

Ministry of Finance
BRIEFING DOCUMENT

To: Honourable Carole James
Minister of Finance

Date Requested:
Date Required:

Initiated by: Paul Flanagan

Date Prepared: October 17, 2017

Ministry
Contact: Andrew Avis
Tax Policy Branch

Phone Number: 778 698-5669
Email: Andrew.Avis@gov.bc.ca

Cliff #: 361491

TITLE: Federal Government's Income Tax Changes for Small Business:
Tax Planning Using Private Corporations

PURPOSE:

(X) FOR INFORMATION

COMMENTS: This note provides a description of the federal government's proposals to eliminate tax planning using private corporations.

DATE PREPARED:

TITLE: Federal Government's Income Tax Changes for Small Business: Tax Planning Using Private Corporations

ISSUE: The federal government has proposed changes to limit tax planning opportunities using private corporations.

BACKGROUND:

On July 18, 2017, Finance Canada released a consultation paper with proposed tax measures to address specific tax planning strategies used by private corporations: income sprinkling, passive investments, and surplus stripping.

On October 16, 2017, Finance Canada announced that due to responses received through the consultation process, Canada will be lowering the small business corporate income tax rate, currently at 10.5 per cent, to 10 per cent on January 1, 2018 and 9 per cent on January 1, 2019. Finance Canada also announced it will simplify the proposals relating to income sprinkling, including cancelling the proposal to limit "multiplication" of the Lifetime Capital Gains Exemption. Multiplication is when families, through corporations or trust, are able to claim a lifetime capital gains exemption for each family member on the same asset. With the October 16th announcement, it appears multiplication will continue to be allowed. Finance Canada will provide details about these changes "in the coming days".

1) Income Sprinkling:

Income sprinkling (also known as income splitting) is achieved by distributing (or "sprinkling") a corporation's income among family members through dividends or other payments, rather than distributing the corporation's income entirely to the owner/operator(s). By sprinkling corporate earnings among family members with low taxable income, income that would otherwise be taxed at high rates of tax in the hands of the owner/operator will be subject to lower rates of tax. ^{s.13}

s.13

For example, a BC individual who has \$300,000 of employment income in 2017 would pay approximately \$113,000 in federal and provincial income tax. A BC individual who earns \$300,000 in a small business corporation, and then uses dividends to "sprinkle" the income equally to their spouse and two adult children, would face a total tax bill of approximately \$24,000.

The federal government cracked down on income sprinkling in 1999 with the introduction of the tax on split income. Any payments that are received by minor children from a parent's corporations are automatically subject to tax at the highest marginal personal income tax rates. The federal government is proposing to extend the tax on split income to adult children, spouses and other related individuals, unless the amounts paid to family members are reasonable based on the recipient's capital or labour contributions to the company.

BC has a tax collection agreement with the federal government, under which the province agrees to accept the federal government's calculation of taxable income.

s.13

Budget 2017 Update introduced a new personal income tax rate of 16.8 per cent for incomes in excess of \$150,000 for the 2018 and subsequent taxation year. s.13

s.13

2) Investing the Corporation's Retained Earnings in Passive Investments:

Income earned by a corporation will be taxed twice; once at the corporate level and then again at the personal level when it is distributed to shareholders. The dividend tax credit ensures that the total tax paid at the corporation and personal level is roughly equivalent to the tax paid on income earned outside a corporation. However, owners of privately held corporations can defer the tax at the personal level by retaining the earnings of the corporation within the company and instead investing in a portfolio of passive investments (e.g. stocks, bonds and mutual funds). This allows owners of corporations to have a higher initial investment than taxpayers that earn their income directly (employees and sole proprietors).

A business owner who earns income through a corporation will have a total tax bill of corporate income tax plus personal income tax. The dividend tax credit mechanism ensures that the total tax bill of a business owner that earns income through corporation is roughly equivalent to a business owner that does not earn income through a corporation. s.13

s.13

The federal government is proposing to levy an additional tax on the passive investment income of a corporation in order to place all Canadians that make passive investments on a level playing field. s.13 the federal government is seeking feedback from stakeholders.

3) Converting Regular Earnings into Capital Gains ("Surplus Stripping"):

Surplus stripping refers to a variety of techniques by which owners of private companies extract value from their corporation as a capital gain rather than as income. The incentive to engage in these transactions exists since capital gains receive favourable tax treatment: capital gains are generally taxed at half the rate of ordinary income, and in certain circumstances are exempt from tax through the lifetime capital gains exemptions. There are many specific anti-avoidance rules targeting such transactions and a general anti-avoidance rule that has been used to prevent surplus stripping transactions, but court decisions have narrowed the scope of both tools.

The federal government is proposing to^{s.13} introduce a new specific “anti-stripping” rule that would apply whenever it is reasonable to consider that the taxpayer undertook a transaction to remove a corporate surplus as a capital gain.

s.13

DISCUSSION:

s.13

On October 3, 2017, the Department of Finance Canada stated that any future decisions regarding these proposals would be based on the following five key principles:

1. Support small businesses and their contributions to our communities and our economy.
2. Keep taxes low for small businesses, and support owners to actively invest in their growth, create jobs, strengthen entrepreneurship and grow our economy.
3. Avoid creating unnecessary red tape for hard-working small businesses.

4. Recognize the importance of maintaining family farms, and work with Canadians to ensure we don't affect the transfer of a family business to the next generation.
5. Conduct a gender-based analysis on finalized proposals, to ensure any changes to the tax system promote gender equity.

s.13

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Date Requested:
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Contact:**

Phone Number:
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Cliff #:

TITLE: Federal Government's Income Tax Changes for Small Business:
Tax Planning Using Private Corporations

PURPOSE:

(X) FOR INFORMATION

COMMENTS: Optional. Two or three sentences which put the issue into context.

DATE PREPARED:

TITLE: Federal Government's Income Tax Changes for Small Business: Tax Planning Using Private Corporations

ISSUE: Description of Federal Government changes to limit tax planning opportunities using private corporations.

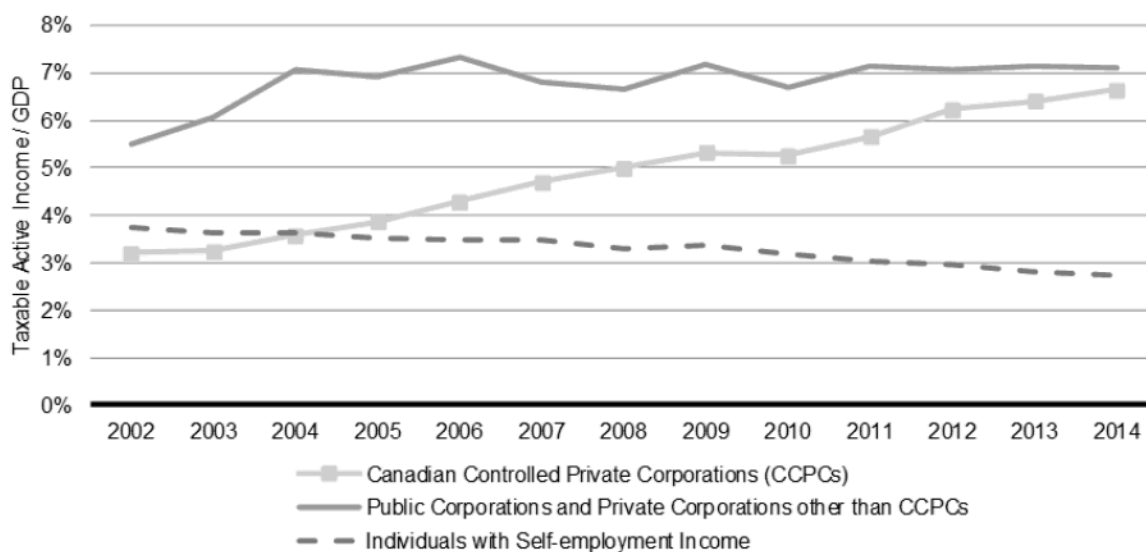
BACKGROUND:

The 2017 federal budget pledged to address specific tax planning strategies that used private corporations. To that end, it released a report titled, "Tax Planning Using Private Corporations," on July 18, 2017 outlining the scope of the problem as well as proposed solutions. The federal government was seeking comments by October 2017. ^{s.13}

s.13

The federal government begins its proposals by pointing out that the use of Canadian-controlled private corporations (corporations not traded on a public exchange that controlled by a small group of people) has increased greatly. The following chart demonstrates this growth with reference to the business income relative to GDP for private corporations, public corporations and self-employed individuals (sole proprietors).

Chart 4
Trend in Taxable-Active-Income-to-GDP Ratio, by Type of Business



Fed finance notes this growth in CCPCs has been particularly pronounced with regard to professional services for which the use of professional corporations has tripled since over the last 15 years. ^{s.13}

s.13

Fed Finance has identified three tax-planning techniques available to owners of private corporations have historically used to minimize their tax bills: income sprinkling, passive investments and surplus stripping. Details about each of these techniques is provided in the Appendix.

DISCUSSION:

BC relies on the federal determination of taxable income, and therefore any measures identified in the consultation paper that the federal government enacts will apply to BC's corporate income taxes. ^{s.13}

s.13

Income Sprinkling:

Income sprinkling (also known as income splitting) is achieved by distributing ("sprinkling") a corporation's income amongst family members through dividends or other payments, rather than distributing the corporation's income entirely to the owner/operator.

The desire to sprinkle income emerges due to Canada and BC's progressive personal income tax rates that rise as the taxpayer's income rises.

BC		Canada	
\$0 - \$38,898	5.06%	\$0 - \$45,916	15%
\$38,899 - \$77,797	7.7%	\$45,917 - \$91,831	20.5%
\$77,798 - \$89,320	10.5%	\$91,832 - \$142,353	26%
\$89,321 - \$108,460	12.29%	\$142,354 - \$202,800	29%
\$108,461 - \$150,000	14.7%	\$202,801 +	33%
\$150,001* +	16.8%		

* the new tax bracket on income in excess of \$150,000 becomes effective January 1, 2018.

By sprinkling the business's after-tax income amongst close family members (particularly family members with low income), the owner/operator is able apply the lower personal income tax rates to a greater portion of his or her income than taxpayers that cannot income sprinkle. ^{s.13}

s.13

Since the Income Tax Act's inception in 1917, the Act has contained rules to prevent income splitting. The most recent and furthest reaching change occurred in 1999 when the federal government removed the ability to split income with minor children through the tax on split income. The tax on split income applied the highest marginal tax rate to any split income received by children of the owner/operator of the business.

The federal government is now proposing to extend the tax on split income to adult children (particularly those aged 18 to 24 that typically have low taxable income) unless the amount received by the adult children is reasonable based on the child's capital or labour contribution to the parent's company.

