Private company tax proposals: What's the status?

On July 18, the Department of Finance released draft legislation proposing changes to the way private corporations are taxed. During the 75-day consultation period that followed, the government received more than 21,000 submissions—many of which expressed concerns with the new proposals. Among them was a rather robust submission from Grant Thornton, which reflected our views and concerns, as well as those of our clients.

Only two weeks following the submission deadline of October 2, the Minister of Finance outlined the government's response to the submissions in a series of announcements. While there are more announcements to come—and inevitably more changes to how private corporations will be taxed—below is the information we know so far.

Limitation on access to lifetime capital gains exemption (LCGE)

The government will not be moving forward with measures to limit access to the LCGE because of the feedback it received regarding the potential unintended consequences (i.e., potential impact on intergenerational transfers of family businesses). However, it did not clarify whether the proposed changes to the tax on split income rules (TOSI), which prevent an individual from claiming the capital gains exemption on shares that are subject to TOSI, will still be applicable. Draft legislation surrounding the TOSI is expected to be released in the near future.

Converting income into capital gains

The government will not proceed with measures relating to the conversion of income into capital gains (i.e., proposed draft legislation for sections 84.1 and 246.1) due to the unintended consequences and potential challenges with respect to intergenerational transfers of businesses, including farms.

In the coming year, the government will continue its outreach to farmers, fishers and other business owners, with the intention of developing proposals that better accommodate intergenerational transfers of businesses while protecting the fairness of the tax system. Various tax professionals believe that the Department of Finance is unlikely to leave this issue alone since it has already been highlighted and that we will likely see new proposals related to this issue sometime in the future.

Income sprinkling

The government intends to proceed with income sprinkling measures, but will simplify the proposed measures to provide greater certainty for family members that contribute to a family business. Specifically, the government will:

- reduce the compliance burden with respect to the contributions of spouses and family members, including labour, capital, risk and past contributions;
- better target the proposed rules; and
- address double taxation concerns.

Revised draft legislation outlining the proposed changes is supposed to be released later in the fall—the exact date is not known–and is expected to be effective for the 2018 and subsequent taxation years.

Some tax professionals believe the reasonability test should be removed and replaced with a bright line test and that spouses should be excluded (i.e., the existing rules should just be extended to include those up to 24 years old).

Passive investment

The government will move forward with measures to limit the deferral opportunities related to passive investments. While doing so, it will ensure that:

- The measures will only apply on a go-forward basis (i.e., investments already made by private corporations' owners, including the future income earned from such investments, are protected).
- Businesses will be able to save the funds they need for contingencies or future investments (e.g., the purchase of equipment, hiring and training of staff, business expansion, etc.).
- A passive income threshold of $50,000 per year will be made available to provide more flexibility for business owners and allow them to hold savings for multiple purposes (including savings that can later be used for personal benefits such as sick leave, parental leave or retirement).

The government will assess key design aspects and release new draft legislation as part of Budget 2018 and will also consider whether in certain circumstances the new rules will exclude capital gains realized on the sale of shares of a corporation engaged in an active business.

Many tax professionals feel the government has not made a strong case to support the passive income proposals (i.e., they're too complex and would likely not result in significant government revenue) and believe more clarity is needed especially with respect to the effective date of the proposals.

Waiting for answers

The proposed rules affecting private corporations are still unclear. Over the coming months, we will take great strides to keep our clients abreast of any progress made on this issue—and swiftly relay pertinent information as it is made available. In the meantime, please feel free to contact your Grant Thornton advisor should you have any questions or concerns.

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