PRIVATE CORPORATION TAX CHANGES: GOVERNMENT OF CANADA TAKES CANADIAN SMALL BUSINESS TO THE CLEANERS

Understanding the Implications of the Recent White Paper on Changes to the Taxation of Private Corporations in Canada

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On July 18, 2017, the federal government published its long-awaited (and long-dreaded in the tax community) white paper on changes to the taxation of private corporations in Canada (the "White Paper") (available here, along with technical documents: **http://www.fin.gc.ca/n17/17-066-eng.asp**). The White Paper follows commitments noted in Budget 2017 which saw the Liberal Government (the "Government") promising to fix so-called "tax loopholes" available to private corporation owners. The White Paper represents another "nail in the coffin" for small business tax incentives; combined with prior proposals, such as changes to the small business deduction rules, the tax system is looking to become vastly more complex (and costly) for small business owners.

The White Paper changes can be generally grouped into three (3) headings, which form the subject matter of this resource document:

1. **Income Sprinkling** - The apportionment of corporate income among various individuals (typically members of a family) so as to reduce the overall "economic" or "family" group's tax incidence. A common, and currently permissible, example includes the direction of dividends to a child over the age of 18, in most cases for paying University tuition. That child pays a lower rate of tax than if the same income were taxed in the hands of his or her parents (who are presumably in a higher tax bracket).

2. **Passive Investment through a Holding Corporation** - The use of pre-tax dollars within a corporation to invest in passive assets (e.g. marketable securities, land). A common, and currently permissible example, is where a small business owner directs excess income from their operating company to a holding company; that holding company then uses the funds to invest in a stock portfolio.

3. **Converting Regular Income into Capital Gains** - The modification of regular streams of income to business owners (such as dividends or salaries) into capital gains, the latter of which are only half-taxed. These types of plans vary wildly but one that may come under this proposal is so-called "pipeline planning" which concerns a strategy for minimizing tax after a person has died when that person owned shares of a company.

This document will cover these areas at a high level in an effort to give the reader some appreciation of the proposals currently on the table. The writer has chosen to begin each area with an "example scenario" pulled directly from the White Paper. The reason for this is that the White Paper proposals are complex; however, a review of the examples really drives the point home about the "improper" action that is being taken by a small business owner. These examples, in the writer's opinion, frame the policy actions taken by the Department of Finance in the White Paper.

Critically, it should be kept in mind that the proposals are not final but are open for comment until October 2, 2017. Professional advisors, business-advocacy groups such as local chambers of commerce, and especially small business owners should be particularly alarmed by the White Paper and should ensure their voices are heard in the ongoing discussion.

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Income Sprinkling

Example Scenario

Jonah and Susan are neighbours living and working in Ontario. Jonah and Susan live with their spouses and children who have no significant sources of income, other than as described below. Although Jonah and Susan each earn $220,000 in 2017, Susan's household pays about $35,000 more tax than Jonah's household.

This is because Susan earns $220,000 as an employee. As an individual with $220,000 in employment income, she pays about $79,000 in income tax for the year.

Jonah has an incorporated consulting business that earns $220,000 before taxes and salary. Jonah provides the consulting services for the corporation. The corporation qualifies for the small business deduction in respect of its income from the business.

Jonah owns the voting shares in the corporation. Jonah's spouse and two children, ages 19 and 21, also own shares in the corporation, for which they paid very little. The corporation pays Jonah $100,000 in salary, and pays its remaining after-tax profits in equal amounts to the spouse and children as dividends. The dividends are taxable income of the spouse and children.

After accounting for corporate income tax, taxes on Jonah's salary, and dividend tax credits claimed by the spouse and children, about $44,000 in total tax is paid on the $220,000 earned in the year through the corporation and distributed to Jonah's family—$35,000 less than the amount of tax paid by their neighbour, Susan, on the $220,000 she earns to support her household.

As the example illustrates, these new rules are aimed at determining whether compensation paid to a family member is reasonable based upon factors such as that member's contribution of value and financial resources to the company. Much of the outrage on the point seems to stem from data unearthed by the Government which shows that 18-24 year olds earn more non-eligible dividend income than 26-29 year olds. This is apparently an indicator of improper use of the tax system.

