

THE WAY FORWARD

Navigating Proposed Tax Changes to Private Corporations



Hendry Warren LLP

Dan Warren, CPA, CA, TEP
Jacob Milosek, CPA, CA



LaBarge Weinstein LLP

Paul LaBarge
Estelle Duez



Raymond James Ltd.
Craig Tubman, CFA, FCSI

Agenda

- Introduction
- Case study
- Current Rules
- Proposed Changes
- Planning
- Top 10 issues
- Have your voice heard!

Introduction

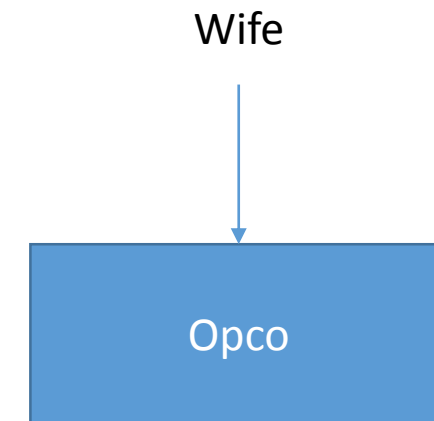
- July 18, 2017: Department of Finance released proposed tax changes that affect private corporations in Canada and announced a 75 day consultation period open to the public
- October 2, 2017: deadline for consultation period in which comments can be made to the Department of Finance on these proposed changes

HAVE YOUR VOICE HEARD

Case Study

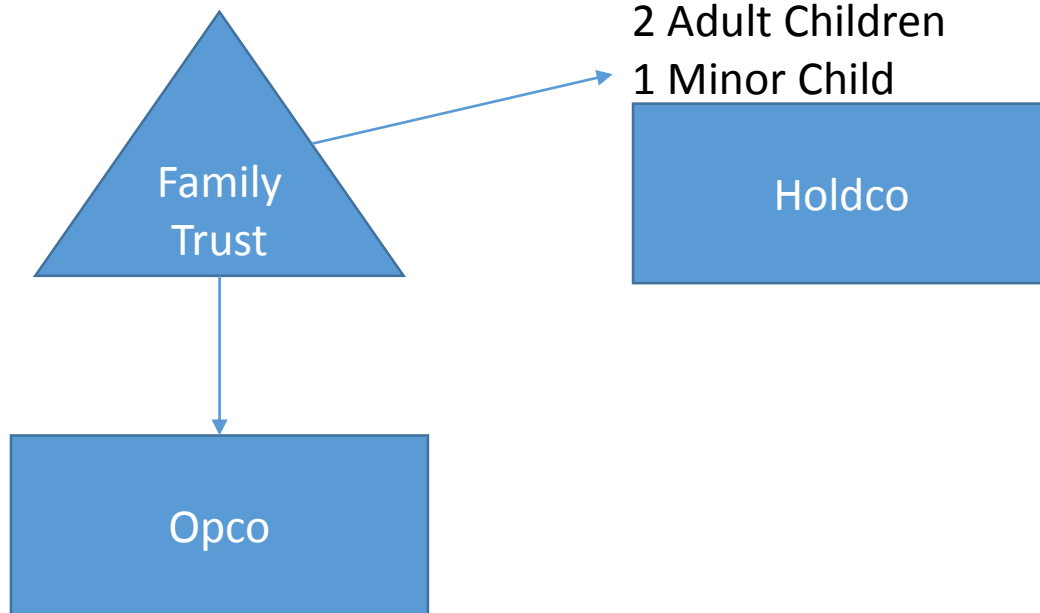
- Wife's company struggled for many years
 - Family relied on Wife's night job and Husband's employment to provide for their family during these years
- Company was financed through mortgage of home and personal guarantees
- Family resources were used to capitalize the company
- Finally in a position to withdraw from the company
- Discussed various tax structures with accountant and lawyer

