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Private Company Tax Update

On October 16, 2017 the federal government announced an update to their private company tax proposals. The tax proposal was originally released this past July and feedback during the consultation phase ended on October 2, 2017. The latest announcement reflects both changes from their initial proposal and confirmation of other aspects. The changes are reflective of the criticism on the scope and impact that these new tax rules would have on small business owners.

The announcement does not provide finality to all of their July proposals as there are still a number of items that were not addressed. We have prepared the following summary of the October 16, 2017 announcement.

We hope you find this information interesting and useful. Feel free to pass this document along to your friends and colleagues. Should you have any questions relating to how the following will affect you and your business please contact one of the members of our tax group at info@ddwca.com or (250) 220-7311.

Small Business Corporate Income Tax Rate

The federal government unexpectedly reduced the small business tax rate. The federal portion of the corporate income tax rate will be reduced from 10.5% to 10% on January 1, 2018 and a further reduction to 9% will occur on January 1, 2019.

Earlier this fall, the provincial government released the first NDP budget that reduced the small business rate from 2.5% to 2% on April 1, 2017.

The impact of both of these changes is that the combined British Columbia small business corporate tax rate will be 12% on January 1, 2018 and 11% as of January 1, 2019.

The small business tax rate only applies to active business income earned by a Canadian controlled private corporation on its first $500,000 of earnings.

Liftetime Capital Gains Exemption

The proposal in July would have disallowed the multiplication of the lifetime capital gain exemption (LCGE) to minor shareholders and inactive shareholders. These proposed rules would have limited the ability to multiply the LCGE through a family trust.

The federal government will not be moving forward with the changes to address the multiplication of the LCGE.

The reason for the change is that the government noted that during the consultation phase that they identified potential unintended consequences associated with their proposed measures. These included the impact to intergenerational transfers of family businesses.

Income Splitting

The ability to income split through a private company was one of the key items limited by the proposed changes in July. The intention was to address the concern that high income individuals were using private corporations to lower their income tax burden through splitting income with their spouse and children who were in a lower tax bracket.

The October 16th announcement did not change this and going forward there will be a limit to income splitting using private corporations. However, to the extent that there are clear and meaningful contributions by family members, income splitting will be allowed.

The government's announcement stated that there will be clarity around what a new reasonableness test will be to determine family members' contributions.

These adult family members will be asked to demonstrate their contribution to the business based on four basic principles:

1. Labour contributions;
2. Capital or equity contributions to the business;
3. Taking on financial risks of the business, such as co-signing a loan or other debt; and
4. Past contributions in respect to previous labour, capital or risks.

Draft legislation of the above is not yet available to see exactly how these principals will be applied. It is expected that these changes will be effective starting in 2018 and subsequent years.

Items Awaiting Update

The following significant items from the July proposal have not yet been addressed:

1. The tax treatment of passive investments in a private corporation

The taxation of a private company's investment portfolio is the most far reaching and complicated of the proposed changes. Unfortunately, no further information was provided on this matter.

Once additional information is available we will communicate it to you.

2. Conversion of income to capital gains

No update was given on the tax proposal to address the tax planning of converting income into capital gains.