FINANCE SIGNALS POTENTIAL GAAR SCRUTINY FOR TECHNICALLY COMPLIANT INTERGENERATIONAL BUSINESS TRANSFERS

Simon Pereira and Adam Friedlan

First published by the Canadian Tax Foundation in the August 2026 issue of *Canadian Tax Focus*.

LEADING TAX THOUGHT™

CTF FCF CANADIAN TAX FOUNDATION FONDATION CANADIENNE DE FISCALITÉ

Canadian Tax FOCUS

FINANCE SIGNALS POTENTIAL GAAR SCRUTINY FOR TECHNICALLY COMPLIANT INTERGENERATIONAL BUSINESS TRANSFERS

The explanatory notes that accompanied Bill C-15, which received royal assent on March 26, 2026, contain comments that may have significant implications for taxpayers relying on the intergenerational business transfer rules in section 84.1.

The explanatory notes include what appears to be a warning that a transaction satisfying the detailed statutory requirements could nevertheless face scrutiny under GAAR if it is regarded as a surplus-stripping arrangement rather than a bona fide transfer of a family business.

In general terms, section 84.1 is an anti-avoidance rule designed to limit the extraction of internal corporate funds on the sale by a taxpayer (other than a corporation) of shares of one corporation ("the subject corporation") to another corporation ("the purchaser corporation") with which the vending taxpayer does not deal at arm's length. Other conditions must be satisfied. If section 84.1 applies, it can limit the ability to extract internal corporate funds (including ACB derived from the lifetime capital gains exemption previously claimed by the vending taxpayer and certain non-arm's-length parties) and can convert sale proceeds into a deemed dividend. As noted in *Pomerleau v. Canada* (2018 FCA 129), the purpose of section 84.1 is "to prevent amounts which have not been subject to tax from being used in order to allow shareholders to withdraw corporate surpluses on a tax-free basis."

Historically, section 84.1 treated related-party share sales and sales to arm's-length purchasers unequally. Unlike related-party purchasers (for example, a child purchasing the shares of a parent), arm's-length purchasers could acquire a vending taxpayer's shares through a holding corporation without triggering section 84.1.

To address this disparity (in permitted circumstances), the intergenerational business transfer rules were introduced first in Bill C-208 and then in revised form in 2024 to address surplus-stripping concerns.

Bill C-15 amended paragraphs 84.1(2.31)(g) and (2.32)(h). Basically, each of those paragraphs sets out a required time frame by which a vending parent must transfer the management of each active business of a subject corporation and permanently cease to manage the businesses carried on by the subject corporation.

According to the explanatory notes, the amendments are intended to clarify that the conditions in these paragraphs "could be satisfied if reasonable steps to transfer management of the business to the child were taken before the disposition time." In the previous version, these steps had to be taken no later than 36 or 60 months, respectively, after the disposition time. On its face, Finance's clarification appears to be favourable to taxpayers.

However, the explanatory notes also include an important cautionary point following this clarification:

> However, if other hallmarks of a genuine intergenerational business transfer under subsection (2.31) have already been fulfilled prior to the disposition time (such as a child who already controls the subject corporation prior to the disposition time), a question may arise under the general anti-avoidance rule regarding whether the disposition of the subject shares to the purchaser corporation was undertaken for the purpose of transferring a business to the next generation or merely to facilitate the payment of a corporate distribution in the form of a capital gain.

A similar observation is made pertaining to paragraph 84.1(2.32)(h).

Concern appears to arise in situations where the substantive transfer of business ownership and management has already occurred before the share sale transaction. In such circumstances, Finance is concerned that the subsequent sale to a purchaser corporation may not be a genuine "succession plan," but rather may be an attempt to extract corporate surplus.

These comments arise against the backdrop of sustained CRA and Finance warnings about surplus stripping. Finance's explanatory notes accompanying the most recent GAAR amendments specifically identified capital gains strips as transactions lacking economic substance (see the "Jane" example in the Bill C-59 technical notes), and the CRA has repeatedly signalled that surplus stripping remains an area of significant concern (see, for example, CRA document nos. 2024-1008251I7, February 28, 2024; 2023-0987941I7, February 29, 2024; and 2024-1016011E5, April 29, 2024).

The comments in Bill C-15 may be of more concern to practitioners in light of the SCC decision in *Deans Knight Income Corp. v. Canada* (2023 SCC 16). In *Deans Knight*, the SCC emphasized that when applying GAAR it was critical to "distinguish the rationale behind a provision from the means chosen to give that rationale effect." This arguably renders reliance on bright-line tests, such as those contained in the intergenerational business transfer regime, more open to attack under GAAR.

Finance's commentary calls into question the degree of certainty that taxpayers might have expected from technical compliance with the intergenerational business transfer rules.

Simon Pereira
KPMG Law LLP, Toronto
simonpereira@kpmg.ca

Adam Friedlan
Friedlan Law, Richmond Hill
adam.friedlan@friedlanlaw.com

Canadian Tax Focus
Volume 16, Number 3, August 2026
©2026, Canadian Tax Foundation