Initial Structure



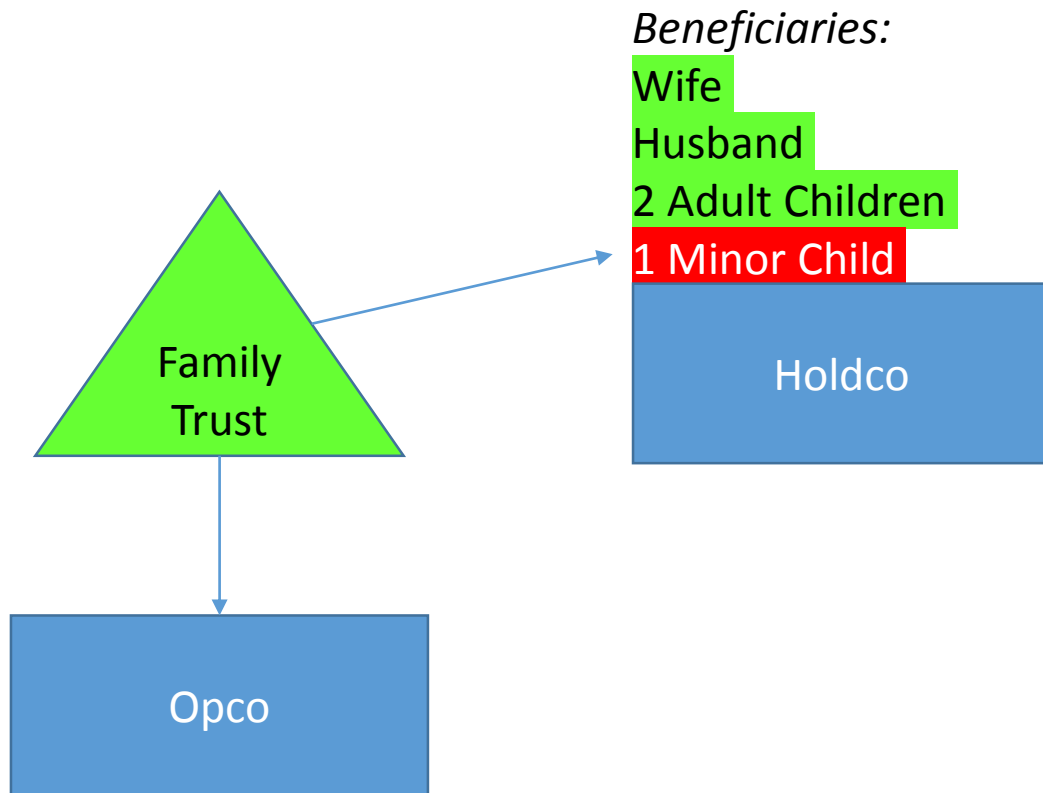
Case Study

Final Structure



- Wife: owner/operator of Opco
 - Had a night job during years the company struggled but quit when the company started seeing success
- Husband is employed full-time at an unrelated company
- Three children: two are adults and one is a minor child (age 12)
 - Adult children currently attend post-secondary education and have limited income
- Holdco is owned 50/50 by Wife and Husband