OPTIONS:

-
-
-

RECOMMENDATION: (only include this if the briefing note is for decision)

-

APPROVED / NOT APPROVED (only include this if the briefing note is for decision)

Carole James
Minister

Date

From: [Karp, David FIN:EX](#)
To: [Vinkle, Angela FIN:EX](#)
Cc: [Avis, Andrew FIN:EX](#); [Flanagan, Paul FIN:EX](#); [Purnell, Richard FIN:EX](#)
Subject: FW:
Date: Tuesday, October 17, 2017 1:34:00 PM
Attachments: [BN - Fed Lib Tax Changes 2017 Summary for QP draft 2.doc](#)

Angela, FYI, Paul has circulated Andrew's un-CLIFFed note to Heather, and to Rob Gillezeau in the Minister's office.

From: Flanagan, Paul FIN:EX
Sent: Tuesday, October 17, 2017 1:28 PM
To: Galbraith, David J FIN:EX; Wood, Heather FIN:EX; Purnell, Richard FIN:EX; Karp, David FIN:EX; Gillezeau, Rob FIN:EX
Subject:

From: Flanagan, Paul FIN:EX
To: Galbraith, David J FIN:EX; Wood, Heather FIN:EX; Purnell, Richard FIN:EX; Karp, David FIN:EX; Gillezeau, Rob FIN:EX
Date: Tuesday, October 17, 2017 1:27:57 PM
Attachments: BN - Fed Lib Tax Changes 2017 Summary for QP draft 2.doc

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2) Investing the Corporation's Retained Earnings in Passive Investments:

Generally, when individuals make investments, they must pay income tax on interest or dividends they receive, and on capital gains when they sell profitable investments. Some exceptions exist — notably, registered retirement savings plans (RRSPs) and tax-free savings accounts (TFSAs) — to allow for individual savings. With RRSPs, for example, individuals pay tax when they withdraw investments, but not each time they receive a dividend or sell a profitable investment within an RRSP. This ability to shelter investment income allows individuals to “defer” taxes on their investments.

Owners of privately held corporations can defer additional tax by retaining a corporation's earnings within the company and investing them in a portfolio of passive investments (e.g. stocks, bonds and mutual funds). This allows professionals to have more tax-deferred retirement savings than other individuals.

s.13

The federal government is proposing to levy an additional tax on the passive investment income of a corporation in order to place all Canadians that make passive investments on a level playing field. The tax would be designed to ensure that corporations' passive investments are effectively taxed at the highest marginal personal income tax rate.

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s.13

From: [Gunther, Mark FIN:EX](#)
To: [Karp, David FIN:EX](#)
Subject: FW: Send Us Your Submissions | Tax Planning Using Private Corporations Paper
Date: Tuesday, August 1, 2017 1:52:51 PM
Attachments: [~WRD000.jpg](#)
[image001.jpg](#)
[image002.jpg](#)
[image003.jpg](#)
[image004.jpg](#)
[image005.jpg](#)

Obviously not for our submissions, but thought you may be interested in monitoring.
Thanks,

Mark

From: Canadian Tax Foundation / Fondation canadienne de fiscalité [mailto:ctf-fcf@ctf.ca]
Sent: Tuesday, August 1, 2017 11:44 AM
To: Gunther, Mark FIN:EX
Subject: Send Us Your Submissions | Tax Planning Using Private Corporations Paper

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with us



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Tax Planning Using Private Corporations Paper

On July 18, 2018, the much-anticipated discussion paper,
Tax Planning Using Private Corporations, was released by

the Department of Finance. The paper, which covers income sprinkling, the taxation of passive corporate income, and surplus stripping, was accompanied by draft legislation and explanatory notes.

Submissions on these proposals are being accepted by the government until October 2, 2017. Given the sweeping nature and complexity of the proposals and the relatively brief consultation period, we invite members to share submissions on the **CTF Website** in the interests of encouraging constructive dialogue in the tax community.

[Click here](#) to share your submission for posting on our website.

Please note that the views reflected in any posted submission are those of the author(s) and not of the Canadian Tax Foundation.

Image removed by sender.



Le 18 juillet 2017, le ministère des Finances a publié le document de consultation tant attendu, sur la planification fiscale au moyen de sociétés privées. Ce document, qui aborde la répartition du revenu, l'imposition du revenu de placements passifs, gagné dans une société privée, et le dépouillement de surplus, est accompagné de propositions législatives et de notes explicatives. La date limite pour présenter au gouvernement des observations relatives à ces propositions est le 2 octobre 2017.

Vu l'ampleur et la complexité de ces propositions et la période relativement courte de consultation, nous invitons nos membres à partager leurs observations sur **Le site Web de la Fondation canadienne de fiscalité** dans l'intérêt d'encourager un dialogue constructif dans la communauté fiscale.

[Cliquez ici](#) pour partager vos observations à poster sur notre site.

Veuillez noter que les points de vues reflétés dans les observations sont ceux des auteur(e)(s) et non ceux de la Fondation canadienne de fiscalité.



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[Privacy Statement](#)

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From: Karp, David FIN:EX
To: Gunther, Mark FIN:EX
Subject: RE: Save the date! Policy Conference and Live Webcast | September 25, 2017
Date: Thursday, August 10, 2017 2:07:00 PM
Attachments: [image001.jpg](#)
[image002.jpg](#)
[image003.jpg](#)
[image006.jpg](#)
[image007.jpg](#)
[image008.jpg](#)

Yes. I might see if there's interest on our end in sending someone too.

From: Gunther, Mark FIN:EX
Sent: Thursday, August 10, 2017 1:52 PM
To: Karp, David FIN:EX
Subject: FW: Save the date! Policy Conference and Live Webcast | September 25, 2017
Any interest in putting a training proposal for a webcast?

Thanks,
Mark

From: Canadian Tax Foundation [<mailto:ctf-fcf@ctf.ca>]
Sent: Thursday, August 10, 2017 1:03 PM
To: Gunther, Mark FIN:EX
Subject: Save the date! Policy Conference and Live Webcast | September 25, 2017

Connect with us
Se connecter
avec nous



Image removed by sender. CTF News



Image removed by sender. CTF



Important:

**Monday, September 25,
2017**

8:00 am to 5:30 pm EST

Infinity Convention Centre
2901 Gibford Drive | Ottawa

Preliminary Program »

French below »



**POLICY
CONFERENCE
AND LIVE
WEBCAST**

***Tax Planning Using
Private Corporations -
July 18, 2017:
Analysis and***

Discussion with Finance

Much has been said and written about the "Tax Planning Using Private Corporations" consultation paper and draft legislation released July 18 2017 by the Minister of Finance. Join us on September 25 in Ottawa or via live webcast for a full day of analysis and discussion of the consultation document and draft legislation with Finance officials and experts from across the country. Don't miss out on the opportunity to be part of the conversation.

Register today and take advantage of the early-bird rates!

The topics will include:

- Setting the Stage: Department of Finance Panel
- Income Sprinkling and Surplus Stripping: History, Policy framework, and Current Regime
- Discussion of July 18 paper, draft legislation, and alternatives
- Taxation of Investment Income:
 - History, policy framework and current regime
 - What is the policy objective? What policy options are being proposed? What are other options?
 - Practitioner Perspectives on Proposals and Potential Issues
- Reactions & Closing Observations: Department of Finance and Practitioners Panel



**POLICY
CONFERENCE
AND LIVE
WEBCAST**

***Planification fiscale au
moyen de sociétés***

Important



**Le lundi 25 septembre
2017**

8 h 00 à 17 h 30 HNE

**Infinity Convention Centre
2901 Gibford Drive | Ottawa**

Programme préliminaire »

***privées : 18 juillet 2017
Analyse et discussion
avec le ministère des
Finances***

(présentations en anglais)

Beaucoup a été dit et écrit au sujet du document de consultation et des propositions législatives sur « la planification fiscale au moyen de sociétés privées » publiés le 18 juillet dernier par le ministre des Finances. Joignez-vous à nous le 25 septembre à Ottawa ou par webémission en direct pour une journée entière d'analyse et de discussion relatives au document consultatif et aux propositions législatives avec des représentants du ministère des Finances et des experts de partout au pays. Ne ratez pas cette occasion de faire partie de la conversation.

**Inscrivez-vous dès aujourd'hui
et profitez du tarif réduit.**

Les sujets de discussion porteront sur :

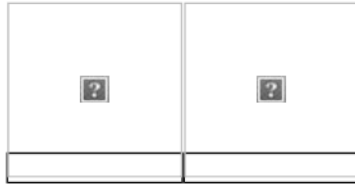
- La mise en scène : Un panel avec le ministère des Finances
- Répartition du revenu et dépouillement de surplus: Historique, cadre politique et régime actuel
- Discussion du document de consultation et des propositions législatives du 18 juillet, et des solutions de rechange
- Imposition du revenu de placement:
 - Historique, cadre politique et régime actuel
 - Quel est l'objectif de la politique? Quelles options sont proposées? Quelles sont les autres options?
 - Le point de vue des praticiens sur les propositions et les questions potentielles
- Réactions et remarques de




clôture : Un panel avec le
ministère des Finances et
des praticiens

Joignez-vous à nous le 25
septembre 2017!

[Back to top](#)



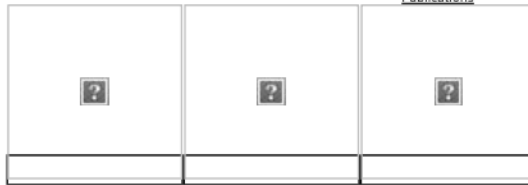
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POLICY CONFERENCE AND LIVE WEBCAST



From: [Karp, David FIN:EX](#)
To: [Avis, Andrew FIN:EX](#)
Subject: FW: CTF Presentation
Date: Monday, September 25, 2017 9:29:13 AM
Attachments: [2017 CTF Tax Planning Using Private Corporations - Analysis and Discussion with Finance.pdf](#)

Might find this helpful for your briefing note.

From: Gunther, Mark FIN:EX
Sent: Monday, September 25, 2017 8:24 AM
To: Karp, David FIN:EX
Subject: CTF Presentation
You didn't get it from me...

