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Tax Alert – Canada

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Topic	RELEASE OF CONSULTATION PAPER AND DRAFT LEGISLATION TARGETING TAX PLANNING USING PRIVATE CORPORATIONS

As the Federal Government's 2017–18 Budget papers indicated in March 2017, the Government continues to review the use of private corporation tax planning strategies that may reduce the personal tax of high-income earners in a manner considered inappropriate by the Government.

On July 18, 2017, federal Finance Minister Bill Morneau announced the Government plans to close so-called tax loopholes that allow for income splitting through the use of privately held companies. The Government has indicated that it will seek input on three specific practices that are currently used:

- **Income splitting**. Commonly referred to as income sprinkling, the practice involves causing income that would be taxable to an individual at a high rate to be realized by, and therefore taxed in the hands of, a family member subject to a lower marginal tax rate. For example, this often involves paying dividends or salaries out of the family business. The Government is suggesting dividends and income paid to a family member by a private corporation could be subject to a reasonableness test that would determine the recipient's connection to the business and the legitimacy of the recipient to the income. Amounts not meeting the reasonableness test would be subject to tax at the highest marginal rate regardless of income level.

- **Holding a passive investment portfolio inside a private corporation**. The Government will be looking at passive investment income earned and held within a private corporation. Due to the low tax rate paid by Canadian controlled private corporations, the taxes paid on investment income earned within a corporation are lower than those that are payable by an individual. The Government is seeking input on possible measures to "neutralize" this perceived advantage.

- **Conversion of regular income into capital gains**. As part of a tax planning strategy, it has been possible to cause income that would normally be paid to the shareholder as salary or dividend to be converted to capital gains, taxed at a significantly lower tax rate. The Government has released detailed draft legislative proposals, effective on July 18, 2017, intended to prevent a private corporation's surplus income from being converted into a capital gain.

These proposed measures represent the most significant amendment to the taxation of private corporations in Canada since the 1972 tax reform. In light of the complexity and broad scope of the proposed changes, Facet Advisors will continue to analyze the implications of the proposals and provide further comment and guidance in the near future.

To learn more about how these changes may impact your private business, please contact your Facet Advisors professional, or call us at 604-534-3004.