Canadian Tax Alert

Updated proposals on the taxation of private corporations

October 20, 2017

Over the past five days, the Minister of Finance issued a number of announcements regarding the taxation of private companies, highlighting changes that will be made to proposals originally released on July 18, 2017. These changes come only two weeks after the close of the consultation period, a process that attracted over 21,000 submissions.

This Canadian Tax Alert provides a summary of the changes announced this past week, with a comparison to the July 18, 2017 proposals.

Your dedicated team:

Sheri Penner
National Deloitte Private Tax Leader
Tel: 506-663-6637

Quebec
Geneviève Provost
Tel: 514-393-7806

Eastern Region
Sheri Penner
Tel: 506-663-6637

Toronto
Michael Belz
Tel: 416-643-8712

It is important to note that the announcements made this week were not accompanied by revisions to previously released draft legislation or any new draft legislation. The information provided was vague at best and left many questions unanswered. Accordingly, caution should be exercised when assessing actions to take before legislation is formally introduced.

Western Region
Mike Bird
Tel: 403-267-1852

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Tax issue	**Initial proposals (July 18, 2017)**	**Revised proposals (Week of October 16, 2017)**	**Our comments**
Small business tax rate	No change was originally proposed in July (although this rate change was previously promised and then cancelled by the government). The rate was expected to hold at 10.5%.	Rate reductions were announced, dropping from 10.5% to 10% on January 1, 2018, and to 9% on January 1, 2019.	A widening of the gap between personal tax rates and corporate tax rates is largely recognized as increasing the incentive to incorporate, which appears contrary to the policy objectives of the government.
Income sprinkling Lifetime capital gains exemption (LCGE)	Restrictions on access to the LCGE were put forward under the income sprinkling proposals, including preventing gains that accrue while shares are held by a trust or during the time the shareholder is a minor from being eligible for the exemption.	Proposals to restrict access to the LCGE are now being abandoned.	The Department of Finance's change is welcome and will alleviate some concerns associated with the tax proposals related to business transfers. Presumably with the removal of these proposals, the one-time LCGE election proposed for 2018 will also be abandoned. It is unclear whether this abandonment will apply to all situations originally covered under the proposals, including gains subject to "tax on split income" rules. The Government has confirmed its intention to proceed with other income sprinkling measures.

Tax issue	Initial proposals (July 18, 2017)	Revised proposals (Week of October 16, 2017)	Our comments
Capital gains Conversion of income to capital gains	A requirement to track all gains previously realized by non-arm's length parties for the purposes of future share transfers was introduced, as were rules that deem certain transactions to be dividends instead of capital gains.	Proposals related to converting income to capital gains are now being abandoned, and the government will continue to examine this area for future changes over the next year.	This is a positive change that significantly reduces uncertainty for private companies and helps ensure that the transfer of family businesses are not taxed in a punitive manner. In addition, this eliminates a large portion of the retrospective nature of the overall proposals. The related proposed changes to capital dividend account payments will also presumably be abandoned as a result of this announcement.
Passive income Grandfathering and de minimis rules	Draft legislation was not released, but various proposals were presented in the consultation paper.	The Department of Finance has confirmed that existing assets and income earned thereon would be exempt from any new rules. A de minimis threshold of $50,000 of investment income before the proposed rules would apply was introduced.	Grandfathering is consistent with previous comments from the Department of Finance, although the effective date of the new rules is still unclear. Introduction of a de minimis test will reduce complexity and narrow the application of the rules. However, the de minimis amount suggested by the government may not be adequate to address taxpayer concerns. Draft legislation was not released and there are still many unknown details.

Looking ahead

The announcements this week provide significant directional clarity with respect to the changes that will be made to the proposals released by the government on July 18, 2017. Additional details may be released in the government's fall economic update on October 24, 2017 and the 2018 budget in the spring, but could also emerge at any time between now and then.

Taxpayers should begin to prepare for the changes by assessing the impact of the proposals on their businesses and families. Private companies and their shareholders should develop a plan of action to ensure that their businesses remain competitive in the face of these changes. Although some planning should be undertaken before the end of the year, we continue to remind our clients that these announcements are technically incomplete, with draft legislation and the enactment of the changes still to come. Caution should be exercised in undertaking any transactions based on these comments. Speak with your Deloitte advisor about what is best for your company in the current circumstances.

Deloitte LLP
Bay Adelaide Centre, East Tower
22 Adelaide Street West, Suite 200
Toronto ON M5H 0A9
Canada