TAX PLANNING USING PRIVATE CORPORATIONS

Canadian Tax Foundation

September 25, 2017



Department of Finance
Canada

Ministère des Finances
Canada

Canada

Outline

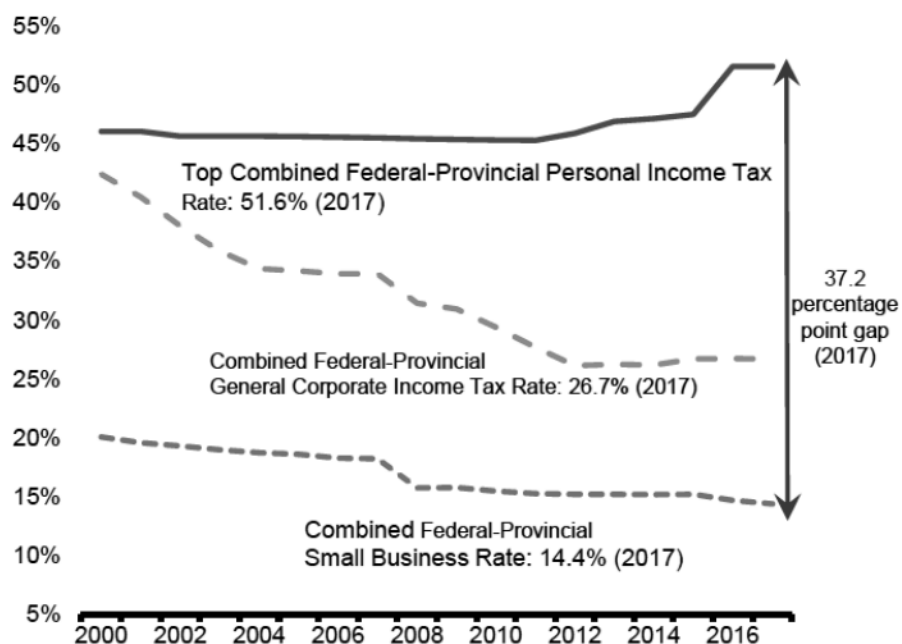
- **Policy context**
- **Historical context: current rules**
- **Consultations: approaches put forward for discussion**
- **Key questions for discussion**

Increasing Incentives for Tax Planning Using a Private Corporation

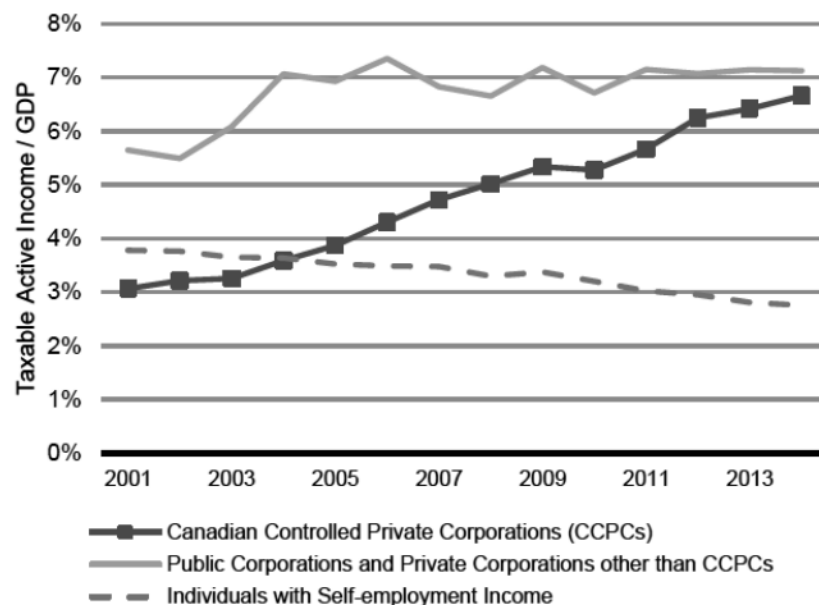
The **growing gap** between corporate and personal income tax rates since 2000 has increased rewards associated with tax planning in a private corporation...

... Over this period, a growing share of high-income self-employed individuals have chosen to incorporate

Federal-Provincial Tax Rates



Trend in Taxable-Active-Income-to-GDP Ratio, by Type of Business



Integration

- Low corporate tax rates on business income are intended to provide a tax advantage as long as income is retained for active business reinvestments.
- Income that is paid out of a corporation as a dividend is generally meant to be subject to the same amount of tax as income received directly by the individual.

Corporate taxes on earnings + Personal taxes on dividends = Personal taxes on income earned directly

- Integration issue: incentive to hold savings financed by retained earnings within corporations to save taxes
 - This issue was recognized in 1972

Historical context: Current rules

- **Current system introduced in 1972**
- **Refundable taxes on investment income ensure integration when business owner uses after-tax income to finance a passive portfolio within a corporation**
- **In 1972, the introduction of Part V tax ensured integration when using retained earnings to finance a passive portfolio**
- **Part V tax repealed on the basis that:**
 - It was seen as complex
 - This added complexity was believed not necessary

I believe that these small corporations which enjoy the benefit of the lower rate of tax will, in fact, use these savings to expand their businesses, to improve their technology and to create more jobs for Canadians

Consultations

- **Government is seeking input on best manner to eliminate deferral advantages going forward**
- **Paper lays out two broad approaches:**
 - Reintroduction of Part V tax, with adjustments
 - Introduction of a deferred taxation model
 - A deferred taxation model could take various forms, two of which are described in the paper:
 - Apportionment approach
 - Elective approach

Reintroduction of Part V Tax

- **Imposition of an upfront tax when retained earnings are used to acquire passive investments**
 - This additional tax would bridge the gap with top PIT rate
 - For example, a business eligible for the small business deduction would pay a 35% additional tax at the time of acquisition of portfolio assets
 - Tax refundable if later on assets are used to reinvest in the business
 - Need to keep track of income streams in order to apply the appropriate amount of tax when investment assets are purchased
- **Passive investment income would continue to be taxed as per current rules**

Deferred Taxation Model: Apportionment Approach

- **Need to track source of financing for passive investments in order to estimate deferral**
- **Affects businesses at the moment of dividend payout:**
 - Affects tax outcomes at the moment a dividend is paid out, rather than when an investment asset is acquired
 - But in effect, same overall outcome as Part V tax
 - Those saving to reinvest in their business not materially affected
 - Precision in tax outcomes, tailored to various business situations

Deferred taxation model: elective approach

- **Minimizes needs for tracking, in favour of proxy methods**
- **Default tax treatment tailored to the case of a business using retained earnings to finance portfolio investments**
- **Elections available for businesses with general rate income**
- **Under both approaches, options to keep current tax regime available when investments finance with savings taxed at the personal level**

Key questions for discussion

- **Government is seeking feedback, in particular:**
 - What is the best approach to tackle the issue?
 - How to minimize complexity, while achieving policy objectives?
 - Capital dividend account: what is the appropriate scope of the new tax regime with respect to capital gains?
 - Transition issues

Page 044 to/à Page 306

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s.3

From: [Purnell, Richard FIN:EX](#)
To: [Karp, David FIN:EX](#); [Avis, Andrew FIN:EX](#)
Subject: FW: Request for BN for FMM
Date: Monday, September 25, 2017 3:36:32 PM
Attachments: [image001.jpg](#)
[image002.jpg](#)
[BN template.docx](#)

David and Andrew, I think we've done something on this already. Can you provide it to IGRS in the template provided. If I'm mistaken, don't kill yourself to get it done. It can wait.

If Heather is here tomorrow have her review it. Paul and I are in Vancouver all day.

Richard Purnell

Managing Director

Tax Policy Branch

British Columbia Ministry of Finance

Phone: (250) 387-9072

Cell: (250) 507-0410

Fax: (250) 387-9061

From: Ewing, Patrick FIN:EX
Sent: Monday, September 25, 2017 3:26 PM
To: Sigurdson, Judi IGRS:EX
Cc: Smith, Grant H IGRS:EX; Purnell, Richard FIN:EX; Flanagan, Paul FIN:EX
Subject: FW: Request for BN for FMM

Judi,

The timing is very challenging because of Tax Policy staff involvement in UBCM. I spoke with Richard Purnell of Tax Policy Branch, and unfortunately he doesn't have a note on hand that could be shared by tomorrow noon, but he will get you something as soon as possible.

--

Patrick

From: Sigurdson, Judi IGRS:EX
Sent: Monday, September 25, 2017 3:04 PM
To: Ewing, Patrick FIN:EX
Cc: Smith, Grant H IGRS:EX
Subject: Request for BN for FMM

Hi Patrick. Further to our conversation, we received an update from the federal government that Chief Statistician of Canada, Anil Arora, will be presenting with BoC Governor Poloz to the FMM in Ottawa on Oct 3. The theme of the joint presentation was revised slightly to be, "Inclusive Economic Growth and Job Creation".

While we still want the questions for the Governor as requested last week, we expect that some PTs may raise their concerns over federal tax changes and should prepare the Premier for such a discussion. Does FIN have any briefing material on the subject that may be useful for this purpose that you can share with IGRS? If nothing on the shelf, would you be able to craft a short 1-2 page note by tomorrow afternoon? I'm sorry for the short deadline and appreciate your help, as always. I have attached a template if you're working from scratch.

Please let me know if you have any questions.

Thanks again.

Judi

From: Brubacher, Kelly IGRS:EX On Behalf Of IGRS IGRS:EX

Sent: Monday, September 25, 2017 10:59 AM

To: Maranda, Pierrette IGRS:EX; Smith, Grant H IGRS:EX; Sigurdson, Judi IGRS:EX; Van Dyck, Brad IGRS:EX

Subject: Manitoba News Release: Private Sector joins Province to Voice Concern over Federal Tax Changes
FYI.

From: News Media Services [<mailto:nmservices@leg.gov.mb.ca>]

Sent: Friday, September 22, 2017 11:38 AM

To: IGRS IGRS:EX

Subject: Manitoba News Release: Private Sector joins Province to Voice Concern over Federal Tax Changes

Image removed by sender. Manitoba News Release



September 22, 2017

**PRIVATE SECTOR JOINS PROVINCE
TO VOICE CONCERN OVER FEDERAL TAX CHANGES**

Copyright

Page 309

Withheld pursuant to/removal as

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||

MEETING NOTE

Intergovernmental Relations Secretariat - Office of the Premier

CONFIDENTIAL ADVICE TO THE PREMIER

PREPARED FOR:	Premier John Horgan
MEETING:	Meeting with First Ministers (October 3, 2017)
ISSUES:	
SUGGESTED MESSAGES:	
BACKGROUND:	

From: [Karp, David FIN:EX](#)
To: [Vinkle, Angela FIN:EX](#)
Cc: [Purnell, Richard FIN:EX](#); [Flanagan, Paul FIN:EX](#); [Avis, Andrew FIN:EX](#)
Subject: FW: some comments from MO
Date: Tuesday, October 17, 2017 12:18:06 PM
Attachments: [BN - Fed Lib Tax Changes 2017 Summary.doc](#)
Importance: High

Angela, do you know whether the attached note was sent up to DMO or MO?

From: Wood, Heather FIN:EX
Sent: Tuesday, October 17, 2017 12:12 PM
To: Purnell, Richard FIN:EX; Karp, David FIN:EX
Cc: Flanagan, Paul FIN:EX; Galbraith, David J FIN:EX
Subject: RE: some comments from MO
Did this go forward to the DMO/MO?

From: Purnell, Richard FIN:EX
Sent: Tuesday, October 17, 2017 10:23 AM
To: Wood, Heather FIN:EX; Karp, David FIN:EX
Cc: Flanagan, Paul FIN:EX; Galbraith, David J FIN:EX
Subject: RE: some comments from MO
Here's an updated note.
Richard Purnell
Managing Director
Tax Policy Branch
British Columbia Ministry of Finance
Phone: (250) 387-9072
Cell: (250) 507-0410
Fax: (250) 387-9061

From: Wood, Heather FIN:EX
Sent: Tuesday, October 17, 2017 8:52 AM
To: Purnell, Richard FIN:EX; Karp, David FIN:EX
Cc: Flanagan, Paul FIN:EX; Galbraith, David J FIN:EX
Subject: FW: some comments from MO
Re: CCPC, can you take the last note you did for the MO/PO and add a new section to it on yesterday's federal announcement, thanks.