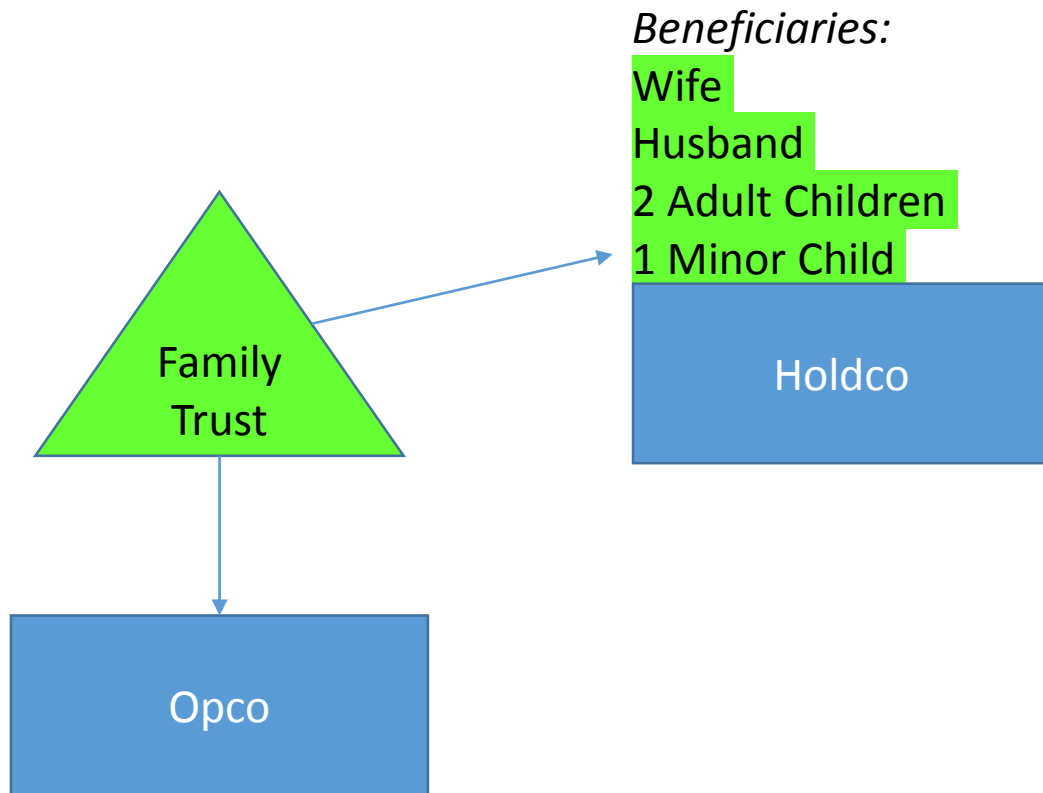
Current Rules



Benefits:

- Income sprinkling amongst adult family members

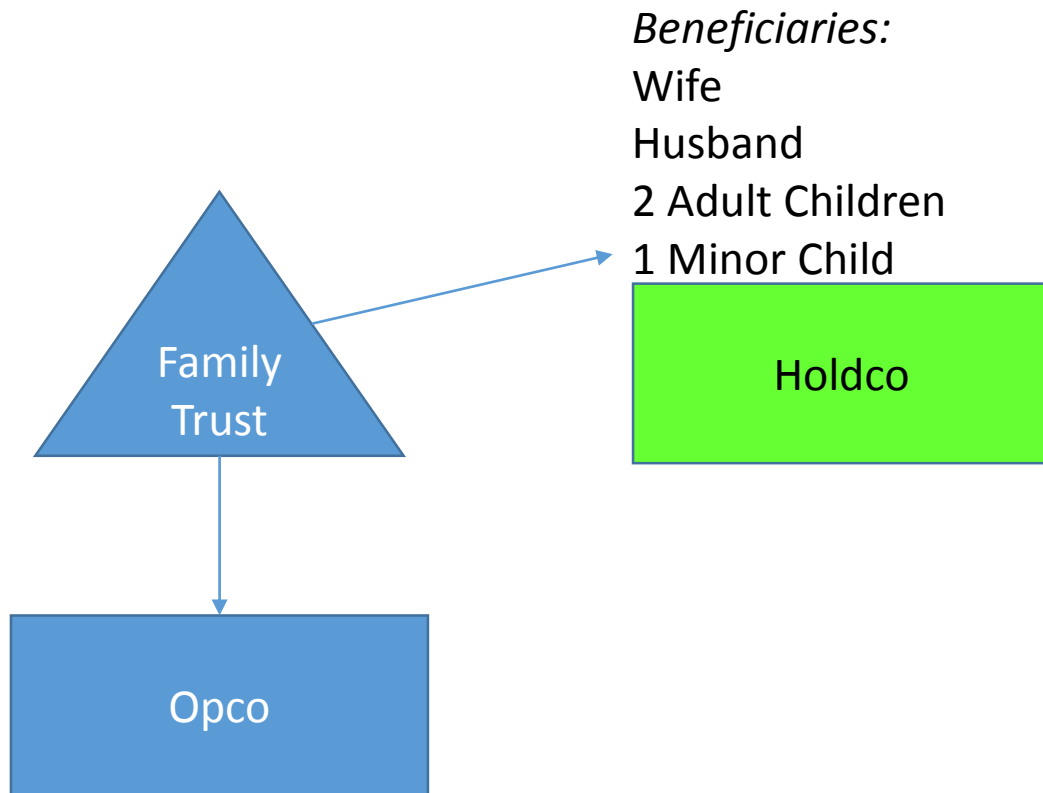
Current Rules



Benefits:

- Income sprinkling amongst adult family members
- Multiplication of Lifetime Capital Gains Exemption

Current Rules



Benefits:

