Money MATTERS

COLBY•STECKLY
CHARTERED PROFESSIONAL ACCOUNTANTS

As many of you have no doubt heard, there have been some potential changes to tax law introduced by Finance Minister Bill Morneau this summer. While these changes are not yet law, we here at Colby Steckly want to keep you abreast of two main areas to focus on and how they can affect your business moving forward.

INCOME SPRINKLING

Proposed Changes

Income sprinkling is a tax planning strategy that has been used for many years to redirect income to family members with lower taxable income. For example, let's say Mrs. X owns and operates a small business, with shares owned by herself, her spouse Mr. X and their adult children. Currently dividends can be paid to any of the shareholders, depending on types and classes of shares, regardless of whether the shareholders are actively involved in the business. Now let's say, Mrs. X works day-to-day in the business, and Mr. X and the adult children are not involved at all with the business. Currently any dividends paid to Mr. X or the adult children are taxed at each individual's marginal tax rate.

The potential changes will mean that a person must be active in the company to have the dividends treated as per above. When a person that is not active in the company, (like Mr. X, or the adult children) and is issued a dividend, that dividend will be subject to a reasonability test. The details of this reasonability test have not yet been made clear by CRA. Any portion of the dividend that is deemed to be unreasonable will be subjected to the ***highest*** marginal tax rate. This means that if a dividend was paid to Mr. X or any of the adult children, they would pay substantially more personal tax after the changes, than they would under the current tax rules.

This is only the quick version of the proposal. Of course, the new proposed rules are even more complex than this, with further restrictions for adult children aged 18-24 and age 25+.

Visit us in our NEW office located at:

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PASSIVE INCOME
Proposed Changes

Passive Income itself is as simple as it sounds – ***income received that did not require active participation in a business*** – whether from a rental property, ownership of another company, investing in the stock market, and so on.

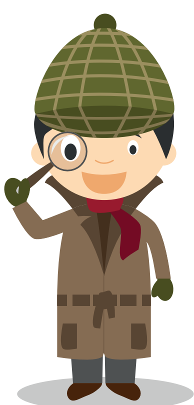
With the current rules, the corporation pays 50.67% on this type of income, but 30.67% of that is refundable when the company issues a dividend to the shareholders. This brings the corporate tax rate down to 20%. The shareholders then pay personal income tax on the dividend that was issued at ineligible dividend tax rates. If investments held by the corporation are sold and generate capital gains, the untaxed portion (50%) of the capital gains can be paid to the shareholders tax free as a capital dividend. Many owners of small businesses have used a holding company to hold the corporate passive investments, which in essence is their personal retirement fund to be drawn out over several years.

Currently there are several suggested changes put forth by the government. Here we wanted to touch on only a few key points, to try to keep a very complex issue easier to understand. The proposal seeks to do the following:

- **Eliminate the refundable portion of tax on passive income.** So effectively this means paying 30% more corporate tax, or about 50% tax on passive income held in a corporation.
- **Eliminate capital dividends on capital gains income within the corporation.** This means no longer being able to pay tax free capital dividends to shareholders.
- **Permanent corporate tax will be equal to the highest personal tax rate.**

These proposed changes are the most significant changes in 45 years and will cost the small business owner significant tax.

If you want to know more about the proposed changes and how they will affect your unique situation, give us a call, we are happy to chat.



Q: Who makes the best detective – Sherlock Holmes or a tax accountant?

A: The tax accountant – she makes more deductions.

Have questions? Feel free to get in touch!

COLBY STECKLY Chartered Professional Accountants **colbysteckly.ca**

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