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LIBERALS REVIEWING PRIVATE CORPORATIONS, HIGH-INCOME TAX STRATEGIES

Simon Doyle / March 22, 2017

The federal government's budget plan issued a warning to financial advisors and their clients: Your tax strategies are under review.

The government said it is launching a tax review of strategies for the use of private corporations and other advantages for "high-income individuals."

Outlined in Liberal's 2017 budget on Wednesday, the government says the review is part of efforts to make a tax system that's "fair" for the middle class.

The review will include:

- "**Sprinkling income using private corporations**": The practice can reduce taxes by causing one person's income to "be realized (e.g., via dividends or capital gains) by family members who are subject to lower personal tax rates (or who may not be taxable at all)," the budget says.
- "**Holding a passive investment portfolio inside a private corporation**": The budget says this may be financially advantageous for owners of private corporations because "corporate income tax rates, which are generally much lower than personal rates, facilitate accumulation of earnings that can be invested in a passive portfolio."
- **"Converting a private corporation's regular income into capital gains**": The practice can reduce income taxes by taking advantage of the lower tax rates on capital gains, the budget says, as opposed to paying income from a private corporation through a salary or dividends.

"It's disappointing," says Kim Moody, director of Canadian tax advisory for Moodys Gartner, adding the proposed review reflects biased positions about tax advantages cited in the Liberals' election campaign platform.

"Most of these private corporations, or a lot of them, are entrepreneurs. They're being punished for taking risk. I think there's a tipping point. There's got to be an incentive to risk your capital," he says.

The government will release a paper on the review "in the coming months," providing further details and proposed policy responses.

The 2017 budget did not propose hiking the capital gains inclusion from its current rate of 50%—as observers had speculated—though a change to the inclusion rate isn't off the table.

"It's conceivable the inclusion rate could be part of that whole package of proposals that's forthcoming in the position paper," says Doug Carroll, vice-president of tax and estate planning for Invesco. He says the government appears to want to "make sure the intended benefits are taken where desired—but that they not be overused."

The government noted the review will look at tax planning strategies for private corporations, particularly those "that inappropriately reduce personal taxes of high-income earners."

The review will also consider any negative impacts on family business transfers, looking at whether the income tax system has features that "have an inappropriate, adverse impact on genuine business transactions involving family members," the budget says.

Finance minister Bill Morneau said he has "always paid his fair share of taxes" and that tax planning strategies using private corporations "can result in some very wealthy individuals getting unfair tax breaks at the expense of others."

The government identified some "tax loopholes" to close, including the immediate introduction of an anti-avoidance rule for the use of offsetting derivative positions in "straddle transactions" (where a person enters into two or more positions).

Also effective immediately, the government will extend anti-avoidance rules, similar to those currently in place for TFSAs and RRSPs, to Registered Education Savings Plans and Registered Disability Savings Plans.

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