- Income sprinkling amongst adult family members
- Multiplication of Lifetime Capital Gains Exemption
- Dividends to Holdco
 - Tax deferral
 - Creditor proofing
 - Retirement planning

Proposed Changes

On July 18, 2017 the Department of Finance released proposals for major tax changes that affect private corporation in Canada, these changes are largely focused on the following:

- Income sprinkling

(effective January 1, 2018)

- Multiplication of the Lifetime Capital Gains Exemption

(effective January 1, 2018 with transitional rules available for the 2018 taxation year)

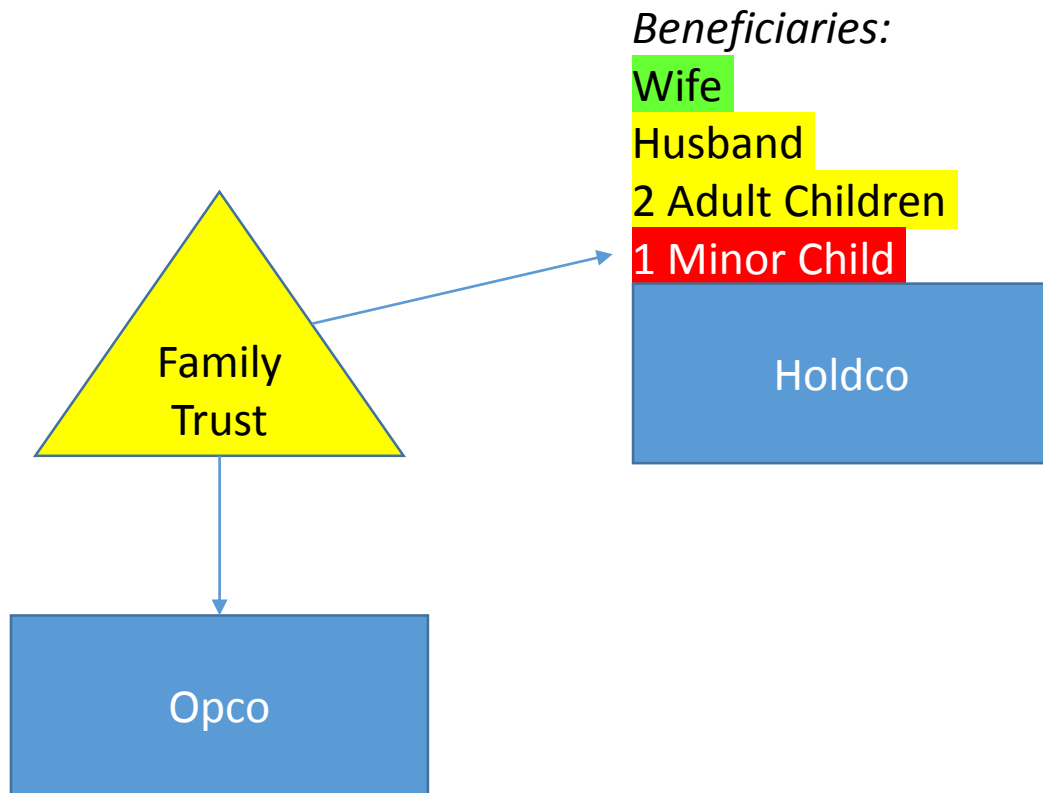
- Holding passive investments in a private corporation

(effective date is not yet known)

- Non-arm's length sales of shares

(effective retroactive to July 18, 2017)