From: Galbraith, David J FIN:EX
Sent: Tuesday, October 17, 2017 8:51 AM
To: Wood, Heather FIN:EX; Flanagan, Paul FIN:EX
Subject: some comments from MO
Hi Paul/Heather,

Talking to Rob this am, he had some comments/direction on ^{s.12} plus
a request for an updated or up to date note on CCPC (given whats going on the with the feds right
now). I will pop by when you are in paul ^{s.12}
David Galbraith
Secretary to Treasury Board
Treasury Board Staff
Ph. 250 356-5427

Ministry of Finance
BRIEFING DOCUMENT

To: Honourable Carole James
Minister of Finance

Date Requested:
Date Required:

Initiated by:

Date Prepared:

**Ministry
Contact:**

Phone Number:
Email:

Cliff #:

TITLE: Federal Government's Income Tax Changes for Small Business:
Tax Planning Using Private Corporations

PURPOSE:

(X) FOR INFORMATION

COMMENTS: This note provides a description of the federal government's proposals to eliminate tax planning using private corporations.

DATE PREPARED:

TITLE: Federal Government's Income Tax Changes for Small Business: Tax Planning Using Private Corporations

ISSUE: The federal government has proposed changes to limit tax planning opportunities using private corporations.

BACKGROUND:

On July 18, 2017, Finance Canada released a consultation paper with proposed tax measures to address specific tax planning strategies used by private corporations: income sprinkling, passive investments, and surplus stripping.

On October 16, 2017, Finance Canada announced that due to responses received through the consultation process, Canada will be lowering the small business corporate income tax rate, currently at 10.5 per cent, to 10 per cent on January 1, 2018 and 9 per cent on January 1, 2019. Finance Canada also announced it will simplify the proposals relating to income sprinkling, including cancelling the proposal to limit "multiplication" of the Lifetime Capital Gains Exemption. Multiplication is when families, through corporations or trust, are able to claim a lifetime capital gains exemption for each family member on the same asset. With the October 16th announcement, it appears multiplication will continue to be allowed. Finance Canada will provide details about these changes "in the coming days".

1) Income Sprinkling:

Income sprinkling (also known as income splitting) is achieved by distributing (or "sprinkling") a corporation's income among family members through dividends or other payments, rather than distributing the corporation's income entirely to the owner/operator(s). By sprinkling corporate earnings among family members with low taxable income, income that would otherwise be taxed at high rates of tax in the hands of the owner/operator will be subject to lower rates of tax. ^{s.13}

s.13

For example, a BC individual who has \$300,000 of employment income in 2017 would pay approximately \$113,000 in federal and provincial income tax. A BC individual who earns \$300,000 in a small business corporation, and then uses dividends to "sprinkle" the income equally to their spouse and two adult children, would face a total tax bill of approximately \$24,000.

The federal government cracked down on income sprinkling in 1999 with the introduction of the tax on split income. Any payments that are received by minor children from a parent's corporations are automatically subject to tax at the highest marginal personal income tax rates. The federal government is proposing to extend the

tax on split income to adult children, spouses and other related individuals unless the amounts paid to family members are reasonable based on the recipient's capital or labour contributions to the company.

BC has a tax collection agreement with the federal government, under which the province agrees to accept the federal government's calculation of taxable income.

s.13

Budget 2017 Update introduced a new personal income tax rate of 16.8 per cent for incomes in excess of \$150,000 for the 2018 and subsequent taxation year. s.13

s.13

2) Investing the Corporation's Retained Earnings in Passive Investments:

Income earned by a corporation will be taxed twice; once at the corporate level and then again at the personal level when it is distributed to shareholders. The dividend tax credit ensures that the total tax paid at the corporation and personal level is roughly equivalent to the tax paid on income earned outside a corporation. However, owners of privately held corporations can defer the tax at the personal level by retaining the earnings of the corporation within the company and instead investing in a portfolio of passive investments (e.g. stocks, bonds and mutual funds). This allows owners of corporations to have a higher initial investment than taxpayers that earn their income directly (employees and sole proprietors).

A business owner who earns income through a corporation will have a total tax bill of corporate income tax plus personal income tax. The dividend tax credit mechanism ensures that the total tax bill of a business owner that earns income through corporation is roughly equivalent to a business owner that does not earn income through a corporation. s.13

s.13

The federal government is proposing to levy an additional tax on the passive investment income of a corporation in order to place all Canadians that make passive investments on a level playing field. s.13 the federal government is seeking feedback from stakeholders.

3) Converting Regular Earnings into Capital Gains ("Surplus Stripping"):

Surplus stripping refers to a variety of techniques by which owners of private companies extract value from their corporation as a capital gain rather than as income. The

incentive to engage in these transactions exists since capital gains receive favourable tax treatment: capital gains are generally taxed at half the rate of ordinary income, and in certain circumstances are exempt from tax through the lifetime capital gains exemptions. There are many specific anti-avoidance rules targeting such transactions and a general anti-avoidance rule that has been used to prevent surplus stripping transactions, but court decisions have narrowed the scope of both tools.

The federal government is proposing to ^{s.13} introduce a new specific “anti-stripping” rule that would apply whenever it is reasonable to consider that the taxpayer undertook a transaction to remove a corporate surplus as a capital gain.

s.13

DISCUSSION:

s.13

On October 3, 2017, the Department of Finance Canada stated that any future decisions regarding these proposals would be based on the following five key principles:

1. Support small businesses and their contributions to our communities and our economy.
2. Keep taxes low for small businesses, and support owners to actively invest in their growth, create jobs, strengthen entrepreneurship and grow our economy.
3. Avoid creating unnecessary red tape for hard-working small businesses.
4. Recognize the importance of maintaining family farms, and work with Canadians to ensure we don't affect the transfer of a family business to the next generation.
5. Conduct a gender-based analysis on finalized proposals, to ensure any changes to the tax system promote gender equity.

s.13

From: [Flanagan, Paul FIN:EX](#)
To: [Purnell, Richard FIN:EX](#); [Avis, Andrew FIN:EX](#)
Subject: FW: URGENT REQUEST
Date: Friday, September 29, 2017 9:31:36 AM
Attachments: [04e FIN BN federal tax changes.docx](#)
Importance: High

We need speaking notes to go with this. Andrew, is there anything from the presentations you saw on line that might help?

From: Wanamaker, Lori FIN:EX
Sent: Thursday, September 28, 2017 4:44 PM
To: Wood, Heather FIN:EX; Flanagan, Paul FIN:EX
Cc: Stonnell, Jennifer FIN:EX
Subject: Fw: URGENT REQUEST
Importance: High

Heads up. Rush request for PJH.

Sent from my BlackBerry 10 smartphone on the TELUS network.

From: Maranda, Pierrette IGRS:EX <Pierrette.Maranda@gov.bc.ca>
Sent: Thursday, September 28, 2017 4:41 PM
To: Wanamaker, Lori FIN:EX
Cc: Nicholson, Riley FIN:EX; Dawes, Sandra IGRS:EX
Subject: URGENT REQUEST

Lori:

Next week, there will be a First Ministers' Meeting (FMM) and Premiers intend to raise the federal tax reform issue with the Prime Minister. Okenge briefed the PO today on next week's FMM and given the profile and importance of the federal tax reform issue, additional info is needed for the Premier on this specific item.

The Premier will need precise speaking points that he may wish to deliver at the meeting: i.e. key messages that will either state or foreshadow the BC position. Attached is the one pager that we have in the binder.

Can you provide the additional speaking points by tomorrow 10:00 am. Sorry for the quick turnaround time.

Thanks,
Pierrette

MEETING NOTE

Intergovernmental Relations Secretariat - Office of the Premier

CONFIDENTIAL ADVICE TO THE PREMIER

MEETING:	Meeting with First Ministers (October 3, 2017)
ISSUES:	Proposed federal tax changes for private corporations
SUGGESTED MESSAGES:	s.13,s.16
BACKGROUND:	<p>The 2017 federal budget pledged to address specific tax planning strategies that are used by private corporations.</p> <p>In response to the increased use of private corporations compared to other business entities, on July 18, 2017, the Department of Finance released a consultation paper discussing three specific advantages for private corporations and the proposed solutions to the identified problems: income sprinkling, passive investments and converting business income to capital gains. The consultation period is open until October 2, 2017.</p> <p>These tax planning mechanisms are only available to incorporated business with very high incomes.</p> <p>Business owners that use these tax planning mechanisms have been vocal about their opposition to the proposed changes. s.13,s.16 s.13,s.16</p> <p>Media reports of public reaction to the proposed changes have largely been negatives. s.13,s.16 s.13,s.16</p> <p>Doctors are split in their support or opposition to the changes. Those that support the proposed changes argue that they are not in a position to take advantage of the tax planning mechanisms and the tax system should not be used to indirectly address things like paid leave for maternity. s.13,s.16</p> <p>The Minister of Finance's mandate letter contains the following priority, "Take measures to improve tax fairness and ensure the tax system reflects our commitment to work for all British Columbians, not just those at the top."</p>

From: [Karp, David FIN:EX](#)
To: [Zoeller, Sonja GCPE:EX](#)
Cc: [Avis, Andrew FIN:EX](#); [Flanagan, Paul FIN:EX](#)
Subject: Issue notes
Date: Tuesday, September 5, 2017 3:53:33 PM
Attachments: [IN Credit union tax treatment 10Aug17 DRAFT.docx](#)
[IN Elimination of some PIT credits 31Aug17 DRAFT.docx](#)
[IN Federal Income Tax Changes consultation 1September17 DRAFT.docx](#)
[IN Film tax boundary change 1Sept17 DRAFT.docx](#)
[IN General corporate income tax rate increase 1Sept17 DRAFT.docx](#)
[IN New top PIT marginal rates 1Sept17 DRAFT.docx](#)
[CM Small Business Venture Capital Tax Credits 31Aug17 DRAFT.docx](#)
[CM Training Tax credits 31Aug17 DRAFT.docx](#)

Hi Sonja,
s.13

Thanks,
David.

David Karp

Director, Income Tax | Tax Policy Branch | Ministry of Finance
105 – 617 Government Street, Victoria, BC V8W 9V8
Tel. 250-387-5044 | Email: David.Karp@gov.bc.ca

ADVICE TO MINISTER

<p>CONFIDENTIAL DRAFT GCPE-FIN ISSUE NOTE</p> <p>Ministry of Finance RECORD OPR: GCPE Finance Date: September 1, 2017 Minister Responsible: Carole James</p>	<p>Federal income tax changes consultation</p>
---	---

DRAFT

ADVICE AND RECOMMENDED RESPONSE:

s.13

KEY FACTS REGARDING THE ISSUE:

In its Budget 2017, the federal government committed to reviewing tax planning strategies used by owners of private corporations to “inappropriately” reduce personal income tax liabilities.

