Proposed Tax Overhaul for Private Corporations

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Standard financial and tax planning advice for the past several decades for business owners has included the use of incorporation to both insulate Canadians from business risk and liability and for asset building and income cash flow planning.

The validity of this tax policy is now under attack, as you have likely heard, now that the Federal Government is proposing major changes to the way private Canadian corporations are taxed and monitored in an effort to eliminate certain tax minimization strategies. The overhaul upends many decades of public policy and has led some to call for a Royal Commission given how drastic the changes are to public policy, the Canadian economy in general and the expected impacts on the business planning of individual Canadians.

The comment period for feedback to the proposed tax policies closes in October 2017 with a target implementation date of January 1, 2018. Below is a brief summary of the proposed changes.

The Federal Government is pointing to reasons such as income splitting or "sprinkling" amongst family members who are shareholders and the amount of taxable passive investment income that has tripled in the last 15 years, from $8.6 billion in 2002 to $26.8 billion in 2015 as justification for their proposed changes. They also point to the growth in the use of corporations by professionals, which has tripled in the last 15 years, and self-employed individuals*. Finally, the government is attempting to limit the use of corporations for passive investment purposes which enables asset accumulation at the corporate level.

There is also a move to extend the current tax on split income (TOSI) rules, also known as the "Kiddie Tax" rules, to all related party adults by considering labour and capital contributions to the business. The Federal Government will also restrict the ability to multiply the use of the Lifetime Capital Gains Exemption by family members or through the use of a Trust upon the disposition of the shares of the corporation.

What the policy changes fail to acknowledge is that incorporation allows business owners to build up cash reserves for times when business is poor and to smooth out capital requirements over time. It also fails to address the need for business owners to provide for their own pensions and to provide for rewards for taking risks in their business. This is unlike those many Canadians who have employer sponsored pension plans to fall back on.

Should the proposed changes get implemented without any amendments, then there are two points which are certain. The first is that the impact of the proposed tax changes will be broad and that every private corporation with multiple shareholders will likely be impacted. The second impact is that compliance costs for preparing corporate tax returns and the need for further organizational and operational reporting requirements will likely increase in order to comply with the proposed tax measures.

While the changes may have a major impact on many people, there are some factors that may mitigate the total impact. The first is that, under income tax principles, a dollar of income should attract the same level of overall tax whether taken as income or dividends now or in the future.

In addition, there are other advantages to incorporation that can still make it a viable strategy for Canadians. Ongoing tax planning might still incorporate the use of Holding Companies, to move passive investment assets outside of active corporations, as well as using investments that will not attract tax as a "passive income", such as the use of cash value life insurance, corporate class mutual funds and so on.

Please contact our office for an appointment to review how the proposed changes may impact you [1] and what your planning options are!

***CI Investments, July 2017 Report.**

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