Federal Fall Economic Statement October 24, 2017

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With a backdrop of the tax proposals Finance Minister Bill Morneau released in July, and the 21,000 responses as part of the "consultation process" the Fall Economic Statement did not reveal any new information on the government's plans, but rather acknowledged there were "unintended consequences" to the proposals and other inherent flaws in the current legislation that need to be addressed. The following is the latest on the key topics:

Income Sprinkling by Private Corporations

Draft legislation will be released later this fall to address what the government has labelled to be "income sprinkling". If passed the legislation would go into effect for 2018 and subsequent years. It seems there will be more restrictive rules for family members under 25. It also seems that dividends received will no longer be solely based upon "ownership", but rather "contributions" to the family business. Treating dividends (after-tax profit distribution) as equivalent to salary may open the door to CRA deciding what is reasonable or not reasonable compensation for family members resulting in biased assessments in favor of the tax department.

Investing Passively in Private Corporations

Finance Canada is deferring the details of draft legislation related to the taxation of investment income earned in a private corporation until the 2018 Budget. For now it has come out to say that there would be a $50,000 threshold before any additional tax is levied. In addition, future income on existing investments would be unaffected by any new tax, and only new investments that result in more than $50,000 of investment income will have a higher tax rate, or possibly a surtax. To keep pre and post Budget date investment pools segregated for tax purposes will be a challenge for business owners, tax preparers, as well as the CRA, and so any legislation will need to be as clear as possible to avoid future disagreements with and audits by the tax department. It's clear however that the government believes that individuals have a benefit by investing through private corporations. The source of this benefit is the low rate of tax paid by private active business corporations, where the tax rate is well below 20% (17 in Quebec by 2019) and the ability to invest the after-tax profits into passive investments.

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The investment income is currently taxed at very high tax rates and come with tax refunds to the corporations when dividends are paid out to the shareholders to avoid double taxation. The fact the government collects more tax earlier due to the current high tax rates on investment income doesn't seem to satisfy it, and Finance is using terms like "unfair tax advantages for the wealthiest" as a disguise to simply quench its thirst for a new source of tax revenues.

Conversion of Income into Capital Gains

In the July "proposals" the government introduced draft legislation aimed at preventing the conversion of income into capital gains, as capital gains are currently taxes far less than all other sources of income. The measures Finance came out with were superficial at best, and the massive response it received by Canadians of all income levels exposed flaws not only in the proposed legislation but in the current legislation as well, including double taxation on the death of business owners and disadvantages in inter-generational transfers of business versus selling out to third parties.

As a result of the feedback the government will not proceed with this proposed legislation. In addition, Finance will not move forward with its proposals to limit access to the Lifetime Capital Gains Exemption (LCGE). Finance will have its hands full to fix what is currently unfair to Canadians in this area.

Other Measures

Small Business Tax Rate

As also recently announced the federal tax rate on private active business corporations will fall from 10.5% to 10% in 2018 and to 9% in 2019. This measure was previously introduced as part of the April 21, 2015 Budget but was put on hold until the government got some positive economic news this past summer. The dividend tax credit individuals claim on non-eligible dividends will also drop from 17% to 16% for 2018 and 15% for 2019 to maintain the concept of "integration" of corporate and personal tax rates.

Canada Child Benefit

The government will start to index the Canada Child Benefit (CCB) as of July 2018.

Look further for more highlights…

Commentary

We would like to thank business owners, tax professionals and the multiple small business organizations for submitting their representations, not only to Finance Canada, but to their Members of Parliament as well. We would also like to thank our clients and contacts for signing the petition for the government to rethink their ill-conceived proposals and to seriously work at having a tax system that is more comprehensive and fair to all taxpayers.

Yours truly,

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