



Proposed Tax Changes Impacting Professional Corporations

We are reaching out to you as courtesy with respect to various changes to the *Income Tax Act* proposed by the federal government with respect to taxation of private corporations and in particular those impacting incorporated professionals like yourself. While we do not provide advice on tax law, we wanted to ensure that you were aware of these changes in a general sense and encourage you to speak with your advisors for additional details.

On July 18, 2017, the Department of Finance released a consultation paper regarding [Tax Planning Using Private Corporations](#) (the Consultation Paper). There are three main areas discussed in the Consultation Paper with respect to taxation of private corporations that we would like to highlight that, if enacted as proposed, may have a significant impact on your Professional Corporation (PC).

First, the Consultation Paper discusses income sprinkling through the use of private corporations. Income sprinkling is achieved through a variety of tax-planning arrangements that permit a high-income earner to, through the use and control of a corporation, distribute profits by way of dividends to individuals in a lower income tax bracket, typically family members (spouse or adult children), to lower the aggregate amount of tax paid by the family unit. The Consultation Paper proposes, among other things, to apply a “split income” tax starting in 2018 on a dividend (effectively raising the tax rate on such income to the highest marginal rate) paid by an incorporated professional (or any other private corporation) to a related individual to the extent that the dividend is not “reasonable”. Under the proposed rules, an amount would not be considered reasonable to the extent that it exceeds what an arm's-length party would have agreed to pay to the shareholder, having regard to the labour and capital contributions to the corporation by the shareholder and previous returns and remuneration paid by the corporation to the shareholder. Special rules are proposed to apply to shareholders between the ages of 18-24 that would make it harder for them to satisfy the reasonable test.

Second, the Consultation Paper discusses changes to the Lifetime Capital Gain Exemption rules. The *Income Tax Act* provides a lifetime exemption for a specified amount of capital gains realized on the disposition by an individual of, among other things, qualified small business corporation shares. Generally starting in 2018, the proposed changes would eliminate the ability to claim this exemption (i) on gains that accrued before the taxation year in which the individual turned 18 years old, (ii) on gains that accrued during the time that subject property was held by a trust (subject to very limited exceptions), and (iii) to the extent that a taxable capital gain from the disposition of the subject property is subject to the “split income” tax discussed above. These proposed changes, if enacted as proposed, may impact the ability of your family members to claim the capital gains exemption on the disposition of shares of your PC. Under the proposals, a transitional rule would allow certain affected individuals to elect to realize, on a day in 2018, a capital gain in respect of eligible property by way of a deemed disposition for proceeds up to the fair market value of the property (resulting in an increase in cost basis of the subject property, thereby reducing taxable capital gains on a later sale) and to use their lifetime exemption with respect to the gain. However, in certain circumstances, minors cannot benefit from this transitional rule.

Third, the Consultation Paper discusses the taxation of passive investments inside a private corporation. While the federal government has not yet proposed legislation on this point, it appears that the federal government is exploring ways to remove the deferral advantage associated with a corporation using active business income to make passive investments. The Consultation Paper indicates that any such rules are intended to apply on a going forward basis (i.e., they are not intended to impact, as much as possible, existing passive investments held by a corporation).

As these changes may have a significant impact on your PC, please contact your existing tax advisor for additional details, or reach out to us to help you connect with a tax specialist or otherwise assist you regarding any of your corporate needs.

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