The Government has proposed to address this "problem" by expansion of the tax rules affectionately known as the "kiddie tax rules" (specifically a concept called "split income"). Those rules (simplified) currently ensure that certain income earned by minors is taxed at the highest marginal tax rates. This obviously destroys the incentive to pay income to minors. The new rules expand this concept to persons in the following groups:

- For those under 18, they are (i) Canadian resident at the end of a year, and (ii) at any time in that year, either (A) they have a parent residing in Canada, or (B) an individual related to them resides in Canada and the minor receives income derived from that individual's business; and

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- For those over 18, they are (i) Canadian resident at the end of a year, and (ii) at any time during that year, a relative of theirs resides in Canada and they receive income derived from that individual's business.

With the proposed amendments, "split income" would now catch (i) dividends from private corporations, (ii) partnership and trust distributions derived from certain related private corporations and services, (iii) certain capital gains, (iv) interest and other amounts in respect of corporate, partnership or trust debt, (v) income received from a benefit being conferred on a taxpayer, (vi) income derived by individuals under the age of 25 from the investment of either (A) other "split income", (B) income attributed by certain tax provisions, or (C) capital dividends, and (vi) trust income, which is effectively item (v) income redirected through a trust.

If one pays amounts to someone under 18, they are effectively "strictly" caught by both the existing and the new rules. For those over the age of 18, they will also be caught where (i) they receive funds from a corporation of which a family member is a principal (generally, an owner), and (ii) the funds are not "commensurate with what would be expected in arrangements involving parties dealing at arm's length". Key question is what does this latter language mean? The answer involves looking at various factors, which are set out in the following chart:

Factor	Aged 18-24	Age 25 and Older
Labour Contributions	Individual is actively engaged, on a regular, continuous and substantial basis, in the activities of the business	Individual is involved in the activities of the business (e.g. contributed labour that could have otherwise been remunerated by way of salary or wages
Capital Contributions	Whether amount exceeds a legislatively-prescribed maximum allowable return (presently 1%) on the assets contributed by the individual in support of the business	Individual has contributed assets, or assumed risk, in support of the business
Previous Returns/ Remuneration	All previous amounts paid or payable to the individual in respect of the business (e.g. dividends on shares, salary and wages)	Same as Aged 18-24

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Satisfying these factors is good (i.e. less chance of a higher tax hit) while not satisfying these factors is bad (i.e. application of the "kiddie tax" rules). The general points made above are augmented in a few key additional ways for the 18-24 crowd:

- **Labour contributions** - These are deemed to be nothing (clearly a negative result) where (i) the principal purpose of the business is to derive income from property (such as interest, dividends, rents, or royalties), or (ii) 50% or more of the amounts to be included in the individual's (i.e. 18-24 year old) income are related to property (such as interest, dividends, rents, or royalties) or capital gains. Consequently, watch out for corporations only earning investment returns in one form or another.

- **Capital contributions** - These are also deemed to be nothing where (i) the assets contributed were derived from a previous "split income" amount, or (ii) the assets contributed were acquired in connection with a person related to the 18-24 year old (A) becoming obligated under a guarantee, covenant, or other agreement to ensure repayment of a debt of the individual, or (B) providing financial assistance to the 18-24 year old. Consequently, watch out for reinvested "split income" as well as guarantee or assistance agreements concerning related 18-24 year olds.

Clearly the factors leave some room for interpretation. It should be borne in mind that this is a "factor analysis" test and so "failing" one factor may not necessarily lead to a negative finding for the taxpayer. For example, perhaps a sufficient degree of involvement in a corporation will offset the lack of substantial investment in that same corporation. One could envision many a technology company with 18-24 year old principals who are clearly involved with (if not entirely responsible for) the business yet have only contributed nominal capital as part of the initial capitalization of the company.

