PROPOSED CHANGES TO PRIVATE CORPORATE TAX PLANNING

Presented by:

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What changed?
Proposed legislation will:

1. Increase personal tax on private company dividends owned by non-active shareholders (ie spouse/adult children) - taxed at highest marginal rate.
2. Disallow lifetime capital gains (LCG) deduction on sale of qualified small business shares held by non-active shareholders.
3. Increase taxation of corporations earning investment income in private corporation.
4. Stop business owners from triggering capital gain (24%) on shares vs personal dividend (41%). Unfair when business owner sells shares to family (pays tax on capital gain). Now family must pay tax when withdrawing their original cost (double taxation).

1. Dividend sprinkling & payments to private company shareholders.

Current:

- Tax on Split Income (TOSI) most typically applies to dividends that are taxed at the highest personal marginal tax rate.
- It most commonly applied to individuals < 18 on dividend income (private companies), trust income or partnership income.

1. Dividend sprinkling & payments to private company shareholders.

Proposed:

- TOSI now applies to all *related individuals (not just minors)* receiving:
    - dividends, partnership income, trust income, indebtedness, income or gains from dispositions by non-active shareholders.
    - More onerous criteria on individuals ages 18 – 24.
- Any individual, no matter their age, not making a *reasonable* contribution to the business is subject to TOSI

1. Dividend sprinkling & payments to private company shareholders.

Proposed:

- Introduce *reasonableness* test - determine whether amount is unreasonable and subject to highest tax rates.
  - 2 main *reasonableness* tests are Labour & Capital
    - Do you trust the CRA to determine what is *reasonable*?
    - Significant litigation will result.
- Related to aunts, uncles, nieces and nephews
- Strict *reasonableness* test rules for individuals < age 24.
  - Labour – efforts are ignored
  - Capital – minimized
  - Only exclusion – 90% actively involved in business

1. Dividend sprinkling & payments to private company shareholders CONT.

Proposed:

- Dividends from private companies to non-active family members taxed at 41%.
- Capital gains on the sale of private corporation shares by non-active shareholder to 3rd party taxed at 24% (highest rate).
- Capital gains on the sale of private corporation shares by non-active shareholder to related parties party taxed at 41%.
- Family trust or partnership distributes income to non-active beneficiaries taxed at highest rates.
- Income from loans, must be *reasonable.*
- Careful – rental properties, loans to relatives, guarantees

2. Limitations on Lifetime Capital Gains Exemptions (LCGE)

1. Before 2018, the sale of shares of qualified small business - first $835,716 capital gain was tax-free.
2. Individuals < 18 do not qualify for LCGE &/or gains accrued before 18.
3. Adult individuals - must meet *reasonableness criteria.*
4. Capital gains in a trust will not qualify for LCGE.
5. Transitional rule permit election to use LCGE in 2018 (similar to 1994)
6. BUT, 2018 election triggers AMT up to $50k payable April 30, 2019. Advance tax planning required to manage AMT.
7. Will frustrate current legitimate estate planning measures.

3. Increase taxation to discourage private companies from holding *passive investments.*

- Companies are taxed at either 13% / 27%, leaving them 87% / 73% to reinvest in their businesses.
  - Finance Objective to penalize business owners who invest in passive investments so they have only 50% to reinvest.
- Changing entire system of corporate taxation … significantly more red tape, rules horrendously complex.
- Small businesses that save pay tax at 50% where Public companies pay tax at 27%.

3. Increase taxation to discourage private companies from holding *passive investments.*

- Investment income earned from passive investments is already taxed at equivalent rates to individuals. The proposal amends tax on earnings *designated for passive investments.*
- Flow passive earnings to individual shareholder, tax rate up to 71% in Alberta
    - Terrible tax result for rental properties in corporations.
    - Terrible tax result for middle income earners ($60–$130K)

3. Increase taxation to discourage private companies from holding *passive investments.*

- Reasons for corporations to save excess cash are:
  - Cushion for contingency and maintaining lines of credit
  - Building up cash for future expansion;
  - Building up personal savings because business owners don't have pensions.
- Unintended result…no cash reserves to counter against bank risks, maternity leave, retirement, etc.
- Unintended result…cannot save for significant reinvestment. Private companies <u>disadvantaged</u> to foreign and public companies.

