Policy Alert: Finance Canada Is Considering Major Changes to How Corporations Are Taxed

The Department of Finance Canada is considering major changes to how corporations are taxed. The proposed rules could have a significant impact on many Canadian businesses: potentially raising taxes, increasing the administrative burden on SMEs and heightening the impact on family-run businesses.

On July 18, Finance Canada launched a consultation on how “tax-planning strategies involving corporations are being used to gain unfair tax advantages.” The document contains proposed policies to close these “loopholes.” There are four key changes that will affect business:

1. **Sprinkling income using private corporations:** The government wants to tighten rules to prevent a business owner from unfairly transferring income to family members who are subject to lower personal tax rates. In certain circumstances, owners would have to demonstrate that wages and dividend payments are “reasonable.”
2. **Multiplying the Capital Gains Exemption:** When an individual sells a small business, the first $850,000 of capital gain is exempt from taxes. The government wants to prevent tax planning structures that enable multiple family members to use their exemptions.
3. **Reducing the tax deferral advantage on portfolio investment inside a corporation:** Currently, an owner can accumulate portfolio earnings inside a corporation and pay corporate income tax rates (which are generally much lower

than personal rates). The owner defers paying personal income or dividend taxes until the money is taken out of the business. The government is considering alternatives that would reduce this tax advantage.

4. **Converting a private corporation's regular income into capital gains:** Income is normally paid out of a private corporation in the form of salary or dividends that are taxed at the owner's personal income tax rate. In contrast, when a business is sold, it is taxed as a capital gain, where only one-half of capital gains are included in income, resulting in a significantly lower tax rate on income that is converted from dividends to capital gains. The government wants to tighten the rules to prevent certain tax planning structures, but it is open to more favourable treatment for genuine family business transfers.

The Canadian Chamber of Commerce and its Taxation Committee are currently studying how the proposed changes will affect members in different industries, in family businesses and those with different ownership structures. We will be submitting recommendations to Finance Canada.

Should you wish to participate or provide input, please email Hendrik Brakel.

In particular, we are looking for detailed examples and cases of how a specific small business will be affected by the changes. We feel concrete examples will be most effective in making our case for easing the changes. We would ask that you send them to us by August 11.

Click here to view the consultation documents released by Finance Canada.