These new rules ostensibly will work well where, for example, a corporation, which a mother owns, directs income (likely dividends) to her adult son, and that son has no real involvement in the corporation. But what about where the mother does not own the corporation but has "influence" over the corporation. By way of example, Bill Gates reportedly still owns 4% of Microsoft; he doesn't "control" Microsoft but it is likely fair to say that he could, if his "muscles were flexed", cause things to happen over there. Unsurprisingly, the Government has thought of this too and introduced the concept of "connected individuals".

In this case, the same "kiddie tax" or "split income" rules noted above would apply where (i) a person receives money from a corporation, and (ii) a relative of that person has a presumed degree of influence over the circumstances around paying that money. How does one determine this influence? Helpfully, the Government has released a list of factors for consideration:

- **Strategic influence:** the individual has factual control of the corporation alone or as part of a related group of persons.

- **Equity influence:** the individual owns property (whether shares of the corporation or assets of the corporation) representing 10 per cent or more of the equity value of the corporation.

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- **Earnings influence:** in the case of a corporation that carries on a service business, the individual or a related person owns shares in the corporation (or other property that derives its value from those shares) and either (i) the individual's services are the primary contributor to the activities or revenues of the corporation's business or the individual performs all or part of the services, or (ii) the individual performs all (or part) of the services and that individual is required to be registered under the laws of Canada or a province or territory in order to perform the services (e.g. professionals such as doctors, lawyers, accountants).

- **Investment influence:** 10 per cent or more of the value of the corporation's property is derived from property acquired from the individual or from another corporation in respect of which the individual is a 'connected individual'.

Where influence goes, so too must the tax man.

As a final comment on the "split income" matters, the Government has thoughtfully expanded the potential liability for "split income" as well. Where it was once the exclusive purview of parents of minors (under 18) to bear the "tax sins" of their children, now parents of children up to the age of 24, as well as potentially any relatives of those same children, can join in the fun. Liability has now truly become a family affair. In addition, being tagged with "split income" has the added bonus of being included (despite not being received in certain cases) in the income base for many tax credits such as the age credit, GST credit, Canada Child Benefit, working income tax benefit, and the recovery tax on old age security benefits; the net result likely being a reduction in these credits.

Trust Changes and the Lifetime Capital Gains Exemption

Aside from constraints around income and dividends, there are also income sprinkling measures proposed that relate to trusts. In a very common scenario, a trust may be the owner of all of the voting shares of a private corporation. That trust is "managed" by two parents (who are "trustees" under the law) and the property of that trust (i.e. the shares) is held for the benefit of the parents and their children (who are "beneficiaries" under the law). Suppose an offer comes in for the purchase of this business. The family obviously has an incentive to reduce their "tax hit" as part of the sale and will likely want recourse to the coveted "lifetime capital gains exemption" or "LCGE". With the new proposals, things are not as easy as they used to be.

By way of quick primer, the LCGE is a tax exemption which "shields" a particular amount of capital gains (for the year 2017, approximately $835,714, indexed to inflation for future years) from taxation on the sale of either (i) qualified small business corporation (QSBC) shares, or (ii) qualified farm or fishing property (QFFP). Given the complexities around the terms in (i) and (ii), the specifics on satisfying the terms are not discussed in this post. It is sufficient to note that accessing the LCGE is a key concern for many a business or property owner looking to sell.

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In the past, a family such as our example family could "multiply" the LCGE among the members of the family by having the trust distribute the "tax hit". This would allow each of mom, dad, son, and daughter to "take one for the team" but use up their LCGE's. For a family of four, this would mean "boosting" the total LCGE to $3,342,856. Under the White Paper, this would fall away, with the negative effects being summarized by age category in the table below:

Age	Proposed Measure
Minor	Not eligible to claim the LCGE at all in respect of dispositions after 2017
Adult	Not eligible to claim the LCGE in respect of capital gains from a disposition of property after 2017: • to the extent the capital gain accrued before the individual turned 18; • to the extent the capital gain accrued while a trust held the property; or • to the extent the taxable portion of the capital gain is included in an individual's split income under the kiddie tax rules/proposed income splitting rules; or • to the extent the fair market value of the property increased as a result of (i) acquisitions of certain property from a trust on a tax-deferred basis, or (ii) an increase in value of a person's interest in a particular trust.