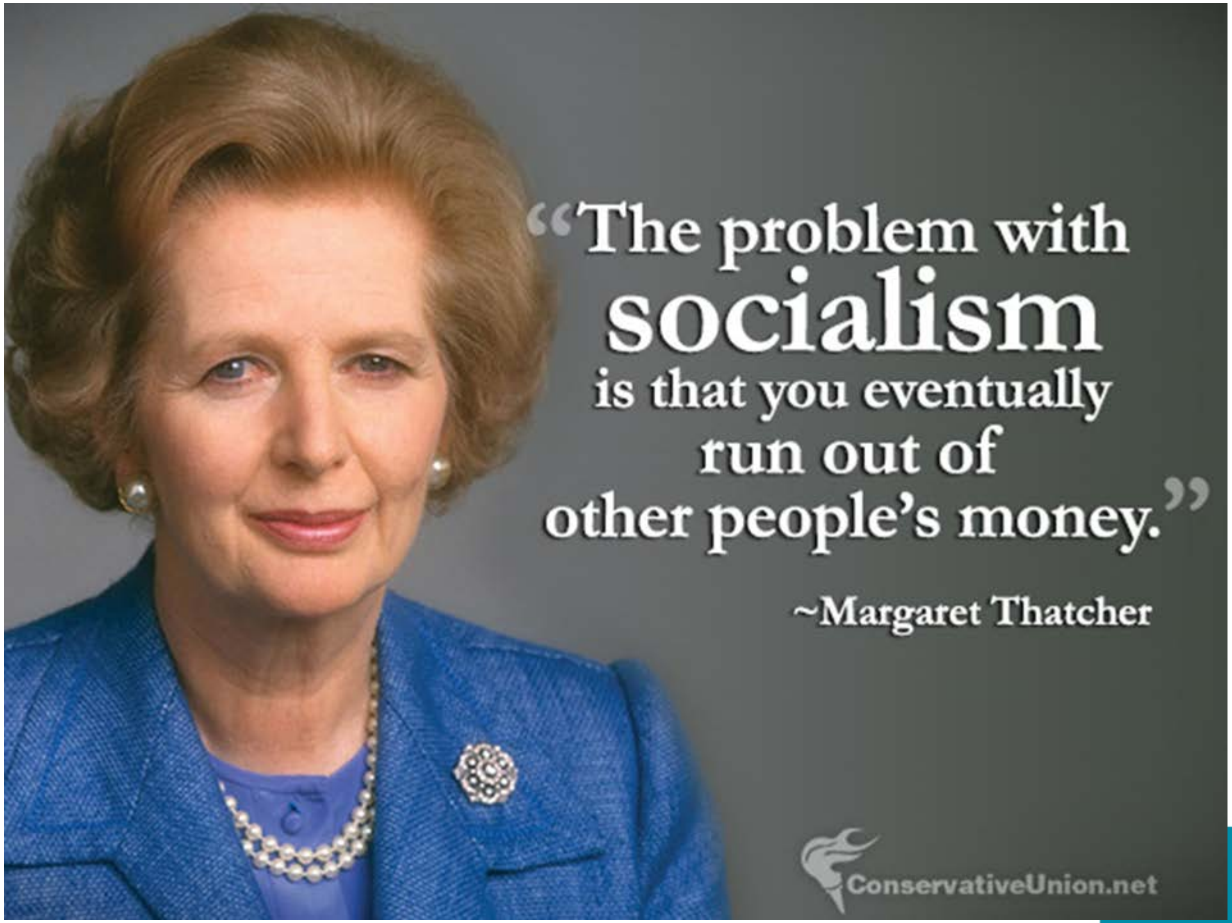
4. Converting Capital Gains to Dividend income

1. Before July 18, 2017, on shareholder death, could effectively avoid double tax and treat corporate assets received as dividend or capital gain.
2. Proposed changes include:
   - Potential double or triple tax upon death of a shareholder - need special planning.
   - Total tax paid in the Estate/heirs to get money to pay tax can increase the tax burden from 53% to 87% - need special planning.
3. Potential double/triple tax on transfer of family business from one generation to next - extremely complex rules
4. Unfair advantage to sell shares to an unrelated party – pay substantially less tax, use CGE to save more tax, no double tax.