The federal government launched a consultation on July 18, 2017, discussing three specific advantages for private corporations and proposed solutions to those problems: income sprinkling, passive investments and surplus stripping. The consultation closes Oct 2, 2017.

s.13

Small business owners, including lawyers, accountants, and contractors, generally oppose the proposed changes as they would likely lead to higher tax liabilities. The Canadian Chamber of Commerce wrote that the proposed changes would lead to:

- Higher tax rates on family members employed by businesses
- An effective 70% tax rate on income earned through investments
- Difficulty for business owners’ children to receive a capital gains exemption when a business is passed down

Doctors have been particularly vocal in their opposition to the proposals, noting that they could exacerbate the doctor shortage. They argue that since doctors are independent contractors who cannot negotiate their fee-for-service, they need these methods to reduce their tax bill in order to run a profitable practice, save for retirement, plan for parental leave and pay down their debt.

Communications Contact: Sonja Zoeller 387-1248
Program Area Contact: David Karp 387-5044
File Created: September 1, 2017
File Updated:
File Location: J:\NEW - OPERATIONS\Issues notes\Tax policy

Program Area	Comm. Director	Deputy	Minister's Office

From: [Karp, David FIN:EX](#)
To: [Wood, Heather FIN:EX](#)
Cc: [Purnell, Richard FIN:EX](#); [Avis, Andrew FIN:EX](#)
Subject: Note for Minister on federal consultation
Date: Wednesday, August 9, 2017 4:25:41 PM
Attachments: [Federal Tax Changes - Private Companies \(for Minister\).docx](#)
Importance: High

Hi Heather,

Attached is the one-pager for the Minister on the federal consultation paper on tax planning.

Thanks,

David.

David Karp

Director, Income Tax | Tax Policy Branch | Ministry of Finance

107 – 617 Government Street, Victoria, BC V8W 9V8

Tel. 250-387-5044 | Email: David.Karp@gov.bc.ca

From: [Morgan, Melissa FIN:EX](#)
To: [Karp, David FIN:EX](#)
Subject: RE: Note for Minister on federal consultation
Date: Wednesday, August 9, 2017 4:27:05 PM

Thanks!

From: Karp, David FIN:EX
Sent: Wednesday, August 9, 2017 4:27 PM
To: Morgan, Melissa FIN:EX
Subject: FW: Note for Minister on federal consultation
Importance: High
Sorry I was supposed to send to you instead.

From: Karp, David FIN:EX
Sent: Wednesday, August 9, 2017 4:26 PM
To: Wood, Heather FIN:EX
Cc: Purnell, Richard FIN:EX; Avis, Andrew FIN:EX
Subject: Note for Minister on federal consultation
Importance: High

Hi Heather,

Attached is the one-pager for the Minister on the federal consultation paper on tax planning.

Thanks,

David.

David Karp

Director, Income Tax | Tax Policy Branch | Ministry of Finance
107 – 617 Government Street, Victoria, BC V8W 9V8
Tel. 250-387-5044 | Email: David.Karp@gov.bc.ca

Issue	Federal Changes – Tax Planning Using Private Corporations
--------------	--

s.13

Current Status

- The federal government is seeking public comments on measures it has proposed to limit the tax planning opportunities through private corporations.

Background and Analysis

- The 2017 federal budget pledged to address specific tax planning strategies that used private corporations.
- Recent tax data indicates that the business income of private corporations relative to GDP is increasing significantly: from 3.1 per cent in 2002 to 5.8 per cent in 2014.
- In response to the increased use of private corporations compared to other business entities, on July 18, 2017, the Department of Finance released a consultation paper discussing three specific advantages for private corporations and the proposed solutions to the identified problems: income sprinkling, passive investments and surplus stripping. Details about these issues are provided in the Appendix.

s.13

- The consultation period is open until October 2, 2017.
- BC relies on the federal determination of taxable income, and therefore any measures in the consultation paper that the federal government proceeds with will also apply to BC's corporate income taxes. s.13

s.13

Contact: Andrew Avis (250-356-6004) August 3, 2017
Tax Policy Branch, BC Finance

From: Vinkle, Angela FIN:EX
To: Avis, Andrew FIN:EX
Subject: RE: Backgrounder for Minister
Date: Friday, September 1, 2017 10:29:27 AM

Hi Andrew,

Thank you again for your notes. I have proofed them and sent them over to Melissa. I made a couple small edits (commas, spacing etc.).

I have included my revised copy below for your records ☺ Thanks so much!

3. Federal Changes – Tax Planning Using Private Corporations

The 2017 federal budget pledged to address specific tax planning strategies that involve the use of private corporations.

Recent tax data indicates that the business income of private corporations relative to GDP is increasing significantly: from 3.1 per cent in 2002 to 5.8 per cent in 2014. In response to the increased use of private corporations compared to other business entities, on July 18, 2017, the Department of Finance released a consultation paper discussing three specific advantages for private corporations and the proposed solutions to the identified problems: income sprinkling, passive investments and surplus stripping.

s.13

The consultation period is open until October 2, 2017.

B.C. relies on the federal determination of taxable income, and therefore any measures in the consultation paper that the federal government proceeds with will also apply to B.C.'s corporate income taxes. s.13

s.13

s.13,s.16

Kindly,

Angela Vinkle, Branch Administrator

Ministry of Finance | Tax Policy Branch
105 – 617 Government Street
Victoria BC V8W 9V8
Tel: 250-356-5928

From: Avis, Andrew FIN:EX
Sent: Friday, September 1, 2017 10:21 AM
To: Vinkle, Angela FIN:EX
Cc: Karp, David FIN:EX
Subject: RE: Backgrounder for Minister
Hi Angela,

I pasted the current text below and added my updates in red. I got Paul's approval for it too.

3. Federal Changes – Tax Planning Using Private Corporations

The 2017 federal budget pledged to address specific tax planning strategies that involve the use of private corporations.

Recent tax data indicates that the business income of private corporations relative to GDP is increasing significantly: from 3.1 per cent in 2002 to 5.8 per cent in 2014. In response to the increased use of private corporations compared to other business entities, on July 18, 2017, the Department of Finance released a consultation paper discussing three specific advantages for private corporations and the proposed solutions to the identified problems: income sprinkling, passive investments and surplus stripping.

s.13

The consultation period is open until October 2, 2017.

BC relies on the federal determination of taxable income, and therefore any measures in the consultation paper that the federal government proceeds with will also apply to BC's corporate income taxes. s.13

s.13

s.13,s.16

Andrew Avis

Strategic Advisor | Policy & Legislation Division | Ministry of Finance
105 – 617 Government Street, Victoria, BC V8W 9V8
Tel. 250-356-6004 Email: Andrew.Avis@gov.bc.ca

From: Wood, Heather FIN:EX
Sent: Friday, September 1, 2017 8:49 AM
To: Avis, Andrew FIN:EX; Karp, David FIN:EX
Cc: Vinkle, Angela FIN:EX; Morgan, Melissa FIN:EX
Subject: FW: Backgrounder for Minister
Importance: High

David/Andrew – can one of you update the section of the attached note that deals with the proposed federal changes to the taxation of private corporations s.13

s.13

s.13 We'll need this by mid-morning please and thanks.

From: Morgan, Melissa FIN:EX
Sent: Thursday, August 31, 2017 4:33 PM
To: Wood, Heather FIN:EX
Subject: FW: Backgrounder for Minister
Here is the note including Cannabis and CCMRS...

From: Nicholson, Riley FIN:EX
Sent: Thursday, August 31, 2017 4:02 PM
To: Morgan, Melissa FIN:EX
Cc: Stonnell, Jennifer FIN:EX
Subject: RE: Backgrounder for Minister
Hi Melissa,

We don't know specific topics yet. I have a message into the MO to ask. Will let you know when we hear back from them.

Thanks,

Riley

From: Morgan, Melissa FIN:EX
Sent: Thursday, August 31, 2017 3:30 PM
To: Nicholson, Riley FIN:EX
Cc: Stonnell, Jennifer FIN:EX
Subject: RE: Backgrounder for Minister

Will do, Riley! Do you happen to have any info on what Minister Morneau wants to discuss? (then we can focus the note on those topics)...

From: Nicholson, Riley FIN:EX
Sent: Thursday, August 31, 2017 2:33 PM
To: Morgan, Melissa FIN:EX
Cc: Stonnell, Jennifer FIN:EX
Subject: Backgrounder for Minister
Hi Melissa,

The Minister is meeting with Minister Morneau again on Tuesday and they have requested a backgrounder. Could you please put in the request and open a cliff log for this? Due by 3:30 tomorrow. Presumably we can just update backgrounder Cliff #359894 that was provided to the Minister for her call with Morneau on August 10th.

Thanks,

Riley

Riley Nicholson

*A/Senior Executive Assistant
Deputy Minister's Office
Ministry of Finance*

T: 250 387 3184 **F:** 250 387 1655

Email: Riley.Nicholson@gov.bc.ca

From: [Karp, David FIN:EX](#)
To: [Zoeller, Sonja GCPE:EX](#)
Cc: [Flanagan, Paul FIN:EX](#); [Avis, Andrew FIN:EX](#)
Subject: RE: Fed tax reform
Date: Wednesday, October 4, 2017 12:31:38 PM

Hi Sonja,

I've made some changes. s.13

s.13

Thanks,

David.

David Karp

Director, Income Tax | Tax Policy Branch | Ministry of Finance

105 – 617 Government Street, Victoria, BC V8W 9V8

Tel. 250-387-5044 | Email: David.Karp@gov.bc.ca

From: Zoeller, Sonja GCPE:EX
Sent: Wednesday, October 4, 2017 10:02 AM
To: Karp, David FIN:EX
Subject: Fed tax reform
Importance: High
Hi David –

Any concerns with these updated messages? MCJ is going on Voice of BC tomorrow evening and we're pulling together her prep.

s.13

Thanks,

Sonja Zoeller

A/Communications Manager

Ministry of Finance

Direct: 250-387-1248

Cell: 250-812-6844

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From: [Karp, David FIN:EX](#)
To: [Avis, Andrew FIN:EX](#)
Subject: RE: Info Note for MCJ and PO RE: Fed Tax Changes
Date: Wednesday, October 4, 2017 6:36:40 PM

Thanks Andrew. Good note for such a technical topic on short notice.

If you have time to incorporate them, I've made a number of suggestions in a different file:

[G:\TPB\ANALYSTS\ANDREW\WIP\Federal Liberal Tax Changes\Small Business Rate\BN - Fed Lib Tax Changes 2017 Summary for QP_DK edits.doc](#)

If you don't have time to go through my suggestions, you can forward your note on to Paul.

