

---

---

# PERSONAL TAX PLANNING

Co-Editors: T.R. Burpee\* and P.E. Schusheim\*\*

---

## REORGANIZING A FAMILY HOLDING COMPANY: WINDUPS AND BUTTERFLIES

*Manu Kakkar\*\*\**

This article examines three methods of reorganizing wealth held in a family holding company: a taxable windup, a paragraph 55(3)(a) reorganization (a “related-party butterfly”), and a paragraph 55(3)(b) reorganization (an “unrelated-party butterfly”). A taxable windup is considered the simplest method of reorganizing wealth and may be appropriate in circumstances where the inherent gain on the shares is too modest to warrant the increased complexities and costs associated with the two butterflies. A related-party butterfly is more complicated and costly than a windup but less complex than an unrelated-party butterfly. Its principal advantages are its ability to effect disproportionate distributions of property to corporations and a lack of stringency in respect of acquisitions of property before the reorganization. It is critical that the related-party butterfly be implemented when the principal shareholder is alive in order not to violate the various tests of relationship in the provision. However (as is also the case for an unrelated-party butterfly), the preferred share rules apply, as well as the potentially far-reaching concept of a series of transactions. The unrelated-party butterfly is the most complex of the wealth reorganization plans to implement. Among the reasons for its complexity are the requirements for classifying property to be transferred and the prohibition of certain transactions before, during, and after the butterfly.

To illustrate various issues associated with the unrelated-party butterfly, the article includes a detailed case study based on an actual reorganization for which an advance tax ruling was obtained.

**KEYWORDS:** WIND-UPS ■ REORGANIZATIONS ■ BUTTERFLY TRANSACTIONS ■ HOLDING COMPANIES ■ ESTATE PLANNING

---

\* Of Ernst & Young LLP, Montreal (retired).

\*\* Of Ernst & Young LLP, Toronto.

\*\*\* Of Ernst & Young LLP, London, Ontario. The author would like to thank Mark Kaplan, Gena Katz, Sandra Meersseman, Christine Purden, Rita Suri, Fay Weatherhead, and Eric Xiao for their assistance in the preparation of this article. Any errors in the article are, however, mine alone.

**CONTENTS**

Introduction	570
Taxable Windup	572
Statutory Framework for Butterfly Reorganizations	574
Subsection 55(2): The Basics	574
Defences Against the Application of Subsection 55(2)	575
Related-Party Butterfly	577
Overview	577
The Basic Steps of a Related-Party Butterfly	578
Problems with After-Tax Proceeds	581
The Meaning of “Series of Transactions”	581
The Impact of the OSFC Decision	581
The Impact of the Granite Bay Charters Decision	583
The Preferred Share Rules	585
Unrelated-Party Butterfly	587
Overview	587
Distribution: Classification of Property and the Pro Rata Test	588
Introduction	588
Classification of Assets Among Property Types	589
Consolidated Lookthrough Approach	590
Investment in Partnerships	591
Pro Rata FMV Issues	591
Indebtedness	593
Debt Transfer During a Distribution	593
Debt Transfer Before a Distribution	594
Other Prohibited Transactions	596
Paragraph 55(3.1)(a)	596
Paragraph 55(3.1)(b)	598
Paragraphs 55(3.1)(c) and (d)	599
The FMV Exceptions	600
Case Study	601
Case Facts	602
Analysis of the Proposed Butterfly Reorganization	603
Other Matters Relating to the Reorganization	612
Conclusion	615

---