What's Next?

1. Comment period open till October 2nd, 2017.
2. Reach out to your MP. Exert influence using lobby groups. DO NOT stay silent.
   - Fix the double tax problems & family succession issues!
3. Sign online petition – it's easy!
   https://petitions.ourcommons.ca/en/Petition/Details?Petition=e-1249
4. Economists commented that "business risk" cannot be measured. Employee cannot be compared to business owner.
5. Start a "Carter 2" commission to review entire tax system and simplify it. Too much red tape bogs down the economy.
6. High taxes on income sprinkling to family members likely to stay. Passive investment remains the most unclear rules.

Thank you


"The problem with
socialism
is that you eventually
run out of
other people's money."
~Margaret Thatcher
ConservativeUnion.net

What about farmers?

Farm Estate Planning

Slides courtesy of:
Thomas R. West, CPA
Charles M. Rotenberg
Ottawa, ON

The Biggest Problems in Farm Estate Planning

- How to pass on farm assets to heirs?
  - During your lifetime or
  - At your death
- How to minimize taxes?
  - During your lifetime or
  - At your death

Lifetime Capital Gains Exemption (LCGE)

- Current farm property exemption is $1M per individual.
- At current tax rates the tax saving would be approximately $240,000 per individual.

Family Farm Rollover or LCGE

Example: Land used in the farm business

Fair market value	$100,000
Adjusted Cost Base (ACB)	$ 16,000
(Vday – Dec 31/71- $100/acre)	-------------
Potential capital gain	$ 84,000

Parent transfers land to child:

If rollover utilized, child will have ACB of $16,000.

If LCGE utilized, child will have ACB of $100,000.

Farm Rollover followed by Sale

- Presently, capital gain shown in previous example will qualify for LCGE.
- Possible to use farm rollover to transfer property from parent to child, followed by sale, whereby parent & child both claim LCGE.
- Can be used in situation where capital gain will be > $1M limit
- **BUT** rollover to child must be > 3 years before the sale
- With proper planning, a combination of rollover and LCGE of parent & child can eliminate tax on capital gain on land.

"Here it is, Child Abuse..... leaving the farm to the children"

What do proposed changes mean to a farm family?

- Most farm families
  must work off the farm to supplement their farm income
- Under proposed rules, income paid to family members is subject to 48% / 41% taxes unless they make a “reasonable contribution”.
- Prove to CRA that spouse or child (working off farm) is still “actively engaged” or invests significant capital.
- Rules do not apply to Hutterite farms.

Reasonableness Criteria 18 – 23 yrs.

Labour

- only recognize labour if individual actively engaged on a "regular, continuous and substantial basis in the activities of the source business";
  - What if child is attending post-secondary education?

Capital

- Basically don't recognize capital contributions
  - What if grandparent still owns land?

Loans & Guarantees (for all individuals)

- from family members to buy capital not recognized as capital contributed to the farm

2018 Election to claim LCGE

- Proposed One-time Election to Crystallize Gain in 2018
- Determine your capital gain exposure
- Use LCGE on farm land owned personally.
- Does the land qualify for LCGE?
- If insufficient LCGE, elect on gains accrued till child turns 18.
- Consider elect on farm corporation shares – complex rules.
- BUT, election will trigger AMT, about $60k, payable April 30, 2019.
  - where is farm family going to find $60k per family member?
- AMT is recoverable from ordinary tax over 7 years
- Likely cannot recover all AMT

Transfer Farm Corporation to Next Generation

- Sell shares to outside party, e.g. factory farm, claim LCGE, save $240k in tax. Proposed rules – no change.
- Existing rules – sell shares to child – generally don’t claim LCGE, 24% tax rate.
- Proposed rules - 41% tax rate as a dividend (increases tax by 71%)
- Extremely complex rules – family could have TRIPLE TAX.
- Rules do not apply to Hutterite farms & Pension Plans buying farmland.
- KEY – 90% assets of farm corporation MUST BE FARM ASSETS.

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