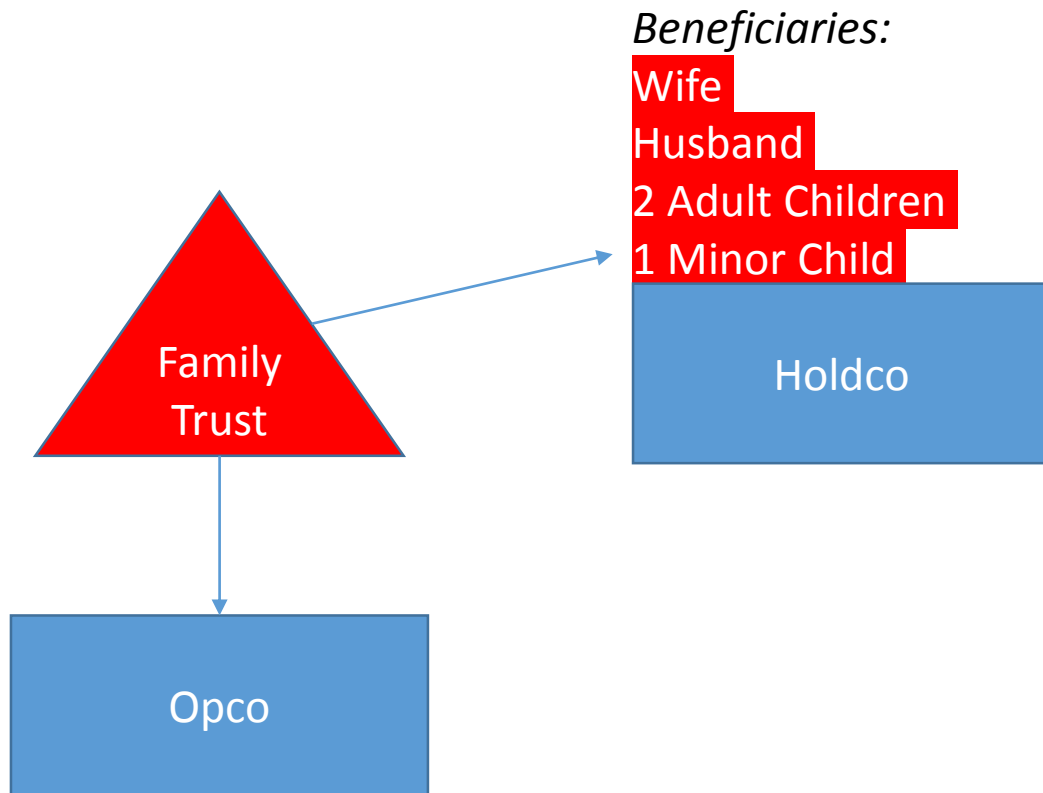
Income Sprinkling



Proposed Changes:

- Limitations on income sprinkling
- Allocation of income subject to “reasonableness test”
 - Tests more stringent for adult children ages 18-24

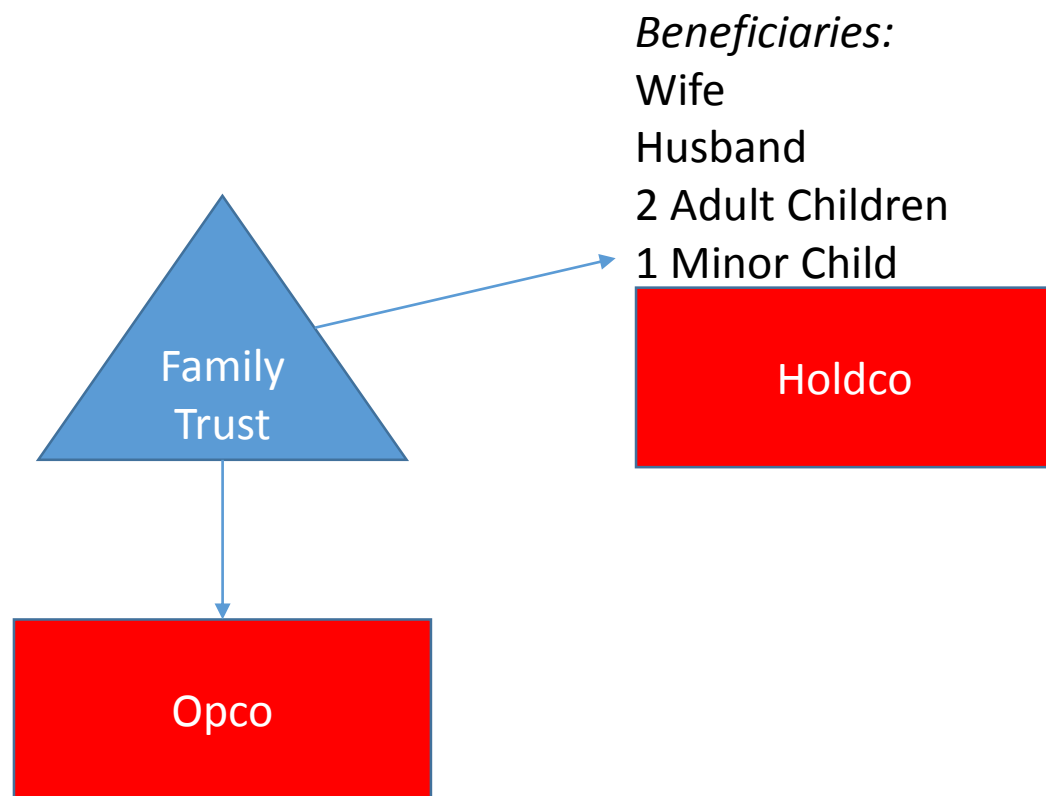
Multiplication of Capital Gains Exemption



