

# Partnership Reorganizations



# Topics

- Transfer of assets into/out of a partnership
- Consequences of changes in partners
- Dissolution of a partnership
- Incorporating a partnership
- Partnership mergers

# Transfers Into Partnerships

- General rule – ss. 97(1) - disposition and acquisition at FMV (subject to possible application of stop loss rules)
- Possible rollover – ss.97(2) – election to avoid FMV transfer
- Adopts rules from ss. 85(1) with change from “share” to “partnership interest”
- No restriction on real estate inventory – but note GAAR IC 88-2

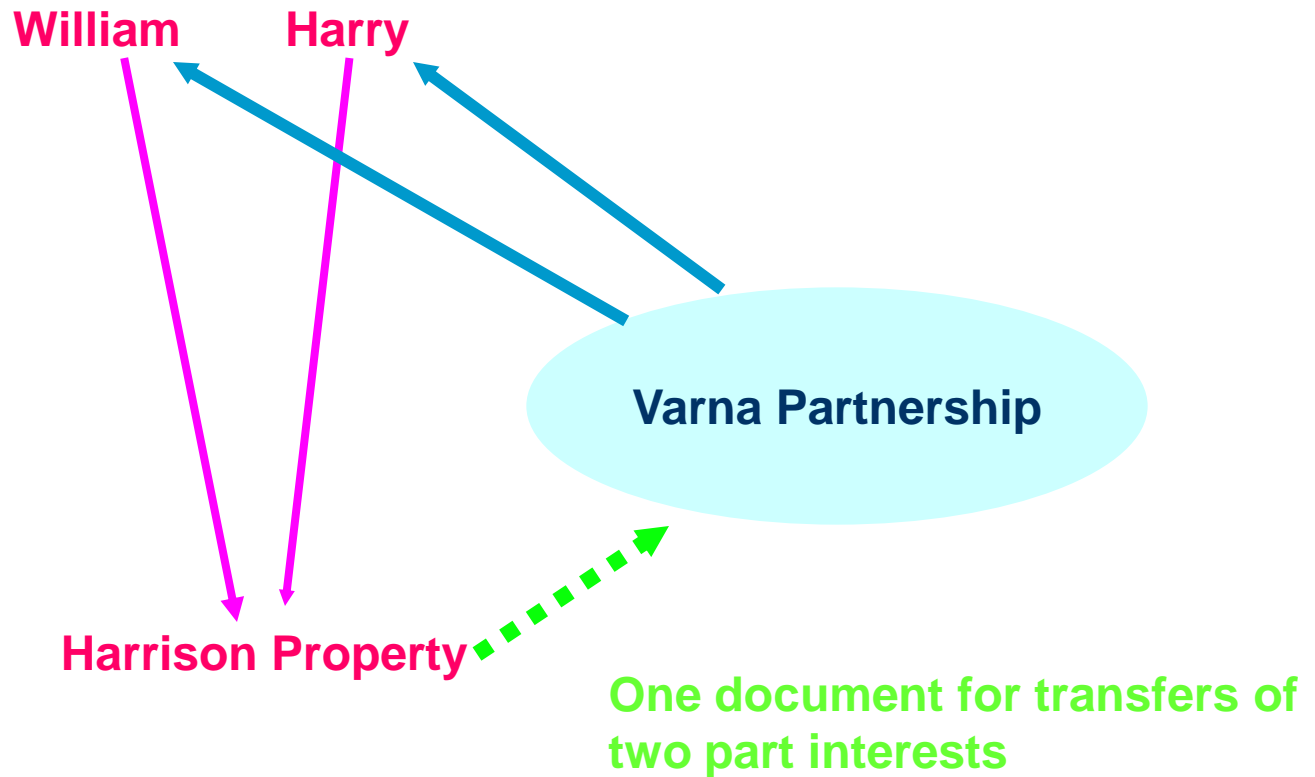
# Transfers Into Partnerships

- All members of partnership must join in election under ss. 96(4) – T-2059
- Election only available where transferee is a “Canadian partnership” after the transfer
- Section 102 – determine status as Canadian partnership “at any time in respect of which the expression is relevant”
- Stacked partnerships – a partnership is a person for purposes of these rules – ss. 102(2) and IT-413R