From: Avis, Andrew FIN:EX
Sent: Wednesday, October 4, 2017 5:12 PM
To: Karp, David FIN:EX
Subject: Info Note for MCJ and PO RE: Fed Tax Changes

Hi David,

Heather asked me to do an info note for MCJ and PO ^{s.13}
s.13

Here is what I prepared:

[G:\TPB\ANALYSTS\ANDREW\WIP\Federal Liberal Tax Changes\Small Business Rate\BN - Fed Lib Tax Changes 2017 Summary for QP.doc](#)

She was looking for a description of the changes, some discussion of the criticism and a summary of the federal government's response.

Since QP is in the morning tomorrow I will understand if you don't have time to review this (I was given this task at 1:30). I will be in a bit early and give it to Paul first thing but there will probably be a chance to incorporate your changes if you don't look at it until tomorrow.

Thank you.

Andrew Avis

Strategic Advisor | Policy & Legislation Division | Ministry of Finance
105 – 617 Government Street, Victoria, BC V8W 9V8
Tel. 250-356-6004 Email: Andrew.Avis@gov.bc.ca

From: [Karp, David FIN:EX](#)
To: [Young, Tonya FIN:EX](#)
Cc: [Cheung, Maria FIN:EX](#); [Krasnick, Jeffrey S FIN:EX](#); [Avis, Andrew FIN:EX](#)
Subject: RE: review of federal split income provisions - status
Date: Friday, August 4, 2017 9:06:01 AM
Attachments: [image001.jpg](#)
[Federal Tax Changes - Private Companies.docx](#)

Thanks Tonya.

FYI, we've been asked to prepare a short note for Lori in preparation for a bilateral call with her federal counterpart, Paul Rochon (the call is their first bilat about a number of issues, not focused on the consultation paper). I have attached the draft note Andrew put together in case you have comments (no firm deadline).

Cheers,
David.

From: Young, Tonya FIN:EX
Sent: Friday, August 4, 2017 7:55 AM
To: Karp, David FIN:EX
Cc: Cheung, Maria FIN:EX; Krasnick, Jeffrey S FIN:EX
Subject: review of federal split income provisions - status

Hi David,

We're currently reviewing the federal split income provisions and will get back to you next week.

Tonya Young

Manager, Income Tax Advisory – Related Programs

Income Taxation Branch

Ministry of Finance

Phone: 250 387-1201 Fax: 250-356-9243

email: Tonya.Young@gov.bc.ca

Partnership_web_tiny (2)



VISION: Trusted financial and economic leadership for a prosperous province

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From: [Avis, Andrew FIN:EX](#)
To: [Purnell, Richard FIN:EX](#)
Cc: [Karp, David FIN:EX](#)
Subject: For Review: DM to DM call Note on Federal Changes RE Tax Planning Using Private Corporations
Date: Thursday, August 3, 2017 4:04:12 PM

Hi Richard,

David has reviewed my note regarding the federal changes to the ITA to address tax planning using private corporations for the DM's call with her federal counterpart.

[G:\TPB\OTHER TAX POLICY ISSUES\Backgrounders for DM to DM call August 2017\Federal Tax Changes - Private Companies.docx](#)

Please let me know if you would like any changes.

Andrew Avis

Strategic Advisor | Policy & Legislation Division | Ministry of Finance
105 – 617 Government Street, Victoria, BC V8W 9V8
Tel. 250-356-6004 Email: Andrew.Avis@gov.bc.ca

From: Karp, David FIN:EX
To: Zoeller, Sonja GCPE:EX
Subject: RE: G&M article
Date: Friday, August 4, 2017 9:33:00 AM
Attachments: Federal Tax Changes - Private Companies.docx

Not for circulation, but here's a draft note that Andrew did up in prep for Lori's bilat with Finance Canada DM, which explains the issue and BC position/implications well.

From: Karp, David FIN:EX
Sent: Friday, August 4, 2017 9:24 AM
To: Zoeller, Sonja GCPE:EX
Subject: RE: G&M article

Documents on the consultation are here (ignore the retail payments stuff – that's a different issue):
http://www.fin.gc.ca/activty/consult_eng.asp

From: Zoeller, Sonja GCPE:EX
Sent: Friday, August 4, 2017 8:53 AM
To: Karp, David FIN:EX; Hawkshaw, Steve FIN:EX
Subject: G&M article
Hi, can we talk about this?

Globe and Mail, Page A11, 01-Aug-2017

Ottawa's new tax measures unfairly target many doctors

By Andre Picard

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Page 336 to/à Page 337

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Issue	Federal Changes – Tax Planning Using Private Corporations
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s.13

Current Status

- The federal government is seeking public comments on measures it has proposed to limit the tax planning opportunities through private corporations.

Background and Analysis

- The 2017 federal budget pledged to address specific tax planning strategies that used private corporations.
- Recent tax data indicates that the business income of private corporations relative to GDP is increasing significantly: from 3.1 per cent in 2002 to 5.8 per cent in 2014.
- In response to the increased use of private corporations compared to other business entities, on July 18, 2017, the Department of Finance released a consultation paper discussing three specific advantages for private corporations and the proposed solutions to the identified problems: income sprinkling, passive investments and surplus stripping. Details about these issues are provided in the Appendix.
- The consultation period is open until October 2, 2017.
- BC relies on the federal determination of taxable income, and therefore any measures in the consultation paper that the federal government proceeds with will also apply to BC's corporate income taxes. s.13

s.13

Appendix

The following is a summary of the three issues identified in the federal government's consultation paper.

1) Income Sprinkling:

- Income sprinkling is achieved by distributing ("sprinkling") a corporation's income amongst family members through dividends or other payments, rather than distributing the corporation's income entirely to the owner/operator(s).
- By sprinkling corporate earnings amongst close family members without much taxable income, income that would otherwise be taxed at high rates of tax in the hands of the owner/operator will be subject to lower rates of tax.^{s.13}
- The federal government previously took action in 1999 by removing the ability to split income with minor children through the tax on split income also known as the "kiddie tax." The tax on split income applies the highest marginal tax rate to any split income received by children of the owner/operator.
- In response to adult children (particularly those aged 18 to 24 that typically have low taxable income) increasingly receiving dividends from private corporations, the federal government is proposing to extend the tax on split income rules to adult children unless the amounts received by adult children are reasonable based on the child's capital or labour contributions to their parent's company.
- Finance Canada has also proposed rules to track any split income received by children under the age of 25 in order to continue to apply the highest marginal income tax rate on any investment income earned on that split income.

2) Investing the Corporation's Retained Earnings in Passive Investments:

- Income earned by a corporation will be taxed twice; once at the corporate level and then again at the personal level once it is distributed to shareholders. The dividend tax credit ensures that total tax paid at the corporation and shareholder level is roughly equivalent to the tax paid on income earned outside a corporation.
- Owners of privately held corporations can defer the payment of tax at the shareholder level by keeping the earnings of the corporation within the company and instead investing in a portfolio of passive investments (e.g. stocks, bonds and mutual funds).
- Finance Canada is concerned is that by deferring tax at the shareholder level, owners of private corporations have greater amounts of after-tax income to invest than individuals who earn the same amount personally. Due to the compounding of returns on passive investments, this extra investment provides an exponential advantage that increases the longer the portfolio is held.

- The deferral of tax created by retaining the earnings also acts as an informal RRSP account for the corporation's owner without any of the restrictions, such as maximum contributions, placed on actual RRSPs.
- Finance Canada is proposing to levy an additional tax on the passive investment income of a corporation in order to place all Canadians that make passive investments on a level playing field.

3) Converting Regular Earnings into Capital Gains ("Surplus Stripping"):

- Surplus stripping refers to a variety of techniques that owners of private companies use to extract value from the corporation as a capital gain rather than as income, since capital gains are taxed at half the rate of ordinary income.
- There are many specific anti-avoidance rules targeting such transactions and a general anti-avoidance rule that has been used to prevent surplus stripping transactions, but court decisions have narrowed the scope of both tools.
- Finance Canada is proposing to ^{s.13} introduce a new specific "anti-stripping" rule that will apply whenever it is reasonable to consider that the taxpayer undertook a transaction to remove a corporate surplus as a capital gain.

Contact: Andrew Avis (250-356-6004)
Tax Policy Branch, BC Finance

August 3, 2017

From: [Karp, David FIN:EX](#)
To: [Avis, Andrew FIN:EX](#)
Subject: RE: G&M article
Date: Friday, August 4, 2017 9:22:00 AM

OK no prob. I had a brief chat with her explaining the issue – at this point she hasn't requested anything specific.

From: Avis, Andrew FIN:EX
Sent: Friday, August 4, 2017 9:20 AM
To: Karp, David FIN:EX
Subject: RE: G&M article
Just let me know when she wants to talk about it.

s.22

Andrew Avis

Strategic Advisor | Policy & Legislation Division | Ministry of Finance
105 – 617 Government Street, Victoria, BC V8W 9V8
Tel. 250-356-6004 Email: Andrew.Avis@gov.bc.ca

From: Karp, David FIN:EX
Sent: Friday, August 4, 2017 9:16 AM
To: Avis, Andrew FIN:EX
Subject: FW: G&M article
FYI. I might need your help with whatever Sonja needs.

From: Zoeller, Sonja GCPE:EX
Sent: Friday, August 4, 2017 8:53 AM
To: Karp, David FIN:EX; Hawkshaw, Steve FIN:EX
Subject: G&M article
Hi, can we talk about this?

Globe and Mail, Page A11, 01-Aug-2017

Ottawa's new tax measures unfairly target many doctors

By Andre Picard

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Page 342 to/à Page 343

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From: [Flanagan, Paul FIN:EX](#)
To: [Karp, David FIN:EX](#); [Avis, Andrew FIN:EX](#); [Purnell, Richard FIN:EX](#)
Date: Tuesday, July 18, 2017 10:12:25 AM
Attachments: [TE Distribution by Province - English.pdf](#)

David. You might want to let Anita/Riley know about this at some point. s.13

s.13

Provincial Distribution of the Cost of Income Sprinkling Measures (\$m)¹

FISCAL YEAR 2017-2018

2017-07-18

Federal-Provincial Relations

	NL	PE	NS	NB	QC	ON	MB	SK	AB	BC	NT	YT	NU	TOTAL
--	----	----	----	----	----	----	----	----	----	----	----	----	----	-------

Provincial Cost	s.13,s.16
Federal Cost	

1. The estimates assume that all provinces would adopt the federal measures as proposed and Quebec would amend its legislation to complement the federal rules.

A negative number indicates a cost to taxpayers (an increase in taxes).

A positive number indicates a benefit to taxpayers (a reduction in taxes).

Provincial Distribution of the Cost of Income Sprinkling Measures (\$m)¹

FISCAL YEAR 2018-2019

2017-07-18

Federal-Provincial Relations

	NL	PE	NS	NB	QC	ON	MB	SK	AB	BC	NT	YT	NU	TOTAL
Provincial Cost	s.13,s.16													
Federal Cost														

1. The estimates assume that all provinces would adopt the federal measures as proposed and Quebec would amend its legislation to complement the federal rules.

A negative number indicates a cost to taxpayers (an increase in taxes).

A positive number indicates a benefit to taxpayers (a reduction in taxes).