Proposed Changes:

- Allocation of capital gains subject to “reasonableness test”
 - Tests more stringent for adult children ages 18-24
- No Capital Gains Exemption available on shares held by a family trust
- Minors no longer eligible for the Capital Gains Exemption

Investments in Private Corporations



Proposed Changes:

1. Increase in overall tax rates (tax could be in excess of 70%) for passive investments held in corporations which reduce benefits of tax deferral
 - Capital Gains realized on passive investments in a corporation will no longer create a balance in the “Capital Dividend Account”
 - Additional administrative burdens by having to track various tax “pools” and grandfathered assets; or
2. High rate tax up front for all amounts not reinvested in the business

Non-arm length sales of shares

The new rules increase the number of barriers to inter-generational transfers of businesses, including:

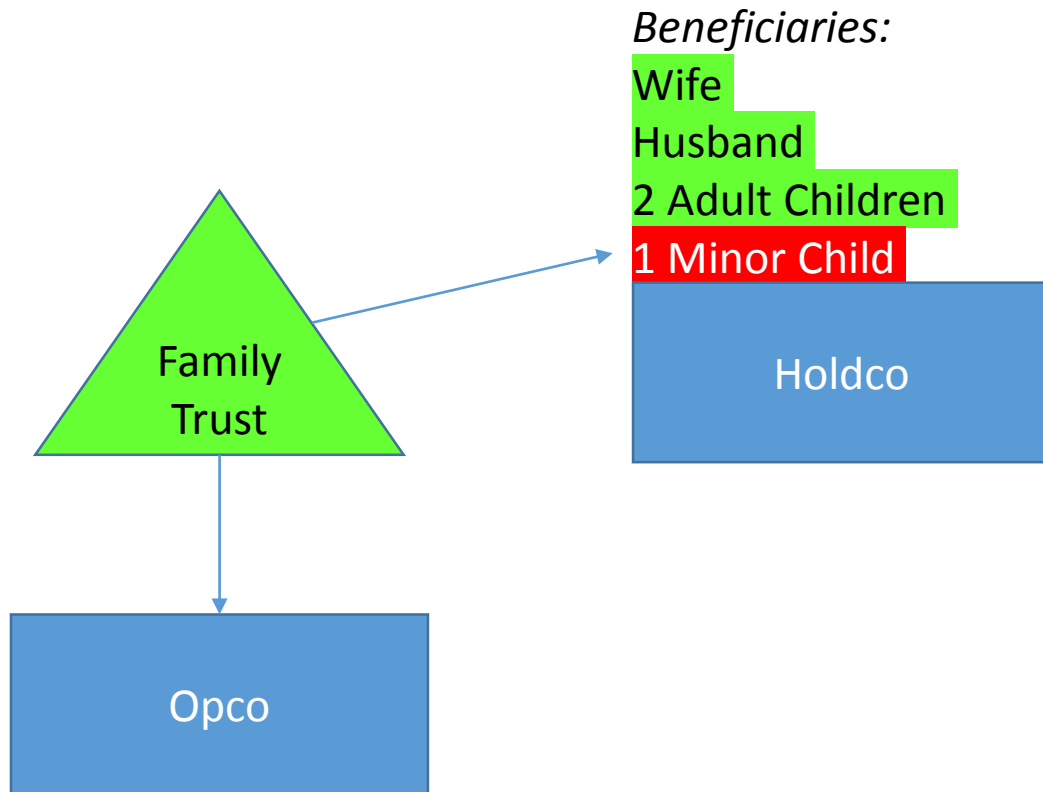
- Transfers on death and “step-up” of cost base
- Sales of shares between related parties

Planning

All situations are unique and must be reviewed on an individual basis; however, we provide the following general planning comments:

