

## SECTION 85(1)

Section 85 permits a tax free rollover of property to a corporation but **only as long as** the transferor accepts **some shares** as part of the consideration received for the transfer. The purpose of subsection 85(1) is to allow a taxpayer to defer gains that are accrued on assets transferred to a Canadian corp.

### When is Section 85(1) Used?

1. To incorporate a proprietorship, trust, partnerships, investments
2. To transfer assets from one company to another company
  - a. Parent transfers asset to a sub
  - b. During an **AOC** to use the streaming rules; you transfer a business assets to the newly acquired company's assets to generate similar profits (i.e. inventory, equipment)
3. Tax planning purposes - to set up a Holding Company for estate freezes. Refer to our estate freeze notes for details on freezes

***Without the s85(1) rollover election; all assets are deemed to be sold at FMV and hence may result in big tax payable!***

### Section 85(1) – The Rules you must follow!

1. **Elected price** must be between UCC (for depreciable properties) /ACB (for non-depreciable properties) and FMV
  - i.e. if FMV is lower must select at FMV.
2. **FMV in = FMV out** all the times
  - i.e. the consideration received (share and non-share consideration) should be equal to the FMV of the assets given up. If that's not the case than there will be tax consequences.
3. Boot (non-cash consideration) should not be greater than elected amount
  - If it is more than elected amount than there will be tax consequences.
4. Transferee **must** be a **taxable Canadian Corporation**
  - **Transferor** can be a resident or non-resident individual, trust, corporation or a partnership
5. Consideration received by the transferor **must** include at least **1 share**
6. Assets with **Terminal loss/capital losses** should not be transferred at 85(1) because you don't have any gain to trigger and also they are **deemed superficial losses and are denied**. Therefore transfer outside of S.85(1) and taking back non-share consideration
  - Capital losses – the transferee can claim it only they ultimately dispose the property
  - Terminal Losses – stay with transferor, and transferor can claim CCA on it
7. Elect at least **\$1** for assets (i.e. for goodwill elect at \$1 even if ABC is 0)
8. Jointly election is required by the corporation and the taxpayer
  - The **deadline to file** an election is the earliest tax return due date of transferee or transferor

### Which properties can be transferred using S.85(1)?

1. Capital Properties (including A/R)
2. Eligible Capital Properties
3. Inventory
4. Resource Properties

### Which properties are not eligible to be transferred using S.85(1)?

The following are **not allowed** to be transferred under S.85(1)

1. Cash
2. Prepaids
3. Real property (i.e. land and buildings) held as inventory

### Assets that are not ideal to be transferred using s85 rollover:

1. **Accounts Receivable** should not be transferred under S.85(1), section 22 is better option  
**Accounts Receivable (use s22 rather than s85)**
  - If there is a loss on the AR; the transferor gets a business loss
  - The transferee can take a reserve
  - 90% of assets of business must be transferred to be eligible for s22
  - If AR is transferred with s85, AR treated like non-depreciable asset with capital losses (i.e. superficial loss)
2. Individuals should not transfer **shares that qualify for the QSBC deduction** into a corporation since corporations are not eligible for the Lifetime Capital Gains Exemption (LCGE)
3. **Depreciable assets with terminal loss**: terminal losses denied on transfer (better to sell for boot outside s85 and reduce taxes)
4. **Non-depreciable assets (land, securities) with accrued capital losses**: capital losses are superficial losses and **denied** (better to transfer outside of s85 and trigger losses to use to reduce taxes)

### Integration with other topics/Tax planning

- Can elect higher than cost to trigger capital gains to use up losses and QSBC credit
- Estate Freezes (Please refer to our estate freeze notes)
- Crystallising QSBC exemption (Refer to Estate Free & emigrating from Canada Notes for details)