

Tax planning using private corporations

Government proposed changes to tax legislation

September 2017

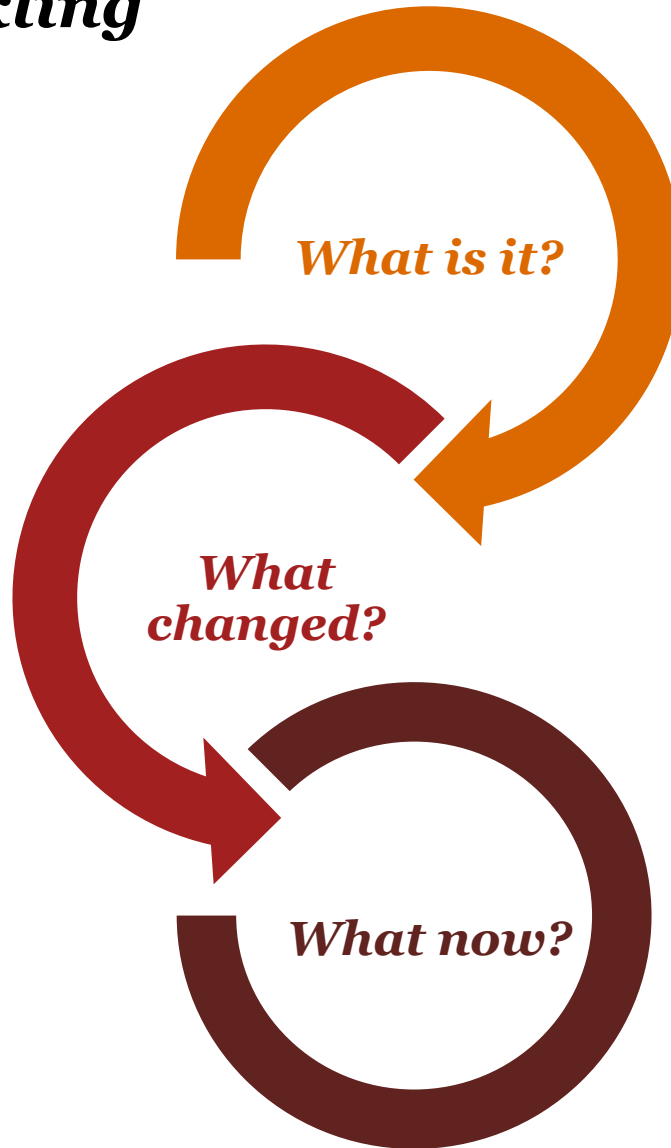


Agenda

- Income sprinkling
- Lifetime capital gains exemption
- Converting income into capital gains
- Holding passive investments inside a private corporation
- Some planning ideas that are still possible

Income sprinkling

- Draft legislation effective in 2018
- Extends “kiddie tax” to adult children
- Any income earned from a related private corporation by a non-active family member will be taxed at the top marginal rate
- Few exceptions
 - reasonable test

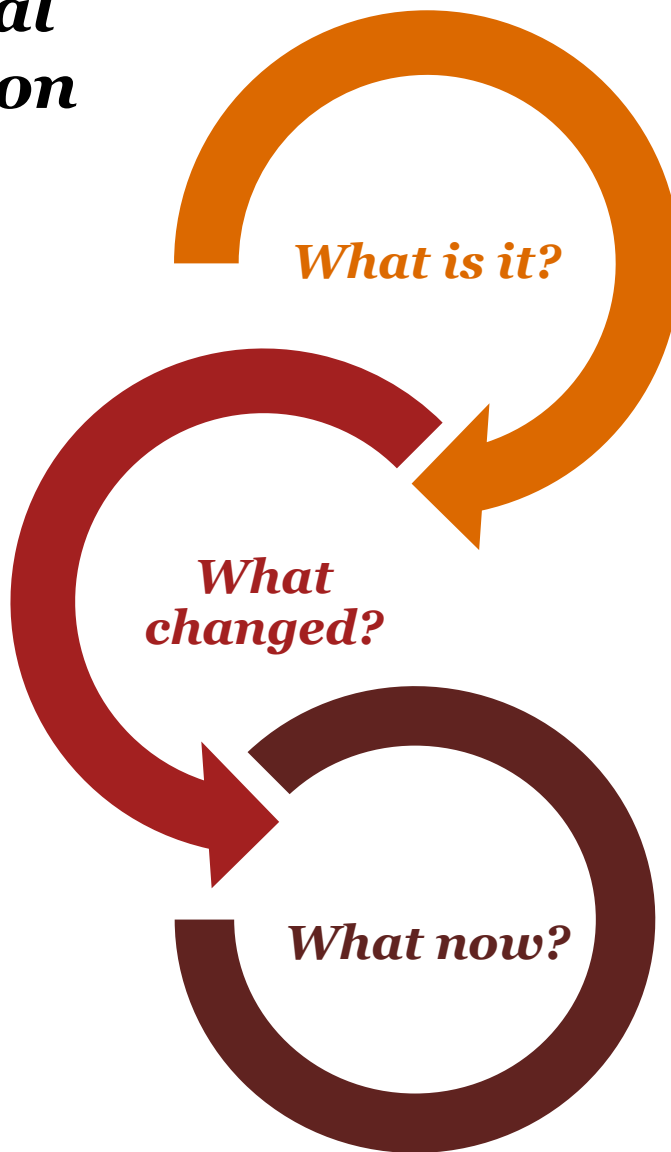


- Taking advantage of lower tax brackets of family members
- “Kiddie tax”
- Typically implemented through use of a family trust
- Most common usage was funding post-secondary education costs

