WINDING-UP OF A SUBSIDIARY – SECTION 88 (1)

- Section 88 rollover is used in the winding up a subsidiary into its parent corporation

Criteria for Section 88(1) to apply:

- The Section 88(1) rollover can only be used where the parent owns **at least 90% of each class** of the subsidiary's shares

What is a Windup?

A wind up occurs when a company has decided to discontinue its operations; it pays off its creditors and distributes the remaining assets to the shareholders

- In a Parent/Subsidiary relationship; the subsidiary will distribute the remaining assets to the parent
- Normally, without Section 88(1), there will be a deemed disposition at fair value and capital gains and recaptures may result
- Section 88 (1) provides a tax free rollover of assets transferred to the parent, provided that there is **substantial evidence that the subsidiary will be dissolved within a short period of time**

Transfer of Assets and Flow through of Balances

- The assets are all **transferred at tax values** just like in an amalgamation (see amalgamation notes for details)
- Balances such as the non and net-capital losses, GRIP, LRIP all flow through to the parent

Section 88(1) and Bump-up Rule

- The Bump-up rule in section 88(1) is the exact same as the rule in Section 87
- The only difference is that in Section 87 the bump-up is only available for a vertical amalgamation involving a 100% owned subsidiary
- Section 88(1) applies to a winding-up of a 90% or more owned subsidiary

Bump-up Formula:

The Bump-up of the ACB of the depreciable capital properties mentioned above is the **lesser of:**

a) ACB of the Sub's shares – the tax values of Net Asset of Sub on date of amalgamation – dividends paid by sub to parent (including capital dividends); and
b) FMV of the Sub's non-depreciable property – ACB of Sub's non-depreciable property at the time the parent acquired control of the sub

Please see amalgamation notes for a detailed example.

Is there a deemed Year End?

- No deemed year when winding up a subsidiary into the parent (unlike amalgamations)
- This makes sense because the subsidiary will be dissolved shortly, and the parent will continue with its own year-end (no new corporation formed)

Loss Utilization

- The **non-capital losses and the net-capital losses** of the subsidiary are deductible by the parent; however, there is a condition:
  - The parent must **wait until the first taxation year following the taxation year in which the winding-up <u>began</u> before utilizing the losses against its income**
    - **Example**
      - If Winding up began on March 31, 2012 and the Parent has a December 31 year end. The winding-up took place in the December 31, 2012 taxation year. Therefore, the parent must wait till December 31, 2013 tax year before claiming losses against its income.

- **Implications of this condition:**
  - This will cause the carryforward period of the non-capital losses to **age by one year** (just like an amalgamation)

Disadvantages of Winding-up (compared to vertical amalgamation)

- Winding-up is **costly**, you need to start the winding up procedures such as **liquidating assets and paying off liabilities** to show CRA proof that the subsidiary will be dissolved within a short time frame