To help alleviate some of the taxpayer's pain, the Government will be implementing a "trigger the tax" day to occur on any day in 2018 that the taxpayer chooses. This would allow personal trusts, employee share-ownership trusts, and individuals to trigger tax on QSBC shares or QFFP and take advantage of the "old world" rules by filing a particular election. Two *positives* with this "trigger the tax" option are that: (i) the previously discussed "split income" rules do not apply to any potential gain; and (ii) the previous 24-month hold period requirement (i.e. thou must hold one's QSBC shares or QFFP for 24 months prior to sale) is reduced to 12 months. Two *negatives* with this "trigger the tax" option are that (i) any QSBC share or QFFP that was previously subject to certain "tax attribution" rules is disqualified from the election, and (ii) property acquired after 2017 is not eligible for the election. In tax, as in life, one has to take the good with the bad.

As a final comment on trust changes, the proposals contemplate that certain specialized types of trusts such as spousal or common-law partner trusts, alter-ego trusts, and employee share ownership trusts, are excluded from these new rules.

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Passive Investment through a Holding Corporation

Example Scenario

Andrea's private corporation owns a manufacturing plant in Saskatchewan. Last year, the corporation generated $800,000 of taxable business income (after payment of employee salaries and other expenses). The corporation is large, and is not eligible for the small business rate. The applicable federal-provincial corporate income tax rate in Saskatchewan was 25 per cent in 2016, leaving the corporation with after-tax income of $600,000. Andrea would like to use $200,000 of that amount to modernize her plant next year, and keep the balance, or $400,000, for longer-term personal savings. As the controlling shareholder, she can either pay herself a dividend or invest the $400,000 in an account held within her corporation. Andrea has already made contributions to her Registered Retirement Savings Plan and her Tax-Free Savings Account up to the maximum limits.

Andrea will be better off if she keeps a diversified passive investment portfolio inside the corporation, rather than investing it as an individual. If she invests within the corporation, Andrea has an after-tax amount of $400,000 to add to her portfolio. If she were to invest in a personal account, she would have about $280,000 to invest (her marginal personal income tax rate is about 48 per cent in 2016, given that Andrea is a high-income earner, and dividend income is subject to the dividend tax credit).

When Andrea invests through her corporation, she benefits from a bigger initial portfolio, which compounds to larger investment income every year, which can be reinvested. Although there is some reconciliation at the end— when Andrea winds down the portfolio and pays personal income taxes on it—she still ends up better off than if she had chosen to invest in a personal account. After 30 years, she would end up with about $570,000 more, after payment of corporate and personal income taxes, if she invests inside her corporation.

Unlike Andrea, an individual earning salary income would have no alternative but to invest in a personal account. As a business owner, Andrea can realize a personal portfolio advantage that is the consequence of the low corporate income tax rate, which is intended to support the growth of active businesses—not to confer a personal savings advantage.

As stated in the White Paper, the lofty goal here is that the current tax rules function so that "a dollar of passive investment income earned via a corporation bears a tax burden, when corporate and personal taxes are combined, that is roughly similar to that of a dollar of passive investment income earned directly by an individual." While the current rules do not always live up to this goal, there are current systems in place (such as the Refundable Dividend Tax on Hand or "RDTOH" regime) which operate to address this issue.

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It should be noted at the outset that the Government has not proposed draft legislation on the "passive investment" issue but has floated two potential solutions:

1. **Bring it Back to 1972** - Like Watergate seemingly being replayed in the present day with events south of the border, so too are questionable 1972 budget proposals being considered by the Government to address passive investment. Back then, a new "refundable tax" was being proposed where business income was used to fund passive investments. Effectively, the business income would lose its preferential small business rate and be saddled with a general corporate income tax rate (of 50% at that time) where it was used to invest in passive investments. If the company "did the right thing" and reinvested money in business operations, it got the tax back; if the company "did the greedy thing" and invested the money, it had to live with the tax hit.