- Pay dividends in 2017 to non-active family members
- Remuneration planning
- Transitional rules for Capital Gains Exemption available for 2018
- Need for valuations will be important
- Corporate structures should be revisited
- Additional estate and retirement planning

Dividends



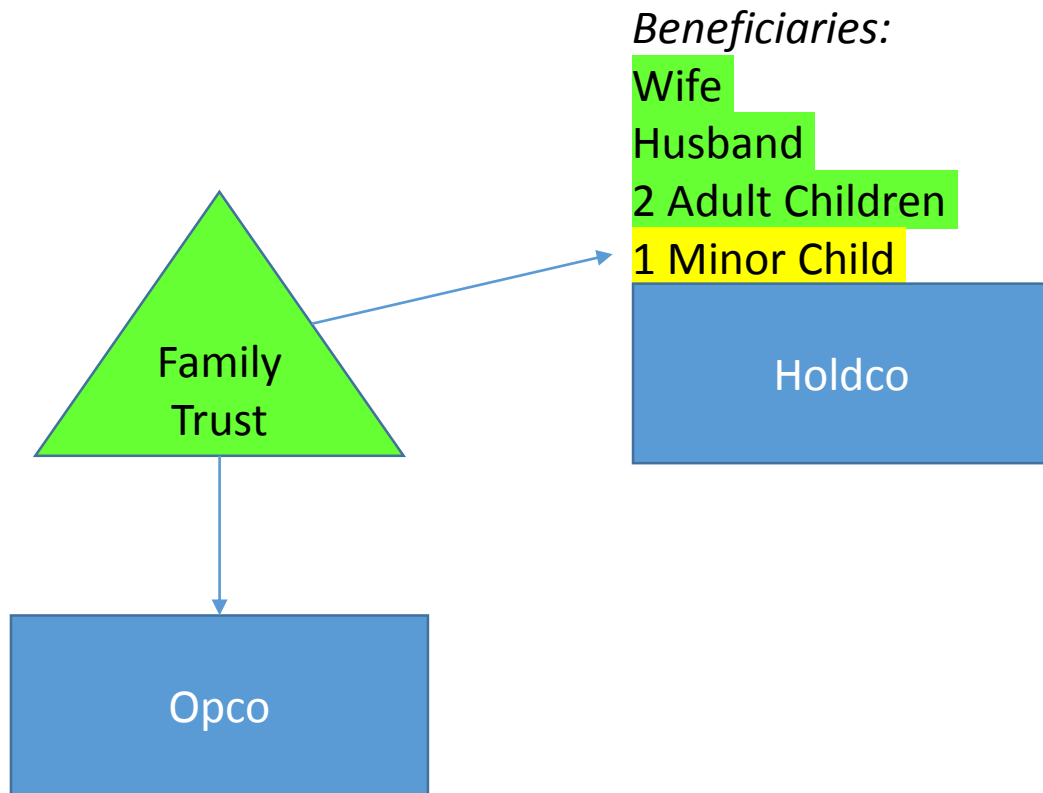
Pay dividends in 2017

- Use up the lower tax brackets of all family members
- Last year of income sprinkling if proposed changes are enacted

Remuneration Planning

- A return to salary from dividends?
- Renewed interest in individual pension plans (IPPs), retirement compensation arrangements (RCAs)
- Maximizing RRSP contributions