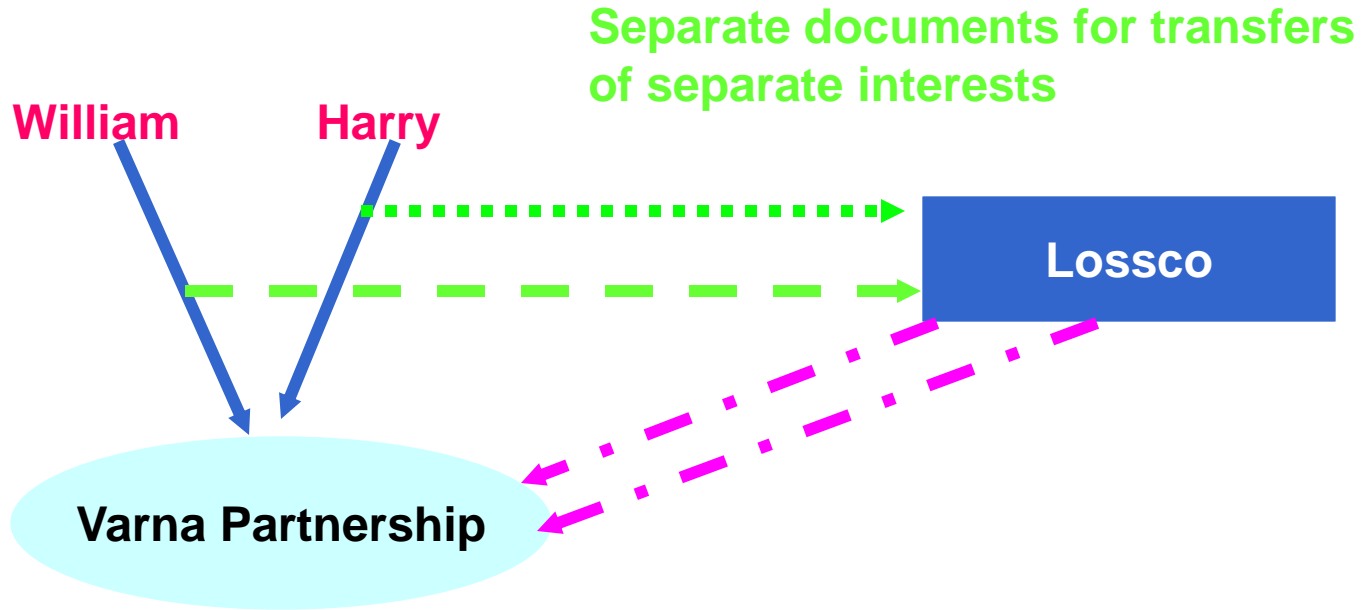
# Partnership Rollovers

- *Loyens* – original personal real estate gains offset by corporate losses
- Case describes how to effect partnership transfer and incorporation
- GAAR analysis
- Obiter comments on waivers

# The First Rollover



# The Second Rollovers



# Critical Points

- Income recognized on transfer into partnership due to assumption of debt
- Capital gain recognized on transfer of partnership interests to Lossco due to negative ACB in partnership interests
- Both partnership and Lossco existed and carried on business



# Transfers Out Of Partnership

- General rule – ss. 98(2)
- Any property distributed to partner results in a disposition at FMV of that property to the partnership and a corresponding acquisition at FMV by the partner
- Consequent recapture/gain in partnership (usually allocated to partner receiving distribution under the partnership agreement)
- Stop loss rules may apply to defer loss

# Changing Partners

- Does change in membership of partnership cause it to cease to exist?
- At common law, a change of partners constituted an event of dissolution unless partnership agreement provided otherwise
- Note presumptions in Partnership Act s. 27 for continuance

# Changing Partners

- Change of status (general to LLP) does not constitute dissolution – PA ss. 44.1(2)
- CCRA- if change in status results in significant changes to rights/obligations of the partners, there may be a disposition of interest – 1990 Roundtable; 1992 CMTC

# Admission of New Partners

- Is admission of new partners really a disguised sale by prior partners?
- *Stursberg* 93 DTC 5271 (FCA) – transfer of property followed by cash withdrawals, creating negative ACB
- MNR and court – partial disposition of property, proceeds equal to cash plus negative ACB
- Note ss. 40(3.1) now addresses this

# Admission of New Partners: Disguised Sale

See also:

- *Haro Pacific* 90 DTC 6583 (FCTD)
- *Pinot Holdings* 96 DTC 1277 (TCC)
- *MDS Health Group* 97 DTC 5009 (FCA)

# Admission of New Partners

- If genuine expansion of continuing partnership, no disposition by continuing partners
- Capital contributed by new partner forms original ACB of partnership interest
- See IT-338R2

# Retirement of Partners

- Retired partner has “residual interest” in partnership until all claims to income and capital paid off
- Income paid to retired partner considered income from partnership business – 96(1)(b)
- Retired partner not considered a partner for purposes of ss. 102 (1) – see preamble to ss. 96(1.1)

# Impact of Change in Partners

- If partnership ceases to exist due to change in partners, ss. 98(1) and (2) apply on the dissolution of the partnership
- Exceptions:
  - Continuance for tax purposes – ss. 98(6)
  - Rollout of property to partners – ss. 98(3)



