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BUZZ ABOUT FURTHER FEDERAL BUDGET 2016 FALLOUT - PREPARING FOR JULY 1, 2017

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Background. The most recent federal budget concluded with the promise (or threat) that the government will be targeting tax planning strategies involving private companies. They are allegedly targeting the problem of high income earning taxpayers taking advantage of opportunities to reduce their personal taxes by using corporate structuring. Family incorporated businesses and professional corporations will almost certainly be caught in the net.

The 2016 Budget from the Trudeau / Morneau administration has stated that they will be releasing proposed policy responses to three particular areas:

1. sprinkling income among family members using private companies,
2. holding passive investment portfolios inside private companies, and
3. converting private companies' regular income into capital gains.

Why Should you Care Now? The proposed policy responses have not yet been released, but are anticipated to be announced on or around July 1, 2017. Since the announcement hasn't yet been made, why worry about it now?

Canadian tax laws are commonly treated as in effect from the time of announcement, not the time they are formally enacted. For example, if a budget is announced on March 25, it may not be adopted into law for months but will be effective as and from March 25. By the time a taxpayer knows about the new rules with any certainty, it is too late to engage in any planning to minimize negative effects of the changes.

The result is that planning in anticipation of tax law changes has become a crystal-ball gazing exercise – what is the Minister of Finance likely to do? What planning can be done in anticipation of what we guess the Minister is likely to do?

Crystal Ball Best Guesses. This brief alert doesn't focus on the threats surrounding converting the income within a company to a capital gain, but rather on the other two aspects.

Income Sprinkling / Splitting. There are already considerable restrictions in this area that make allocating





income from a company to family members a limited vehicle, including “kiddie” tax and attribution rules that limit the ability to income split with one’s spouse or children. This could easily become more restrictive if either of the following were introduced in respect of declaring dividends from a company to spouses and adult children or to a family trust of which they are beneficiaries:

- increasing the age at which parents can income split with their children from 18 to a later age; or
- barring income splitting with spouses altogether.

If your family company has a regular practice of issuing dividends that ultimately are received by, and taxed in the hands of, your spouse or children who are 18 or over, you may therefore wish to consider declaring and paying all of those dividends prior to July 1 in order to ensure that:

- you can access the current available rules that permit this, and
- you are not receiving this dividend income all in the hands of a person who is subject to the highest marginal tax rate.

The personal tax rates for 2017 in BC jump to their highest rate for taxable income over \$108,460, and federally for income over \$202,800 (the second highest federal rate starts at \$142,353). If your company is paying dividends to spouses and/or children 18 or over (either directly as shareholders or to a family trust from which it is then distributed out to them) such that the spouse or child has an aggregate income for the year under these highest rates, declaring all of the dividends before July 1, 2017 that you anticipate declaring for the whole of 2017 could be beneficial if the Minister changes the income splitting rules.

If the possible changes don’t come into effect, this would likely be a step that doesn’t prejudice your company as you would have paid these monies this year regardless.

Passive Investment in Companies. There are an abundance of restrictions already in place that limit the ability to pay tax-free inter-company dividends. The situation would be immeasurably exacerbated if, as some of the buzz suggests may be coming, a refundable tax were imposed on moving money from an operating company to its holding company that is not refunded until the holding company distributes it out to humans.

The likely worst case scenario would be if such a tax materialized together with the restrictions on income splitting mentioned above. This would result in the company being out of pocket for the tax until it claims any available refund, while encouraging the holding company to push it into the hands of an individual who is in the highest tax bracket in order to access the refund.

If your operating company has sizeable retained earnings on its books, it could be advantageous to move an





amount equal to the retained earnings from the operating company to the holding company before July 1, 2017. If the operating company has insufficient cash on hand to effect this, it could consider borrowing in order to do so or evidencing the movement with a promissory note.

If such a tax does not materialize:

- there is likely little to no adverse tax consequence to having dividended the retained earnings to the holding company, provided that the amount of the retained earnings moved up aligns with the amount of the safe income on hand of the operating company. Any amounts dividended up from the operating company to the holding company in excess of the safe income could receive adverse tax treatment, so it is imperative to consider this option with your company's accountant; and
- if monies were borrowed to facilitate this, the retained earnings can be loaned back from the holding company to the operating company in order to repay the loan, and any accrued interest in the interim is arguably deductible.

So... We don't know what the Trudeau / Morneau team will do, but they have made it clear that they are actively targeting these areas. If such changes were to come into effect and result in less money in your and your family's pockets, you may wish to consider undertaking some of these steps.

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Important Note: The information contained herein is premised on the laws of British Columbia as at the date written (June 2017). It should not be treated by readers as legal or tax advice and should not be relied on as legal or tax advice. Detailed legal counsel and tax advice should be sought prior to undertaking any such matter.



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