2. **New Deferred Tax** - The goal of this new, incredibly complex, and likely unwieldy regime would be to "maintain a rate of tax on the passive investment income of private corporations equivalent to top personal tax rates…but which would generally remove the refundability of passive investment taxes where [small business taxed] earnings [are] used to fund passive investments." Without getting into details, the folly of this approach seems best illustrated by the fact that the new regime requires its own annex to the White Paper to explain it, complete with mathematical formulae which would be quite comfortable in an introductory calculus class.

This post will not get into hard detail on either proposal, owing primarily to (i) the Government's own admission that it "is not actively considering" the reintroduction of the 1972 rules at this time, and (ii) the fact that the deferred tax approach is still being floated as an idea, without the benefit of legislative amendments to suss out its contours. Notwithstanding those comments, a few items can be noted about the deferred tax approach:

- **Capital Gains** - It appears that the 50% inclusion rate (i.e. capital gains only being half-taxed) will survive these proposals. However, the non-taxable portion of any gains, which typically flows into a corporation's "capital dividend account" would be eliminated. The "capital dividend account" is especially valuable to private corporations as dividends paid from this account can go to business owners tax-free.

- **Publicly-Traded Company Dividends** - Currently treated as "eligible dividends" (being subject to a preferred rate of tax), the new proposals would see this switched to "non-eligible dividends" (being subject to a higher rate of tax).

- **Tax Pools** - Here, a corporation would be expected to take its income and divide it up among three different "pools", being (i) income taxed at the small business rate, (ii) income taxed at the general corporate rate, and (iii) amounts contributed by shareholders using after-tax proceeds (e.g. amounts paid to subscribe for shares in the company). Each year, "passive income" earned by the corporation (e.g. interest, dividends) would be apportioned among these "pools", with that income then being "sliced and diced" into different components with different tax impacts (i.e. some taxed at low rate, some taxed at high rate, etc.).

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- **Elective Method** - As an alternative to the tax pools (for those who perhaps find it too difficult to "swim" in the pools), passive investment income would be subject to non-refundable taxes (generally equivalent to the highest marginal tax rates) and dividends distributed from that income would be treated as "non-eligible" dividends. The corporation could elect, by sacrificing its small business deduction (i.e. low rate of tax on first $500,000 of active business income), to treat the dividends as "eligible" dividends (taxed at lower rates to the recipient than "non-eligible" dividends).

Again, while these proposals are still very much up in the air, a savvy reader of the White Paper will be able to sense where the proverbial winds are blowing by virtue of data cited in the White Paper. Notably (perhaps to drive home the point about "unfairness" with passive investment), the Government has reproduced a chart demonstrating the large savings advantage of passive investment in a corporation versus a tax-free savings account or personal savings account (over an 11-year time period). It is abundantly clear that a line is being drawn between business owners and salaried unincorporated individuals.

Converting Regular Income into Capital Gains

Example Scenario

Jean-Paul owns a large landscaping business in Manitoba. He operates the business through a private corporation (JPCo) which is eligible for the small business tax rate (10.5 per cent federal and 0 per cent in Manitoba on active business income of up to $500,000 federally and $450,000 provincially). He has operated the business for a number of years. In recent years, the business has earned about $650,000 annually after deducting expenses other than any salary paid to Jean-Paul.

In 2016, JPCo earned $400,000 of income after paying Jean-Paul a salary of $250,000. JPCo would pay corporate tax of $42,000 on the $400,000 (10.5 per cent of $400,000). In 2016, Jean-Paul wanted to withdraw another $300,000 from JPCo.

Alternative 1: If JPCo paid Jean-Paul $300,000 of additional salary (i.e., his total salary would be $550,000), additional personal tax based on Manitoba's top personal income tax rate would have been $151,200. JPCo would have deducted the $300,000 thereby reducing the corporate taxes paid by the business by $31,500. As a result, the net corporate and personal income taxes paid on the additional $300,000 in salary is about $120,000.