# Dissolution of Partnership

- Usually involves distribution of property, so 98(2) may apply
- No deemed realization under 98(2) if:
  - 98(3) – pro rata distribution of assets to all partners
  - 98(5) – distribution of assets to one partner to create proprietorship
  - 98(6) – continuation of partnership by remaining partners

# Dissolution of Partnership

- Para 98(1)(a) – until all partnership property has been distributed to partners:
  - Partnership deemed not to have ceased to exist; and
  - Partners deemed not to have ceased to be partners



# Partnership Rollouts

# Partnership Rollouts - ss. 98(3)

- Canadian partnership must cease to exist
- All partnership property must be distributed to persons who were members of partnership immediately before it ceased to exist
- Immediately after the distribution, each partner must hold a pro rata interest in each property distributed
- All partners must jointly elect – form T-2060

# Partnership Rollouts

- If four conditions satisfied:
  - 98(3)(a) - Proceeds of disposition of a partnership interest is deemed to be an amount equal to the greater of:
    - its ACB immediately before final distribution (the “particular time”); and
    - the amount of money plus the cost amount of property (immediately before distribution) received on dissolution

# Partnership Rollouts

- If conditions satisfied:
  - 98(3)(b) - Cost to former partner of property received deemed to be:
    - pro rata share of cost amount of each property
    - pro rata share of 4/3 of CEC
    - potential “bump” on non-depreciable capital assets

# Partnership Rollouts

- If conditions satisfied:
  - 98(3)(f) - Partnership deemed to have disposed of each property for proceeds equal to the cost amount of that property immediately before distribution

# Partnership Rollouts

- Notwithstanding intention for rollover, partner will realize a capital gain where ACB of partnership interest is less than the pro rata share of the tax cost of assets received on distribution
- Partner cannot realize a capital loss – minimum proceeds deemed to equal ACB



# Partnership Rollouts

- 98(3) does not refer to liabilities assumed by partner
- CCRA practice is to consider liabilities assumed to be equivalent of a capital contribution – IT-471R
- 98(3) does not refer to reserves claimed by partnership

# Continuing the Partnership

- Unlike 98(3), 98(6) applies automatically (no election) where:
  - old partnership ceases to exist
  - all property of the old partnership is transferred to a new Canadian partnership
  - all members of the new partnership were members of the old one

# Continuing the Partnership

- 98(6) ensures that property transferred rolls over at tax cost, with no deemed disposition under 98(2)
- Partners' interest deemed not disposed of
  - so old partner could roll negative ACB to new interest

# Continuing Partnerships

- Problem with 98(6) – all property of old partnership must be transferred to new. So how do you deal with property distributed to retiring partners?
- CCRA – so long as retiring partner gets only cash, and all other assets roll over, it will consider 98(6) to apply

# Incorporating Partnerships

- Two methods:
  - Incorporate partnership assets and liquidate partnership – ss. 85(2) and (3)
  - Transfer partnership interests to corporation – ss. 85(1)
  - See *Loyens* 2003 TCC 214; 2003 DTC 355; [2003] 3 CTC 2381

# Incorporating Partnerships

- Under 85(2) and (3) rollover:
  - Transferor partnership need not be a Canadian partnership
  - cannot elect in respect of RE inventory
  - All partners and corporation must elect – T-2058

# Incorporating Partnerships

- Partnership transfers assets to Newco under 85(2) – same issues as “normal” rollover under 85(1)
- 85(3) applies automatically where:
  - Assets transferred under 85(2);
  - Partnership wound up within 60 days;
  - Only assets of partnership distributed to partners are \$ and Newco shares

# Consequences

- If partnership distributes non-share consideration, cost to partner is its FMV, which reduces the ACB of partner's interest;
- Newco shares have ACB equal to ACB of interest less boot received;
- Partnership deemed to have disposed of Newco shares at cost amount, so no gain inside partnership;
- No gain to partner so long as ACB of partnership interest  $\geq$  value of boot received



# Incorporating Partnerships

- Other approach is to roll over partnership interests under 85(1)
- Rely on operation of law to collapse partnership;and
- Rely on 98(5) rollout to proprietorship to move tax cost of assets into Newco

# Partnership Mergers

- No single rollover provision like section 87
- Must use combination of 97(2) and 98(3)
- Only available for Canadian partnerships



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# Partnership Mergers

- Generally use one of two methods:
  - 98(3) rollout to partners, followed by 97(2) roll-in; or
  - 97(2) rollover into new partnership, followed by 98(3) rollout of new partnership interests

# Consequences of Methods

- First method clean and easy
- Second method presents technical issues but solution may exist



# Problem with Method 2

- For 98(3) rollout, each partner must receive a pro rata interest in every other partners' interest
- To “consolidate” individual interests, each partner must sell a portion of interest - immediate capital gain?
- No rollover of negative ACB of prior interest

# Method 3

- May be able to solve cross-ownership issue by using partition rules in ss.248(20) and (21)