

The Federal Liberal government released a consultation paper on July 18, 2017 including measures that are targeted at tax planning strategies within private corporations, including professional corporations.

Income sprinkling – The most common example is paying dividends to family members in order to make use of their lower marginal tax rates. The measures, if enacted, would apply to dividends starting in 2018, and would subject the dividends to the highest marginal tax rate where the recipient is not involved in the business and has no significant investment/risk in the business.

These measures are also aimed at capital gains sprinkling, including measures designed to prevent the use of the capital gains exemption by shareholders not involved in the business, and/or beneficiaries of a Trust.

Holding a passive investment portfolio inside a private corporation – The corporate tax rates on business income are generally lower than the personal tax rates of the shareholders, providing a significant benefit of tax deferral. The proposals announced are intended to seek measures to “neutralize” this deferral benefit where the after-tax earnings are not re-invested in the business, but are instead used to purchase passive investments.

Finance has indicated that any measures that may come from this consultation process would apply on a going forward basis (i.e. the benefit associated with taxes deferred on existing retained earnings should remain intact).

Converting dividend income into capital gains – The current tax rates for capital gains are significantly lower than the tax rates for dividends. These proposals, if enacted, would be effective on July 18, 2017, and are intended to prevent the conversion of what would otherwise be a taxable dividend into a capital gain.

These proposed measures represent the most significant amendments to the taxation of private corporations we have seen for several decades. Given the complexity and broad scope of the proposed changes we will continue to analyze the implications of the proposals and provide further comment and guidance in the near future.

The submission deadline for public comment on these proposals is October 2, 2017. We expect that the government will release a revised draft later in the fall or in the spring with the 2018 Federal Budget.

To learn more about how these changes may impact your private business, please contact us.

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