BY JAMIE GOLOMBEK

CCPC Tax Proposals

Update on business tax reforms and where the feds go from here

With the consultation period on the Canadian-controlled private corporation (CCPC) tax proposals now behind us, it's been reported that the government received more than 21,000 submissions. The good news is, since the close of the consultation period the government has backtracked on some of the proposals and modified others. Let's walk through what we know so far.

You'll recall that the proposed measures focused on three areas: income sprinkling among family members, including the multiplication of the lifetime capital gains exemption (LCGE), passive investment income earned within corporations, and converting dividends into capital gains.

In mid-October, the government announced it will not proceed with the rules that would have limited multiplication of the LCGE, nor would they proceed with the income conversion rules, which were meant to stop some types of surplus stripping but threatened to negatively affect the transfer of the family farm or business to the next generation.

Of most concern to financial advisors, however, was the government's intention to tax corporately earned passive investment income at a combined effective tax rate, in Ontario, of 73 per cent. Some other provinces provinces' rates would be even higher.

Although no formal effective date or definitive approach for the taxation of passive investment income has been revealed, the government recently announced a $50,000 annual income threshold that would permit a private company to accumulate about $1 million of retained earnings in the corporation and not worry about the high rate of tax on up to $50,000 of income (using a five per cent assumed rate) on that capital.

But even this modification, while welcome, will create an accounting nightmare for most medium- and large-sized private companies, once they reach more than $1 million of retained earnings.

This suggests that perhaps these rules may be further modified once the government has a chance to further digest some of the submissions it has received.

Likely one of the largest, most detailed, and thorough submissions came from the Joint Committee on Taxation of the Canadian Bar Association and Chartered Professional Accountants of Canada.

In its submission on the proposed passive investment income proposals, the Joint Committee points out important non-tax reasons for carrying on business activities through a corporation: the corporate form limits the business owner's liability, thereby encouraging risk-taking, and facilitates the raising of capital. In fact, long-standing tax policy in Canada has been to reinforce the incentive to conduct business activities through corporations by having a substantially lower corporate tax than the top personal tax rate. Many other jurisdictions have low corporate tax rates relative to the top marginal personal rates and nonetheless do not appear to tax passive income at high rates, as Canada does, or generally have legislation that penalizes leaving funds in a corporation for investment.

If truth be told, the submission points out, our Canadian tax system is actually currently "under-integrated," meaning that there is no meaningful tax advantage to earning business income through a corporation if that income is taxed at the general corporate tax rate. In fact, in nine of 10 provinces, both corporate income subject to the general corporate tax rate and investment income earned by a private corporation are subject to higher tax rates than would otherwise apply to such income were it earned by an individual.

And, while the Joint Committee concedes that the investment of income eligible for the small business rate is in some (but not all) provinces taxed at a lower rate, thereby providing an advantage, "that advantage is not significant, and the entire system should not be upended merely to address potential anomalies that arise when corporate income is taxed at the small business rate."

Meanwhile, a report out from the C.D. Howe Institute in October claims that Ottawa's proposed changes for the tax treatment of income from passive investments in incorporated businesses "will not achieve its goal of promoting fairness in the tax system." The report, entitled *Off Target: Assessing the Fairness of Ottawa's Proposed Tax Reforms for "Passive" Investments in CCPCs* was authored by Alexandre Laurin, who assessed the proposals from a fairness perspective and finds them lacking.

Specifically, the proposed regime would end the refundable part of the passive investment income tax for CCPCs who earn active business income in their corporations. As a result, private corporations (and their owners) would be taxed on their passive investment income on the same basis as if they were individual investors in fully taxable accounts. "There would be diminished incentives to defer business consumption, and less income and business saving available for spending on capital equipment," says Laurin. "The same is true of small business income retained for personal purposes — there will be greater incentives for immediate personal consumption of business income rather than saving it for retirement or other purposes."

In his report, Laurin shows that CCPC income taxed at the general corporate tax rate and reinvested passively in the corporation enjoys no significant tax advantages over other saving options, and that business owners earning income taxed at the small-business tax rate and saving it in the corporation for future personal consumption enjoy a tax treatment pretty much on par with others saving through an RRSP or a TFSA.

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