Provincial Distribution of the Cost of Income Sprinkling Measures (\$m)¹

FISCAL YEAR 2019-2020

2017-07-18

Federal-Provincial Relations

	NL	PE	NS	NB	QC	ON	MB	SK	AB	BC	NT	YT	NU	TOTAL
--	----	----	----	----	----	----	----	----	----	----	----	----	----	-------

Provincial Cost	s.13,s.16
Federal Cost	

1. The estimates assume that all provinces would adopt the federal measures as proposed and Quebec would amend its legislation to complement the federal rules.

A negative number indicates a cost to taxpayers (an increase in taxes).

A positive number indicates a benefit to taxpayers (a reduction in taxes).

Provincial Distribution of the Cost of Income Sprinkling Measures (\$m)¹

FISCAL YEAR 2020-2021

2017-07-18

Federal-Provincial Relations

	NL	PE	NS	NB	QC	ON	MB	SK	AB	BC	NT	YT	NU	TOTAL
--	----	----	----	----	----	----	----	----	----	----	----	----	----	-------

Provincial Cost	s.13,s.16
Federal Cost	

1. The estimates assume that all provinces would adopt the federal measures as proposed and Quebec would amend its legislation to complement the federal rules.

A negative number indicates a cost to taxpayers (an increase in taxes).

A positive number indicates a benefit to taxpayers (a reduction in taxes).

Provincial Distribution of the Cost of Income Sprinkling Measures (\$m)¹

FISCAL YEAR 2021-2022

2017-07-18

Federal-Provincial Relations

	NL	PE	NS	NB	QC	ON	MB	SK	AB	BC	NT	YT	NU	TOTAL
Provincial Cost	s.13,s.16													
Federal Cost														

1. The estimates assume that all provinces would adopt the federal measures as proposed and Quebec would amend its legislation to complement the federal rules.

A negative number indicates a cost to taxpayers (an increase in taxes).

A positive number indicates a benefit to taxpayers (a reduction in taxes).

Provincial Distribution of the Cost of Income Sprinkling Measures (\$m)¹

FISCAL YEARS 2017-2018 TO 2021-2022

2017-07-18
Federal-Provincial Relations

NLPENSNBNBQCQCONMBSKABBCNTYTNUTOTAL

Provincial Cost

Federal Cost

s.13,s.16

1. The estimates assume that all provinces would adopt the federal measures as proposed and Quebec would amend its legislation to complement the federal rules.
A negative number indicates a cost to taxpayers (an increase in taxes).
A positive number indicates a benefit to taxpayers (a reduction in taxes).

From: [Flanagan, Paul FIN:EX](#)
To: [Avis, Andrew FIN:EX](#); [Purnell, Richard FIN:EX](#)
Subject: tax changes.docx
Date: Monday, September 25, 2017 4:19:07 PM
Attachments: [tax changes.docx](#)

MEETING NOTE

Intergovernmental Relations Secretariat - Office of the Premier

CONFIDENTIAL ADVICE TO THE PREMIER

PREPARED FOR: Premier John Horgan

MEETING: Meeting with First Ministers (October 3, 2017)

ISSUES: Proposed federal tax changes for private corporations

**SUGGESTED
MESSAGES:** s.13,s.16

BACKGROUND: The 2017 federal budget pledged to address specific tax planning strategies that used private corporations.

Recent tax data indicates that the business income of private corporations relative to GDP is increasing significantly: from 3.1 per cent in 2002 to 5.8 per cent in 2014.

In response to the increased use of private corporations compared to other business entities, on July 18, 2017, the Department of Finance released a consultation paper discussing three specific advantages for private corporations and the proposed solutions to the identified problems: income sprinkling, passive investments and converting business income to capital gains.

s.13,s.16

The consultation period is open until October 2, 2017.

Media reports of public reaction to the proposed changes have largely been negative. s.13,s.16

s.13,s.16

Doctors are split in their support or opposition to the changes. Those that support the changes argue that they are not in a position to take advantage of the tax planning mechanisms and the tax system should not be used to indirectly address things like paid leave for maternity but rather those things should be addressed directly.

s.13,s.16

From: [Karp, David FIN:EX](#)
To: [Avis, Andrew FIN:EX](#)
Subject: FW: BN Format - 2017-08 Bilateral Call
Date: Monday, July 31, 2017 11:16:00 AM
Attachments: [BN Format - 2017-08 Bilateral Call.docx](#)

Hi Andrew,

Please use the attached template for the backgrounder for the DM about the federal income sprinkling consult. You can save your note here: G:\TPB\OTHER TAX POLICY ISSUES\Backgrounders for DM to DM call August 2017

Thanks!

- David

From: Foy, Anne FIN:EX
Sent: Monday, July 31, 2017 10:42 AM
To: Karp, David FIN:EX; Hawkshaw, Steve FIN:EX
Subject: FW: BN Format - 2017-08 Bilateral Call

Anne Foy
Strategic Advisor
Tax Policy Branch
Ministry of Finance

From: Ewing, Patrick FIN:EX
Sent: Monday, July 31, 2017 10:28 AM
To: Foy, Anne FIN:EX
Cc: Molnar, Rory FIN:EX
Subject: BN Format - 2017-08 Bilateral Call

Anne,
I understand you were looking for a template for your note. You can use the attached.
Patrick

From: Karp, David FIN:EX
To: "Gagnon, Claudine (FIN)"
Subject: Income sprinkling costing
Date: Wednesday, October 18, 2017 1:16:00 PM

Hi Claudine,
s.13,s.16

Are there any revised revenue estimates available based on Monday's update that the lifetime capital gains exemption portion of the income sprinkling proposal is not proceeding?

Thanks,
David.

David Karp

Director, Income Tax | Tax Policy Branch | Ministry of Finance
105 – 617 Government Street, Victoria, BC V8W 9V8
NEW Tel. 778-698-5778 | Email: David.Karp@gov.bc.ca

From: Foy, Anne FIN:EX
To: Purnell, Richard FIN:EX; Karp, David FIN:EX; Hawkshaw, Steve FIN:EX
Subject: RE: Backgrounder Requested for Call with DM Paul Rochon
Date: Monday, July 31, 2017 9:14:39 AM

Hi Guys,

I have created a sub folder for the backgrounders

G:\TPB\OTHER TAX POLICY ISSUES\Backgrounders for DM to DM call August 2017

Anne Foy

Strategic Advisor

Tax Policy Branch

Ministry of Finance

From: Wood, Heather FIN:EX
Sent: Friday, July 28, 2017 4:42 PM
To: Primeau, Joseph FIN:EX; Callahan-Maureen, Cynthia FIN:EX; Foy, Anne FIN:EX; Purnell, Richard FIN:EX; Molnar, Rory FIN:EX; Karp, David FIN:EX; Hawkshaw, Steve FIN:EX
Cc: Morgan, Melissa FIN:EX
Subject: FW: Backgrounder Requested for Call with DM Paul Rochon

Can you start working one assembling information (likely no more than 1 page or so) on

s.12,s.13,s.16

We'll then assemble them into one big note. Also, Rory – do we have a summary of the key themes/spending areas of the federal budget that we can attach to this note? I guess we could provide Lori with the decks from the Finance Ministers' Meeting s.13
s.13

Thanks and have a good weekend,

Heather

From: Nicholson, Riley FIN:EX
Sent: Friday, July 28, 2017 2:44 PM
To: Wood, Heather FIN:EX
Cc: Morgan, Melissa FIN:EX; Stonnell, Jennifer FIN:EX
Subject: Backgrounder Requested for Call with DM Paul Rochon

Hi Heather,

Just a heads up, Lori has asked me to set up an introductory call with Paul Rochon and asked if your IGR can please prepare a backgrounder. I will make contact with the DM's Office on Monday or Tuesday of next week and will let you know as soon as a date/time for the call has been confirmed.

Thanks,

Riley

Riley Nicholson

A/Senior Executive Assistant

Deputy Minister's Office

Ministry of Finance

T: 250 387 3184 F: 250 387 1655

Email: Riley.Nicholson@gov.bc.ca

Karp, David FIN:EX

From: Zoeller, Sonja GCPE:EX
Sent: Wednesday, October 18, 2017 10:56 AM
To: Karp, David FIN:EX
Subject: RE: Federal Tax Reform statement

I like it, let me know once it's ready to go. Thanks!

From: Karp, David FIN:EX
Sent: Wednesday, October 18, 2017 10:55 AM
To: Zoeller, Sonja GCPE:EX
Subject: RE: Federal Tax Reform statement

The second bullet now sounds weird, because the feds did come out with more details this week, although more details are still to come in the 2018 federal budget. What do you think of the following? If you're OK with it I'll run it past Richard.

s.13

From: Zoeller, Sonja GCPE:EX
Sent: Wednesday, October 18, 2017 10:47 AM
To: Karp, David FIN:EX
Cc: Purnell, Richard FIN:EX
Subject: Federal Tax Reform statement
Importance: High

Hi David –

A publication is seeking comment from the minister about the federal government's tax reform proposal.

Could you please let me know if this statement is accurate?

Statement from the Minister of Finance:

"One of my priorities is to improve tax fairness and ensure the tax system reflects our commitment to work for everyone, not just those at the top. It is important that everyone pays their fair share of taxes.

s.13

"In B.C., we are focused on supporting business competitiveness, while ensuring our system is fair. In Budget 2017 Update, government announced that we will lower B.C.'s small business tax rate from 2.5% to 2%. This will be one of the lowest provincial small business tax rates in Canada. We're also phasing out the PST on electricity. These changes will help business competitiveness by giving industry the dollars to invest in new technologies and create more jobs."

Sonja Zoeller

A/Communications Manager

Ministry of Finance

Direct: 250-387-1248

Cell: 250-812-6844

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Page 359 to/à Page 367

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8/17/2017

In Part Two, I will share my observations about these rules.

