

The Tax Break

TAX FOR PRIVATE CORPORATIONS

MAJOR CHANGES PROPOSED

On July 18, 2017, Minister of Finance, Bill Morneau announced the release of a **Consultation Paper** which focused on **three tax practices** that the Government considers to provide an **unfair tax advantage** to private corporations and their owners. These include:

- **Income Sprinkling** – The Government is concerned that business owners can direct income to lower income family members who are not involved in the business, gaining a tax advantage unavailable to other Canadians. A common example is dividend sprinkling, where **lower income family members** own a share of the business and therefore can **receive dividends, subject to their lower marginal rate**. The Paper suggests taxing the unreasonable portion of dividends received by a family member of the principal of the business at the top marginal tax rate. Reasonability will be based on factors such as labour and capital contributions, and risk assumed. While this reasonableness test will

apply on all dividends to family members of the principal, a more stringent criteria will apply for individuals aged 18–24.

Similarly, the Paper proposed **limits** on access to the **capital gains exemption (CGE)** based on age and reasonableness, with minors **not entitled to the CGE** at all. The proposals also **deny the CGE** for most gains accumulated while **shares are held by a trust**.

The Paper noted that the **Government** is **committed** to **addressing this issue** in some fashion, and that the changes will be **effective in 2018**.

- **Passive Investment Income** – The Government is concerned that it is unfair to most Canadians to permit the accumulation of **passive investments** with capital **shielded** from the **higher personal tax rates**. **No specific proposals** were made, but a **number of possible approaches** were set out which will essentially **eliminate the advantage** provided by the deferral on funds retained for investment in private corporations.



The **new rules** will be designed in the coming months. The **timing** of any changes was **not specified**.

- **Capital Gains** – The Government is concerned with plans to **withdraw** corporate **funds** as **capital gains rather than dividends**. The overall tax liability on capital gains is generally much lower than that of dividends, in particular for individuals subject to tax at the top marginal tax rate. The Government has proposed some more complicated technical measures which would limit this type of planning.

These changes will **apply to amounts received**, or becoming receivable, **on or after July 18, 2017** (i.e. the date the Paper was released).

If you or your corporation utilize one of the above tax planning strategies, be cognizant of any legislated changes, their impact, and the effective date of the change.

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TELL THE GOVERNMENT WHAT YOU THINK

The government invites your comments regarding the proposed changes to the taxation of private corporations here. You have until **October 2, 2017** to respond: <http://www.fin.gc.ca/activty/consult/tppc-pfsp-eng.asp>

On an unrelated note, we wish to announce our most recent addition to the PEL team. Kindly join us in welcoming **John Zhang, CPA, CGA**, who joined our firm earlier this year!

If you are receiving this newsletter by mail and would like to receive it by email instead (or vice versa), or if you no longer wish to receive our newsletter, please contact Julie at julie@accountantsplus.ca or 604.299.9274.

PROFESSIONALS' WIP EXCLUSION

CHANGES ARE COMING

In the past, taxpayers in certain designated **professions** (i.e., accountants, dentists, lawyers, medical doctors, veterinarians and chiropractors) may have elected to **exclude** the value of **work in progress (WIP)** in computing their income for tax purposes. This essentially enabled these professionals to defer tax by permitting the costs associated with WIP to be expensed without including the matching revenues.

However, the 2017 Federal Budget proposed to **eliminate this election**, effective for the first tax year that begins after March 22, 2017. Transitional rules have been introduced to implement the change over two years. Once fully implemented, WIP, which is valued at the lower of cost or fair market value, will need to be included in income each year.

At present, many professionals either do not account for WIP in their financial accounts or account for WIP at its expected billing amount, using staff and partner billing rates rather than cost. These **professionals** will be **required to determine** the cost of their **WIP** in order to comply with these new provisions. There has been some **uncertainty** expressed regarding how the **cost of WIP** is properly **calculated**.

CRA has stated that the proposed changes are not expected to have any impact on bona fide contingency fee arrangements. That said, some practitioners have expressed concern that this concession has little or no basis in law.

If you are in one of the industries impacted, and have not previously tracked the cost of your WIP, consider doing so. Also, budget for the possible

additional tax liability over the next two years due to catching up the deferral of WIP.



VOLUNTARY DISCLOSURE PROGRAM

PROPOSED TIGHTENING

The Voluntary Disclosure Program (VDP) provides taxpayers (individuals, corporations, partnerships, trusts, etc.) the opportunity to fix incorrect or incomplete previously filed tax returns (or returns that should have been filed) with a reduction to penalties and possibly interest.

CRA recently released fairly substantial proposed changes to the current program, **effective January 1, 2018**. The proposals are expected to be **finalized** in the **fall of 2017**.

The proposals will create **two tracks** for **income tax disclosures**.

General Program (GP)

The GP is similar to the **current VDP**. **Penalties** will be **waived**, subject to the usual ten-year limit, **criminal prosecution** will **not** be **considered** and **interest relief** will be **considered** for years preceding the most recent three years, with 50% of interest generally being waived. Interest for the most recent three years will not be waived.

Limited Program (LP)

The LP will be applicable for disclosures of **major non-compliance** and will provide **reduced relief**. **Examples** of situations where the LP would apply include where there are:

active efforts to **avoid detection** through the use of offshore vehicles or other means; **large amounts** involved; **multiple years** of non-compliance; **sophisticated taxpayers** involved; **disclosures after CRA communications** such as official statements regarding its intended compliance focus, or following CRA campaigns or correspondence; and other circumstances where a high degree of **taxpayer culpability** contributed to the non-compliance.

Under the LP, **gross negligence penalties** will be **waived**, and **criminal prosecution** will **not** be **considered**. However, **all other penalties** will be **assessed**. **No interest relief** will be provided.

No Relief

In addition to current ineligible submissions, a number of situations will no longer be eligible for the VDP, including, for example where there is: income from **proceeds of crime**; a disclosure from a **corporation** with **gross revenue** in excess of **\$250 million** in at least two of its last five years; and a disclosure related to **transfer pricing adjustments** or penalties.

Conditions for Valid Disclosure

The current requirements that any disclosure be **voluntary, complete**, involve a **penalty** or potential penalty, and include information **at least one year past due** will remain unchanged. Some further conditions, such as the requirement that the applicant pay the estimated taxes owing on application are proposed. Payment arrangements supported by adequate security may be accepted.

If you have a disclosure which may be impacted by these proposed changes, ensure to submit your disclosure prior to the proposed changes effective date of January 1, 2018.

We recommend that you obtain professional advice before acting on information contained in this newsletter.

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