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Federal government responds to feedback on proposed changes regarding taxation of private corporations

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During Small Business Week (October 15 to 21), the federal government released an outline of its response to the over 21,000 submissions it received during the consultation period concerning the July 2017 proposed changes regarding the taxation of private corporations. The proposed changes targeted three areas of tax planning: (1) income sprinkling; (2) holding passive investments in a private corporation; and (3) converting income into capital gains.

Large sections of the government's initial proposed changes appear to have been abandoned. The income sprinkling provisions will be simplified, providing greater clarity regarding when the tax on split income would apply. The government also announced that it will not move forward with proposed measures to limit access to the lifetime capital gains exemption. The government will also shelve the measures related to the conversion of income into capital gains, instead continuing to consult with the small business community to develop proposals that would better accommodate intergenerational transfers.

The government signaled its intention to move forward with measures aimed at limiting the deferral benefits of holding passive investments in a private corporation, targeting high-income individuals who can benefit from tax-preferred savings in a private corporation beyond the pension, RRSP, and TFSA limits available to others.

The proposed measures regarding passive investments will be released in the form of draft legislation as part of the 2018 federal budget. The government received feedback from small business owners that these measures would impact their ability to plan for the future, both for the business and personally. Savings within a private corporation can be used to fund future growth and guard against contingencies, but can also be used to deal with personal circumstances (for example, the government's announcement cites parental leave, sick days, and retirement).

Further development of the passive investment measures will involve:

1. Ensuring investments made by private business owners, including any future income earned from those investments would be protected (i.e. the measures would apply on a go-forward basis only);
2. Continuing the ability of private businesses to save for contingencies and future investments in growth;
3. Incorporating an annual exclusion of the first $50,000 of passive income to allow flexibility for private businesses to hold savings in the business for multiple purposes; and
4. Ensuring incentives are maintained for venture capital and angel investors to continue to invest in innovation.

The government's announcement notes that these narrowed measures would not target the majority of private businesses – Canadian-controlled private corporations ("CCPCs") with passive income above the $50,000 threshold in 2015 represented only three (3) percent of all CCPCs, but earned more than 88 percent of total taxable income.

With many details still unknown, once draft legislation is released, further analysis will be required to measure the impact of the modified proposals.

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