Multiplication of Capital Gains Exemption



Transitional rules for Capital Gains Exemption available for 2018

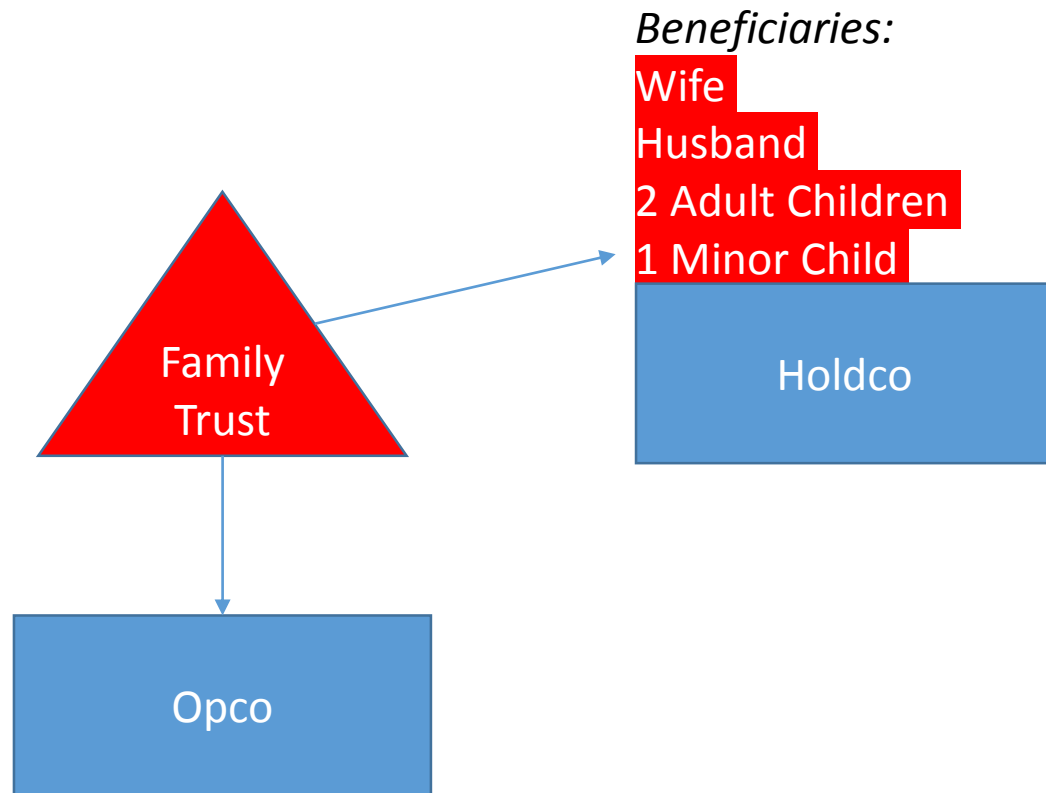
- Election available for the 2018 taxation year to multiply the Capital Gains Exemption amongst non-active age of majority individuals
- Consider triggering gains for minor children before 2018 (election not available to minors)
- Corporation must be “pure”

Valuations

Need for valuations will be increasingly important

- Valuation dates will be created if electing under the transitional rules in 2018, creating capital gains and when children become age of majority
- Punitive tax penalties can be assessed for incorrect valuations

Corporate Structure



Corporate structures should be revisited:

- Changes to the Capital Gains Exemption and the ability to income sprinkle could be affected by an old corporate structure

Estate and Retirement Planning

- Life insurance may become more attractive
- No grandfathering for income sprinkling in retirement for pre-existing wealth inside Holdco
 - Recently retired individuals and those wishing to retire using accumulated wealth inside Holdcos may need to reconsider their retirement strategy

Top 10 Issues

- #10. No grandfathering of income sprinkling for pre-existing wealth
- #9. Lack of pension plans for owners of private corporations
- #8. Ability to pension split
- #7. Increasing CPP contributions
- #6. Reduction of U.S. corporate tax rates

Top 10 Issues

- #5. Brain drain
- #4. Untimely release of proposals from Department of Finance
- #3. Legitimate business reasons for retaining corporate cash
- #2. Reasonableness tests add considerable administrative burden
- #1. “Ensure that people in similar circumstances pay similar amounts of tax” – Department of Finance, July 18, 2017

Having Your Voice Heard

We will be providing our comments to the government and encourage you to have your voice heard through the followings channels:

- The Department of Finance; the consultation period concludes on October 2, 2017 submissions should be made via email to fin.consultation.fin@canada.ca
- Your local MP or the Prime Minister
 - A listing of all contact information has been provided to all guests

Questions

- Hendry Warren LLP
 - Dan Warren, CPA, CA, TEP
 - Jacob Milosek, CPA, CA

Tel: 613-235-2000

dan.warren@hwllp.ca

jacob.milosek@hwllp.ca

- LaBarge Weinstein LLP
 - Paul LaBarge
 - Estelle Duez

Tel: 613-599-9600

pl@lwlaw.com

eduez@LWLaw.com

- Raymond James Ltd.
 - Craig Tubman, CFA, FCSI

Tel: 613-755-4234

craig.tubman@raymondjames.ca