NORTON ROSE FULBRIGHT

Legal update

Tax proposals target tax planning using private corporations

October 2017
Tax

On July 18, 2017, Canada's Minister of Finance released a consultation paper and draft legislative proposals that target the use of private corporations to sprinkle income among family members, hold passive investments, and strip surplus by converting corporate surplus into capital gains (click here for our July 2017 legal update). The minister invited submissions on the proposals by October 2. The proposals generated a great deal of media coverage and over 21,000 submissions. During the week of October 16, the minister made a number of announcements regarding changes to the proposals, which were confirmed on October 24 in the minister's Fall Economic Statement 2017.

I. Income sprinkling – the tax on split income

The government intends to simplify these proposals, which will be effective January 1, 2018, to reduce taxpayers' compliance burden, including by providing further guidance on establishing the labour, capital, risk and past contributions of spouses and family members.

II. Income sprinkling – the lifetime capital gains exemption

The government will not be moving forward with these proposals. It remains to be seen how this decision will interact with the tax on split income.

III. Holding passive investments through private corporations

The government will proceed with these proposals but has indicated that more flexibility will be provided for business owners to save for business purposes and deal with personal circumstances such as parental leaves, sick leaves or retirement. The government has indicated it will ensure that:

- the new rules will not apply to pre-2018 passive investments or the income earned on those investments,
- businesses can continue to save for contingencies or future investments, and
- up to $50,000 of passive income earned in a year will be exempted from the proposals.

In summary, private corporations can continue to accumulate unlimited surplus, but the passive income earned on surplus accumulated after 2017 and which is in excess of $50,000 per year will be subject to additional taxation. The government has indicated that consideration will be given as to whether in certain circumstances the new rules should exclude capital gains realized on the sale of shares of a corporation engaged in an active business. Further details will be released in Budget 2018, including a technical description of how the passive income threshold will be applied.

IV. Surplus stripping

The government will not be moving forward with these proposals because the proposals could result in several unintended consequences, such as in respect of taxation upon death and intergenerational transfers of businesses. As a result, certain tax-planning techniques aiming to preserve capital gains treatment (such as “pipeline” transactions) are still available. In the coming year the government intends to work with business owners to develop proposals to better accommodate intergenerational transfers of family businesses.

V. Venture capital and angel investors

The government announced it will ensure incentives are maintained so venture capital and angel investors can continue to invest in private corporations, and will work with the venture capital and angel investment sectors to identify how this can best be achieved.

VI. Small business tax rate

The government intends to lower the small business tax rate, which is currently 10.5%, to 10% effective January 1, 2018 and 9% effective January 1, 2019.

VII. Comments

While these announcements are welcome, they contain very little detail and no new draft legislation. We will continue to monitor developments as they arise.

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