- Talk to your tax advisor – every situation is unique
- Consider maximizing 2017 distributions
- Consider prescribed rate loan strategies

Lifetime capital gains exemption

- Draft legislation effective in 2018
- No exemptions for minors
- No exemptions for non-active family members
- Can't use a trust to claim, CGE, even if beneficiary active in business
 - life-interest trusts exempted

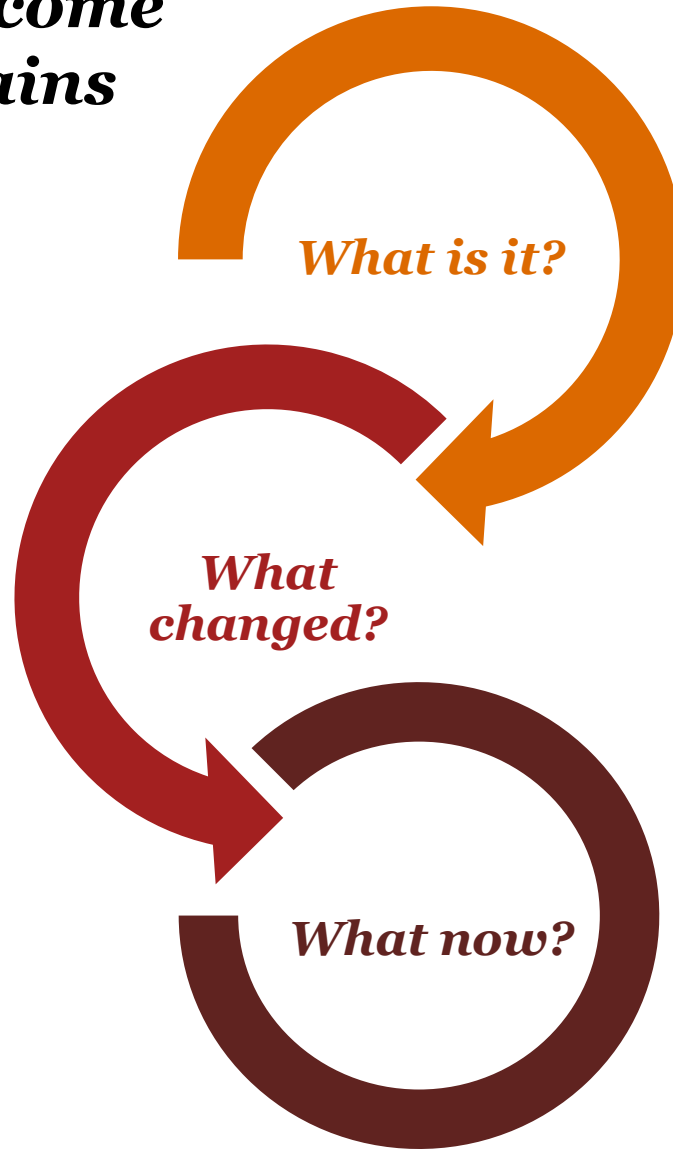


- First approx. \$835,000 of capital gain on sale of qualifying shares is tax free
- Standard planning involved multiplying access via family trust

- Talk to your tax advisor - your situation is unique
- Election available in 2018 for non-minors – watch minimum tax
- Purification required by end of 2017

