

Significant Changes for Private Corporations

Authors: Leilani Kagan, K.C. Melissa Malden

published 07/20/2017

On July 18, 2017, Finance Minister Bill Morneau released a consultation paper and a draft legislative proposal to amend the Income Tax Act (Canada). The proposed changes affect tax planning arrangements in private corporations and specifically target income-splitting, the multiplication of the lifetime capital gains exemption, the conversion of income into capital gains and the deferral of passive investment income earned through a private corporation. The proposed amendments may be summarized as follows:



Income Splitting

Currently, taxpayers earning active business income through private corporations may split income by issuing shares to adult family members who are taxed at a comparatively low rate on dividends paid to them from the corporation. The proposed changes limit the ability to split income to individuals who are actively involved in the taxpayer's corporate business. A "reasonableness" test has been proposed to determine the permissible amounts of dividends. The test will be more stringent for family members aged 18-24 years. In addition, the proposals will apply to "compound" income (i.e., income earned from an investment that was already subject to the tax on split income).

These proposed measures would apply in 2018.

Lifetime Capital Gains Exemption

At present, Canadian resident individuals are eligible for a capital gains exemption on the sale of shares of a qualified small business corporation and on the sale of qualified farm and fishing property. The proposed changes eliminate this exemption on gains that have accrued while the shares or property have been owned by family trusts and on gains that have accrued in the taxation year before the individual turns 18 years of age. These changes will affect many family business owners who have undertaken typical estate planning transactions using family trusts and other share structures that involve ownership by family members who are minors.

These proposed measures would apply in 2018.

Capital Gains Conversions

Under the current tax regime, individuals who hold shares of a corporation that has a surplus of cash can extract the cash in a manner where the individual is taxed at a capital gains rate. The proposed changes convert certain capital gains realized between non-arm's length parties into deemed dividends, which are taxed at a significantly higher rate than capital gains.

These proposed measures would apply to transactions occurring after July 18, 2017.

Investment Income Earned in Private Corporations

Currently, private corporations may leave their after-tax business income in the corporation to invest in passive investments. The consultation paper indicates that Finance is considering amendments that significantly increase the corporate income tax payable on passive investment income, effectively eliminating the tax benefits of retaining the funds within the corporation.

These are significant and complex amendments that will affect many owners of private corporations. We are following the consultation process closely and evaluating the implications of the changes in an effort to provide responsive and effective solutions to our clients over the next several months.

DISCLAIMER: *This article is presented for informational purposes only. The content does not constitute legal advice or solicitation and does not create a solicitor client relationship. The views expressed are solely the authors' and should not be attributed to any other party, including Thompson Dorfman Sweatman LLP (TDS), its affiliate companies or its clients. The authors make no guarantees regarding the accuracy or adequacy of the information contained herein or linked to via this article. The authors are not able to provide free legal advice. If you are seeking advice on specific matters, please contact Keith LaBossiere, CEO & Managing Partner at kdl@tdslaw.com, or 204.934.2587. Please be aware that any unsolicited information sent to the author(s) cannot be considered to be solicitor-client privileged.*

While care is taken to ensure the accuracy for the purposes stated, before relying upon these articles, you should seek and be guided by legal advice based on your specific circumstances. We would be pleased to provide you with our assistance on any of the issues raised in these articles.