Alternative 2: If JPCo paid Jean-Paul the $300,000 as a dividend, additional personal tax would have been $137,220. This is based on Manitoba's top personal income tax rate on dividends received out of income eligible for the small business deduction after June 30, 2016.

Alternative 3: If the $300,000 were converted into a capital gain, additional personal tax would have been even less – $75,600, based on Manitoba's top personal income tax rate on capital gain (through a series of self-dealing private corporation transactions).

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The reader should pause here for moment to appreciate the (presumably intentional) use of the word "self-dealing" in the final paragraph of the example. The point of such pause is to underscore a slanted characterization of small business owners which permeates the White Paper.

The tax mischief here is effectively converting salary income (taxable at high rates) or dividend income (taxable at middle to high rates) into capital gains (taxable at low rates). Of particular concern appears to be transactions between "non-arm's length" (i.e. related) parties that result in increasing the "adjusted cost base" (i.e. tax cost) of shares and/or triggering the LCGE (and thereby shielding tax). The Government proposes a "two-shot" approach to this mischief:

1. **Beef Up Existing Anti-Avoidance Rule** - Current section 84.1 of the tax legislation is a provision which applies where: (i) an individual sells shares of a Canadian corporation to another Canadian corporation; (ii) the individual does not deal "at arm's length" with the second corporation; (iii) the individual receives non-share consideration (e.g. cash, promissory note) as payment for selling those shares; and (iv) the value of that non-share consideration exceeds the greater of (A) the tax cost of the shares being sold by the individual, and (B) the paid-up capital of the shares being sold by the individual. If it applies, the non-share consideration in excess of the greater of (A) and (B) is taxed as a dividend to the individual.

   The proposal contemplates expanding section 84.1 to scenarios where "adjusted cost base" (i.e. tax cost) is increased in a taxable non-arm's length transaction. The White Paper offers one example of such an "improper" situation:

   a. Mr. X sells a share of CorpA for fair market value to CorpB (another corporation not at arm's length to Mr. X) in return for a share of CorpB. Mr. X incurs a capital gain, which increases the adjusted cost base (tax cost) of the CorpB share to fair market value; and

   b. Mr. X sells his newly acquired CorpB share to CorpC (yet another corporation not at arm's length to Mr. X) but takes back cash equal to the fair market value of the CorpB share.

   In this case, the cash taken back does not exceed the adjusted cost base of the CorpB share being sold; consequently, section 84.1 does not apply. Among other transactions, the enhanced section 84.1 would presumably apply to these transactions.

   By way of additional example (found in the explanatory notes to amended section 84.1), the new and improved section 84.1 reduces the cost base of shares where that cost base was derived from previous "family" or non-arm's length transactions. The "nugget of wisdom" from this example is that the new section 84.1 operates to exclude all previous non-arm's length cost base increases when determining the cost base of shares (which is relevant to how much of a capital gain one incurs on a disposition). In the example, a son eventually sells shares of a family business several years after a number of past family transactions among mom, dad, and a sibling. We find son (at the end of the example) selling his shares to

an unrelated third party, only to discover he is hit with a much larger tax liability on sale thanks to mom and dad's prior "self-dealing" transactions. Clearly new section 84.1 is targeted at both improper surplus stripping as well as fostering family enmity.

2. **Implement New Anti-Stripping Rule** - Eerily similar to the existing General Anti-Avoidance Rule or "GAAR", the Government has proposed a new tax rule (new section 246.1) that would trigger dividend income inclusions where: (i) there is a "non-arm's length" transfer; (ii) it is reasonable to consider that one of the purposes of the transaction (or series of transactions) is to pay an individual shareholder/vendor non-share consideration (e.g. cash); (iii) the transaction would, but for the particular planning, be treated as a capital gain; and (iv) the payment of non-share consideration comes out of the corporation's private surplus in a manner that involves a significant disappearance of the corporation's assets. The provision appears aimed at preventing distribution of corporate surplus on a tax-reduced or tax-free basis in a "non-arm's length" situation to an individual shareholder that would otherwise (were it not for these nefarious transactions) have received a taxable dividend.

