



# Intergenerational Transfers: Does The Issuance of A Promissory Note Result In De Facto Control?

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## INTERGENERATIONAL TRANSFERS: DOES THE ISSUANCE OF A PROMISSORY NOTE RESULT IN DE FACTO CONTROL?

The intergenerational business transfer regimes set out in subsections 84.1(2.31) (an “immediate transfer”) and (2.32) (a “gradual transfer”) of the ITA provide conditions that, if satisfied, will, in accordance with paragraph 84.1(2)(e), deem sales that would otherwise be subject to the application of section 84.1 to occur at arm’s length and, accordingly, not be subject to possible deemed dividend treatment.

Paragraph 84.1(2.31)(c) requires, among other things, that “at all times after the disposition time, the taxpayer does not—either alone or together with a spouse or common-law partner of the taxpayer—control, directly or indirectly in any manner whatever,” the corporation whose shares are being sold and the corporation purchasing the shares. It is worth noting that under the corresponding provision in the gradual intergenerational business transfer regime (that is, paragraph 84.1(2.32)(c)), the condition is tied to de jure control.

The CRA recently released technical interpretation no. 2024-1038891E5 (February 18, 2025) (“the TI”), in which it provided its views on, among other things, whether a vending parent holding a promissory note issued by a purchaser corporation would “control, directly or indirectly in any manner whatever,” the corporation (that is, would have de facto control) under paragraph 84.1(2.31)(c).

Specifically, the CRA was asked for its views on a hypothetical situation in which a corporation controlled by an adult individual (“the child”) acquires all the shares of another corporation (“the subject corporation”) owned by the child’s parents (“the parents”). The purchase price is funded in part by external financing from arm’s-length lenders, with the balance—a substantial portion of the price—represented by a promissory note issued to the parents. Under the note, regular principal payments are to be paid over 15 years but bear no interest unless they are not made as scheduled. The child provides personal guarantees for the debts of the purchaser corporation. Following the sale, the parents do not intend to have any involvement in the day-to-day operations of the subject corporation.

Two specific questions were posed in respect of this fact pattern: (1) whether the fact that the parents hold the note would, in and of itself, result in the parents having de facto control of the purchaser corporation; and (2) whether the answer to the first question would be different if the note was payable on demand rather than having scheduled repayments.

1 SCR 795), the SCC held that determining legal control was an exercise in determining who has “effective control” of the corporation. In general terms, de jure control resides with “ownership of such a number of shares as carries with it the right to a majority of the votes in the election of the board of directors,” subject to the caveat that consideration must be given to limitations “on either the majority shareholder’s power to control the election of the board or the board’s power to manage the business and affairs of the company, as manifested” in either the constating documents of the corporation or in a unanimous shareholders’ agreement.

De facto control is defined in subsection 256(5.1) of the ITA and is a test consisting of two parts. The first part provides that a corporation is considered to be controlled by another corporation, a person, or a group of persons (“the controller”) at any time where, at that time, the controller has any direct or indirect influence that, if exercised, would result in control in fact of the corporation. The second part of the test provides an exception with respect to certain arm’s-length arrangements, which are not relevant to the scenario discussed in the TI.

Subsection 256(5.11) was introduced, in part, to legislatively overrule the FCA’s decision in *McGillivray Restaurant Ltd. v. Canada* (2016 FCA 99). In that case, the court had held that in order to make a finding of de facto control, a person or group of persons “must have the clear right and ability to effect a significant change in the board of directors or the powers of the board of directors or to influence in a very direct way the shareholders who would otherwise have the ability to elect the board of directors” and that “a factor that does not include a legally enforceable right and ability to effect a change to the board of directors or its powers, or to exercise influence over the shareholder or shareholders who have that right and ability, ought not to be considered as having the potential to establish *de facto* control.”

Subsection 256(5.11) provides that the determination of whether a taxpayer has de facto control of a corporation “shall (a) take into consideration all factors that are relevant in the circumstances; and (b) not be limited to, and the relevant factors need not include, whether the taxpayer has a legally enforceable right or ability to effect a change in the board of directors of the corporation, or its powers, or to exercise influence over the shareholder or shareholders who have that right or ability.”

The resulting rule—as we noted in our paper “256(5.1)—De Facto Control: A Return to the Past,” in *2017 Ontario Tax Conference* (Toronto: Canadian Tax Foundation, 2017), 5:1-18 (available on *TaxFind*)—is a “conceptual mess” because there is “no statutory tipping point at which some measure of influence will result in control in fact.” We noted, however, that in practice, practitioners should look to the broad range of factors employed by the courts in earlier jurisprudence relating to the “operational control” interpretation of the de facto control test that existed in pre-*McGillivray* case law (see, for example, *Transport M.L. Couture Inc. v. The Queen*, 2020 DTC 817 and *Mimetix Pharmaceuticals Inc. v. The Queen*, [2002] 1 CTC 2188; aff’d 2003 FCA 106). They should also refer to archived *Interpretation Bulletin* IT-64R4 (“the bulletin”), in which the CRA provided a list of factors to be considered when deciding whether de facto control is present.

In the TI, the CRA noted that paragraph 23 of the bulletin cites both (1) the ownership of a large debt of a corporation that “may become payable on demand” and (2) the influence that “a family member, who is a shareholder, creditor, supplier, etc. of a corporation, may have” as factors relevant to a finding of de facto control.

The CRA went on to state that the determination of whether de facto control exists “will depend on whether the [note], considered in the context of all the surrounding circumstances, provides the parents with influence over decisions made by, or in respect of, the purchaser corporation.” That determination would in turn depend on, among

other possible factors, “[t]he relative portion of the financing of the purchaser corporation represented by the [note], the terms of repayment, any obligations/guarantees relating to repayment, and the access that the purchaser corporation has to alternative financing in the event a demand for payment is made.”

That said, the CRA concluded that it was of the view that “a non-interest-bearing promissory note payable over a commercially reasonable period of time would not, in itself, provide the holder with the type of influence that is indicative of de facto control” and that “a personal guarantee of the amount owing under the [note]” by the child “would not, where the purchaser corporation has the capacity to make the scheduled payments under the promissory note (and absent any other factors indicative of de facto control), result in the holder having de facto control of the purchaser corporation.”

The CRA did not directly respond to the second question.

Given the inherent uncertainty in determining whether de facto control exists, practitioners concerned about a potential finding of de facto control where a promissory note is issued as part of the purchase price for an intergenerational business transfer may find it prudent to follow the CRA’s guidance in the TI and make the note payable over a commercially reasonable period of time.

That said, it is far from clear, in our view, that the mere issuance of a promissory note payable on demand, considered in isolation, would result in a finding of de facto control. The TI also serves as a reminder of why the intergenerational business transfer regime has proved challenging for taxpayers and advisers to work with: it contains very complex rules, with fact-driven tests that are often imprecise in their application. In our view, it would be worthwhile to revisit these rules with a view to paring down their complexity and uncertainty.

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