Parliamentary Budget Officer.

Table A-4 provides the estimated and projected foregone tax revenue of the section 55 and section 84.1 amendments based on 2,695 business sales or transfers for each year. Previous capital losses are not considered.

For the section 55 amendment, a composite corporate income tax rate of 13 per cent is used. For the section 84.1 amendment, a composite personal income tax rate of 26 per cent is used for 2014 and 2015; a rate of 27 per cent is used for 2016-2018 to account for the new 33 per cent rate.

As well, a 2 per cent inflation rate is used for the lifetime capital gains exemption.

The annual foregone tax revenue of section 55 is calculated as follows:

Annual Foregone Tax Revenue = retained earnings of corporation/2 * corporate income tax rate * annual number of business sales or transfers

The above formula is appled to each type of CCPC and is summed to obtain the total foregone tax revenue for the year.

The annual foregone tax revenue of section 84.1 is as follows:

Annual Foregone Tax Revenue = the greater of the Capital Gains Exemption or the average FMV of the CCPC/2 * composite individual tax rate * annual number of business sales of that type of CCPC

The above formula is appled to each type of CCPC and is summed to obtain the total foregone tax revenue for the year.

Table A-4 Estimated and Projected Annual Foregone Tax Revenue of the Section 55 and 84.1 Amendments ($), 2014 - 2018

Year	Section 55	Section 84.1
2014	126,000,000	249,000,000
2015	137,000,000	255,000,000
2016	150,000,000	268,000,000
2017	163,000,000	273,000,000
2018	178,000,000	279,000,000

Notes: Data for 2014 are estimates, while data for 2015-2018 are projections.

Year for section 55 denotes the year in which the corporation’s fiscal year ends, while for section 84.1, the year refers to the calendar year.

100 per cent of the retained earnings are issued as a dividend.

2,695 transfer or sales for each year are used with 70 tranfers or sales of farm corporations, five transfers or sales of fishing corporations and 2,320 transfers or sales of QSBCs.

Source: Parliamentary Budget Officer.

Since dividends that would be captured by section 55 would be taxed as a capital gain, up to 50 per cent of the retained earnings of the corporation could now be tax-free if the entire retained earnings were issued as a dividend. If less than 100 per cent of the retained earnings were issued as a dividend, the foregone tax revenue would be less.

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Notes

1. Section 84.1 also prevents a trust from converting a corporate surplus (i.e. retained earnings) into a capital gain as a consequence of a transfer of shares in one corporation to another corporation with which the trust does not deal at arm's length.
2. The amount of $824,176 is indexed annually to inflation. The amount of $1,000,000 applies until the $824,176 amount is equal after inflation, at which time one amount will apply to the gain on the sale of shares in a qualified small business corporation, family farm corporation or a family fishing corporation.
3. Please note that a CCPC may be associated with another CCPC such as a subsidiary and its parent. Each CCPC must file a tax return with the Canada Revenue Agency. Similarly, one individual may control more than one CCPC directly or indirectly if a CCPC is associated with another CCPC.
4. The Department of Finance publishes a list of designated stock exchanges for purposes of the *Income Tax Act*, see Department of Finance Canada, *Designated Stock Exchanges*.
5. Section 248(1) of the ITA, "small business corporation." There is no income or asset threshold under which a CCPC is classified as a small business corporation for purposes of the capital gains exemption.
6. 2014 is the latest year for which there is complete data from the Canada Revenue Agency. The Agency does not collect data on the number of *family* farm corporations or *family* fishing corporations.
7. The number of CCPCs that paid the investment tax was 215,000 in 2013 and according to the Department of Finance Canada is not expected to increase over the 2014-2017 project period see: Department of Finance Canada, *Report on Federal Tax Expenditures*, 2016.
8. Ibid. Please note that one individual may hold shares in more than one CCPC.
9. Assuming that the level of associated corporations has not changed since 2010 and assuming that those shareholders that own at least 10% of the shares of a CCPC as required by Form T2 Schedule 50 also own 50% of the shares.
10. Dividends could also be paid that are based on the funds received from a debt issuance or loan granted to the corporation.
11. A corporation may also distributed dividends for which funds were obtained through the issuance of debt such as bonds. Such funds will be ignored for our calculations.
12. Fields 3660 and 3849 on T2 Form 100 (GIFI).

13. A corporation also has a capital dividend account that allows for the distribution of non-taxable dividends to shareholders. This amount is not included in our analysis. Also, the retained earnings do not include the future income of the corporation that could be distributed as a dividend.
14. Holding companies associated with a farming corporation or a fishing corporation are not considered due to the small number of both types of corporation.
15. Section 40(1.1) of the ITA. A reserve permits a taxpayer to spread-out the gain over 10 years.
16. 2014 is the only year for which data is available from the Canada Revenue Agency.
17. Business owners that under the age of 65 may also transfer or sell a business to a child or grandchild but are not considered in our analysis.
18. Canadian Federation of Independent Business, *Passing on the Business to the Next Generation*, November 2012.
19. Assuming that all small and medium sized enterprises are CCPCs.
20. Enterprises with less than 100 employees have assets valued on average of less than $4.3 million.
21. See Department of Finance Canada, *Report on Federal Tax Expenditures*, 2017, pg 45. A proportion of CCPCs pay income tax at the general corporate income tax rate of 15% which results in an effective rate of 13%.
22. The book value is equal to the share capital of the corporation plus retained earnings and minus any shares repurchased by the corporation.