   This measure seems poised to affect both the popular "pipeline" transactions done largely after a business owner has passed away, and transactions deliberately triggering subsection 55(2) of the tax legislation (another horridly complex anti-surplus stripping provision) in order to trigger a capital gain but also create valuable room in the corporation's capital dividend account.

Clearly such measures suffer from a high degree of ambiguity as to their operation. The latter is particularly ambiguous given both the language and the reality that such a rule would presumably be interpreted by the courts in a very similar manner to the GAAR (which is also susceptible to "variances" in interpretation).

Notably, the White Paper recognizes that expanding these rules could lead to inappropriate results concerning intergenerational business transfers. The common example would be a parent selling their shares of a corporation to a corporation owned by their child. In such a case, section 84.1 may apply to re-characterize capital gains (which may benefit from the LCGE) into dividends; this is ultimately an unwanted result. The Government however seems baffled in drawing a line between (i) "genuine" (using their words) intergenerational transfer of shares, and (ii) tax avoidance transfers of shares. Apparently, the hallmarks of such a "genuine" transfer include, according to the Government:

- The vendor (in the example, the parent) ceasing to have factual and legal control of the business;
- The intent of the new owner (in the example, the child) to continue the business as a going concern;
- The vendor not having any financial interest in the transferred business; and
- The vendor not participating in the management and operations of the business.

This "decree as to genuineness" seems substantially motivated by the United States approach to intergenerational business transfers which involve a number of rules establishing a bright-line test used to determine "genuine" transactions. In the U.S., the common thread appears to be that the vendor/parent (in the example) truly "terminates" his or her interest in the company.

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Closing Comments

"The tax system is crucially important to economic growth in Canada. It supports the development of an equitable society and the redistribution of income to help provide for Canadians who need assistance. It is entirely appropriate for our government to expect all taxpayers to be compliant with the law and to pay, on a timely basis, the amount of tax that they owe … However, it is equally appropriate for all taxpayers to expect fair treatment under our tax laws, regardless of their income or level of wealth. Targeting certain segments of the taxpayer population on the basis of factors unconnected to their compliance is harmful and does little to enhance confidence in the system."

-Heather L. Evans, Executive Director and CEO, Canadian Tax Foundation

The White Paper paints a dark picture as to the future course of the Government vis-à-vis Canadian small business. While tax advisors may not yet close the door on certain corporate and trust planning, the reality is that non-tax reasons for these structures will become paramount, now more than ever. Further, it ultimately remains to be seen how the passive investment issue is to be dealt with in the form of concrete legislation. Some current comments can, however, be made:

- **Gains Conversion** - If enacted, the gains conversion changes noted above (i.e. modifications to section 84.1 and new section 246.1) would already be effective. Clients should therefore review existing structures and see if changes are in order; those who may be selling a business in the near future and have generated cost base in the past from non-arm' s length (i.e. family) transactions should be particularly keen on review.

- **Income Sprinkling** - These new rules do not come into effect until 2018. Consequently, dividend and salary "mixes" should be reviewed prior to this time. In addition, trust structures initially focused around income allocation in a family unit should be re-examined as to whether the non-tax reasons for such trusts justify the trust.

- **Capital Gains Exemption** - Planning around the LCGE should be revisited in light of the changes. Some trusts may choose to make distributions to their beneficiaries on tax-deferred basis or potentially use the 2018 "trigger a gain" option discussed earlier.

- **Compliance** - If absolutely nothing else, the new measures will result in increased work for a corporation's advisors and internal personnel. Conversations should be occurring about the day-to-day effect of the new rules and associated new professional costs to remain compliant.

The larger take-away is that small businesses should pay close attention to these changes and should be vocal about their opposition. The White Paper proposals are incredibly broad, unworkably complex, and targeted at the heart of our Canadian job creators: small businesses. If ever there was a time for advisors and the business community at large to respond to government proposals, now is the time. For information about submitting comments by October 2, 2017, please visit **http://www.fin.gc.ca/activty/consult/tppc-pfsp-eng.asp**.

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