Converting income into capital gains

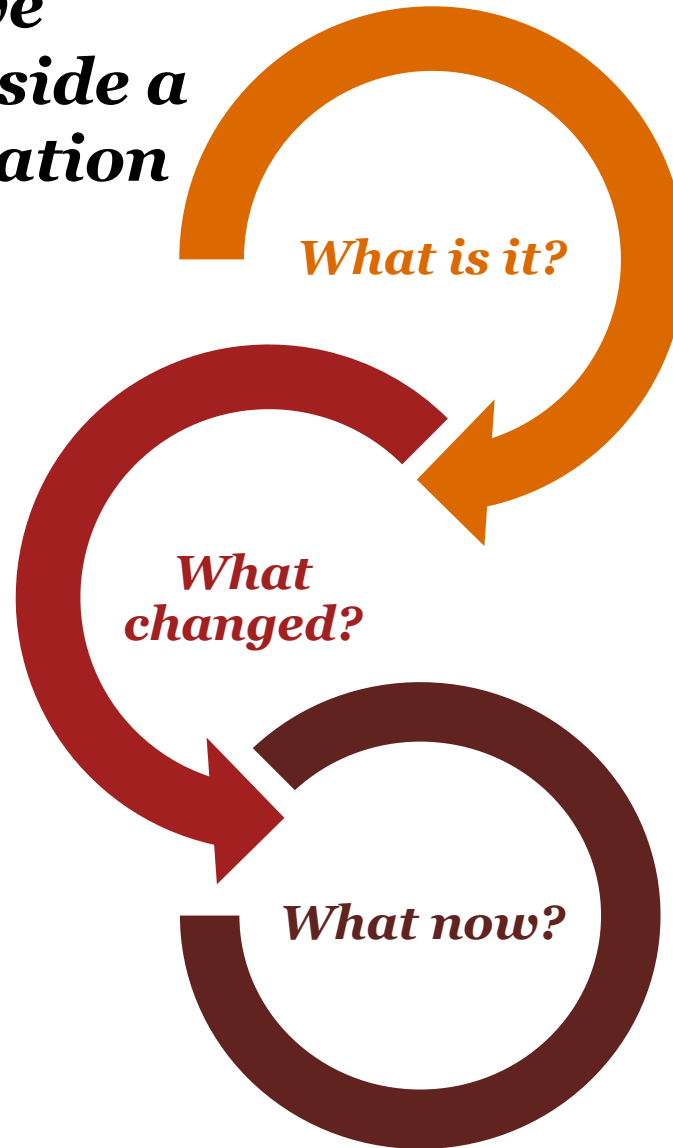
- Prevention of the distribution of corporate surplus to a non-arm's length individual shareholder resident in Canada
- The draft legislation is retroactive
- May have unintended consequences to post mortem planning arrangements
- With current rules, if an individual died owning shares of a private corporation, the tax on death with respect to the shares could be reduced to approx. 23.85% in BC (capital gains rate)



- Converting retained earnings that would be paid as a dividend to a shareholder into corporate capital gains; funds can be distributed at the lower tax rates on capital gains
- Tax on death in BC with respect to the shares may be as high as 55.15% or 64.8%
- This “double” taxation may be avoided if the shares are redeemed in the first taxation year of a qualifying estate, but the tax rate will be the dividend rate of 31.30% or 40.95%, depending upon whether the dividends are eligible or non-eligible, not the current capital gains rate of 23.85%

Holding passive investments inside a private corporation

- The government is considering changes to “restore” fairness in the tax system with respect to the earning of passive investment income by private corporations.
- Any measures to address this issue are expected to be introduced prospectively.



- Because corporate tax rates are generally lower than personal tax rates, private corporations have more after-tax funds to invest to earn passive income than individuals.
- In the government’s view, the current system leads to an unfair tax advantage, whereby a corporate owner would prefer to retain after-tax business income, for passive investment purposes, within his or her corporation, rather than paying it out and investing directly as an individual.
- To be discussed in next few slides

Holding passive investments inside a private corporation

Example of proposed changes to ***investment income*** rates on reinvested business income:

BC resident private corporation with ***eligible dividends*** paid

	Personal	<u>Corporation</u> Existing rules	<u>Corporation</u> Proposed rules
Investment income	\$100.00	\$100.00	\$100.00
Total tax paid (personal + corporate)	\$(47.70)	\$(42.67)	\$(66.90)
After tax cash retained	\$52.30	\$57.33	\$33.10
Personal + corporate Tax %	47.70%	42.67%	66.90%

Holding passive investments inside a private corporation

Example of proposed changes to ***investment income*** rates on reinvested business income:

BC resident private corporation with ***non-eligible dividends*** paid

	Personal	<u>Corporation</u> Existing rules	<u>Corporation</u> Proposed rules
Investment income	\$100.00	\$100.00	\$100.00
Total tax paid (personal + corporate)	\$(47.70)	\$(52.32)	\$(71.54)
After tax cash retained	\$52.30	\$47.68	\$28.46
Personal + corporate Tax %	47.70%	52.32%	71.54%

Holding passive investments inside a private corporation

Example of proposed changes to ***capital gains*** rates on Reinvested business income:

BC resident private corporation with ***eligible dividends*** paid

	Personal	<u>Corporation</u> Existing rules	<u>Corporation</u> Proposed rules
Capital gain	\$100.00	\$100.00	\$100.00
Total tax paid (personal + corporate)	\$(23.85)	\$(17.82)	\$(48.37)
After tax cash retained	\$76.15	\$82.18	\$51.63
Personal + corporate tax %	23.85%	17.82%	48.37%

Holding passive investments inside a private corporation

Example of proposed changes to ***capital gains*** rates on reinvested business income:

BC resident private corporation with ***non-eligible dividends*** paid

	Personal	Corporation Existing rules	Corporation: Proposed rules
Capital gain	\$100.00	\$100.00	\$100.00
Total tax paid (personal + corporate)	\$(23.85)	\$(27.47)	\$(55.65)
After tax cash retained	\$76.15	\$72.53	\$44.35
Personal + corporate tax %	23.85%	27.47%	55.65%

Some planning ideas that are still possible

- History of distributing income – may be reasonable
- Prescribed rate loans
- Making larger distributions in 2017
- Capital Gains Exemption elections in 2018

Thank you for attending



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