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s.16

TAX PLANNING USING PRIVATE CORPORATIONS

Technical Briefing

JULY 18, 2017



Department of Finance
Canada

Ministère des Finances
Canada

Canada

Outline

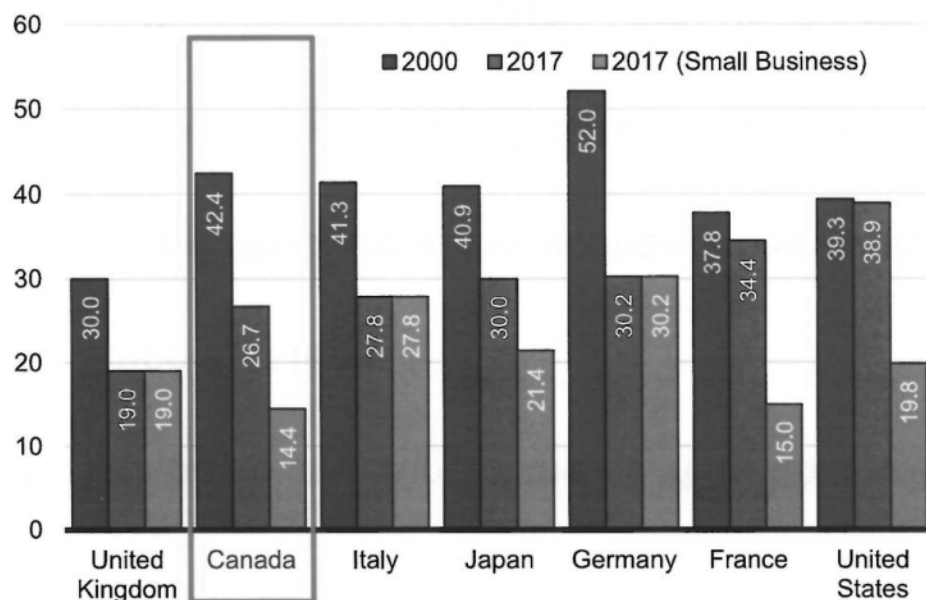
- Context
- Key Features of the Income Tax System
- First Strategy: Income Sprinkling
- Second Strategy: Passive Investment Income
- Third Strategy: Converting Income into Capital Gains
- Conclusion

A Highly Competitive Tax System to Encourage Investment, Job Creation and Innovation

Canada has a highly competitive tax regime compared to G7 peers...

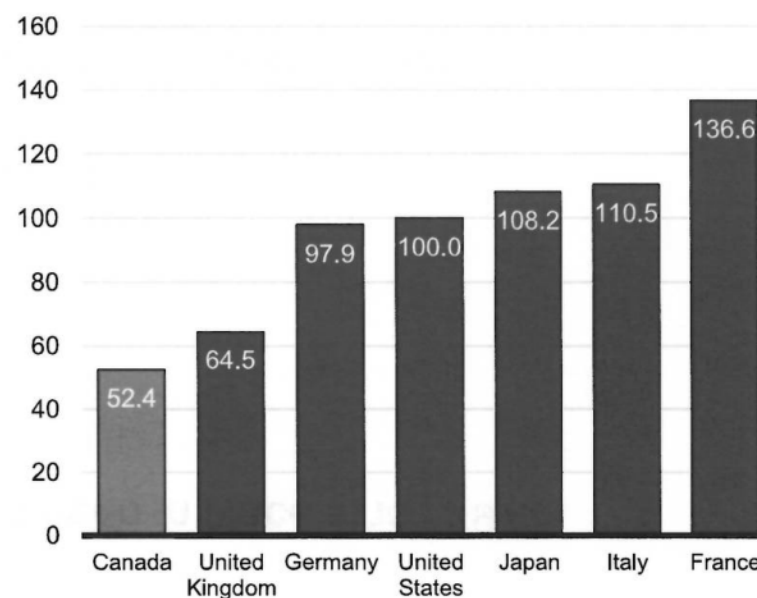
... and the lowest total tax costs according to KPMG

General and Small Business Corporate Income Tax Rates



Source: OECD Tax Database

Total Tax Index, 2016



Source: KPMG, Competitive Alternatives 2016 Special Report: Focus on Tax

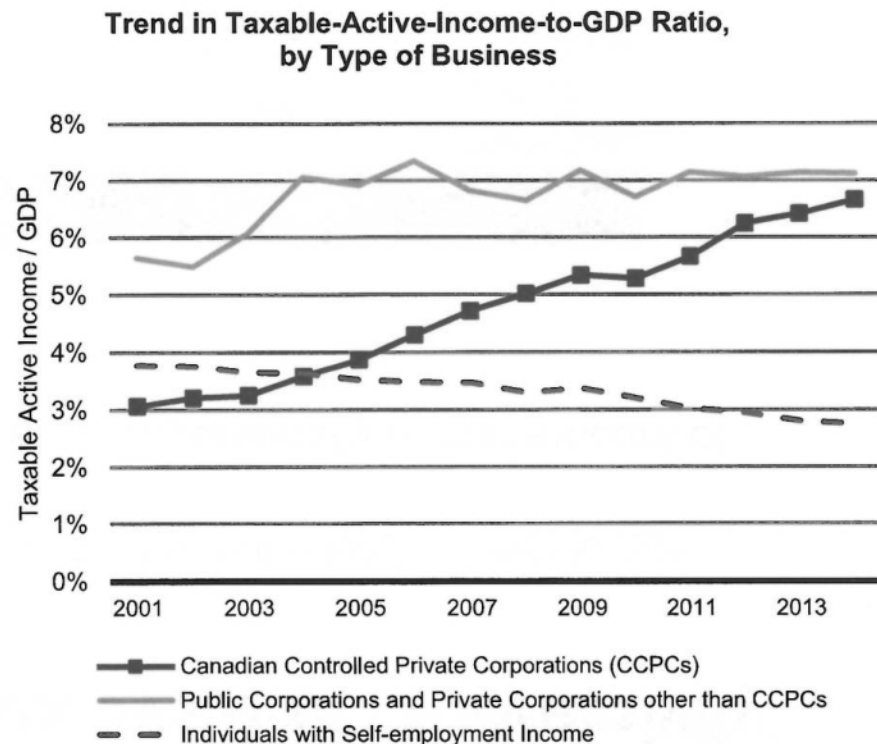
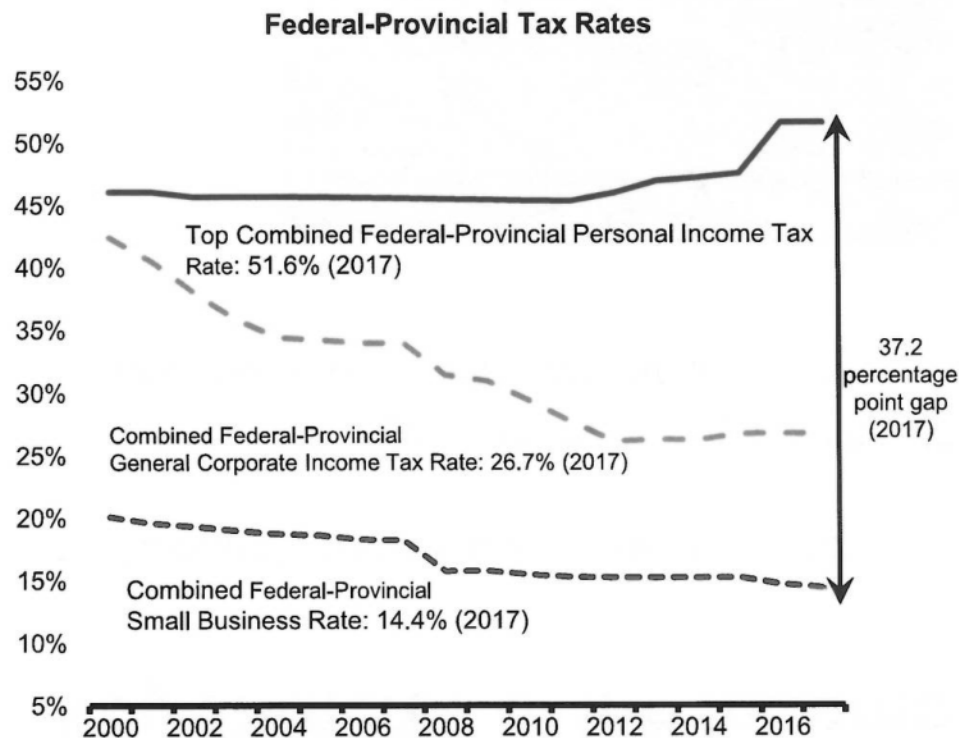
Need for Action

- The basic structure of the existing tax system has been in place since 1972
- Since that time:
 - The structure of the economy has evolved
 - The tax system has undergone important changes
 - Tax planning strategies used by private corporations have grown more sophisticated
- The focus is on private corporations given the scope of the tax planning they provide

Increasing Incentives for Tax Planning Using a Private Corporation

The **growing gap** between corporate and personal income tax rates since 2000 has increased rewards associated with tax planning in a private corporation...

... Over this period, a growing share of high-income self-employed individuals have chosen to incorporate



Key Features of the Income Tax System: Progressivity

- Canada's personal income tax system is based on the individual's ability to pay
- Those with higher ability to pay tax should bear a proportionally higher amount of tax than those with lower ability to pay

Taxable Income (2017)	Federal Personal Income Tax Rate
Up to \$45,916	15.0
\$45,916 to \$91,831	20.5
\$91,831 to \$142,353	26.0
\$142,353 to \$202,800	29.0
Over \$202,800	33.0

Key Features of the Income Tax System: Integration

- Low corporate tax rates on business income are intended to provide a tax advantage as long as income is retained for active business re-investments
- But income that is paid out of a corporation as a dividend is generally meant to be subject to the same amount of tax as income received directly by the individual

$$\text{Corporate taxes on earnings} + \text{Personal taxes on dividends} = \text{Personal taxes on income earned directly}$$

- This is the concept of 'integration' – it applies the progressive personal income tax schedule to income paid out of the corporation, adjusted for tax at the corporate level

Integration Example

- A high-income individual earns an extra \$100. The overall after-tax outcome is generally similar whether that income is earned by an individual directly (i.e., via salary) or indirectly (i.e., via her corporation and paid out as a dividend)

Individual	
Salary	+ \$100
Personal income tax	-\$50
After-tax income	\$50

Corporate Owner	
Business income	+ \$100
Corporate income tax	-\$15
Income after corporate tax	\$85
<i>On distribution as dividend:</i>	
Personal income tax	-\$35
- Dividend income grossed up	
- PIT rates applied	
- Claim dividend tax credit	
Total tax paid	\$50
After-tax income	\$50

Three Key Tax Planning Strategies

- **Sprinkling income using private corporations**
 - Shifts income from an individual facing a higher personal income tax rate to a family member who is subject to lower personal tax rates or who may not be taxable at all
- **Holding a passive investment portfolio inside a private corporation**
 - May lead to higher wealth accumulation than if the passive investment portfolio were held in a personal savings account
- **Converting a private corporation's regular income into capital gains**
 - Reduces income taxes by taking advantage of lower effective tax rates on capital gains

First Strategy: Income Sprinkling – An Example

- Jonah and Susan are Ontario neighbours, each earning \$220,000
 - As a **business owner**, Jonah is able to divert income to three adult family members who have no other sources of income
 - As an **employee**, Susan can't do this. She therefore pays \$35,000 more in tax (\$79,000 minus \$44,000)

	Jonah	Susan
Total earnings	\$220,000	\$220,000
Salary paid	\$100,000	\$220,000
Dividends paid to family members (after corporate tax)	\$102,000	-
Total tax paid (personal and corporate)	\$44,000	\$79,000
After-tax income	\$176,000	\$141,000

First Strategy: Income Sprinkling

- The *Income Tax Act* has rules that curtail income sprinkling. For example:
 - Expenses paid by a business, such as salary, must be reasonable in order to be deductible for income tax purposes
 - Tax on split income subjects minors (individuals age 17 and under) to top tax rate on dividends received from private corporations, as well as certain other income from businesses of family members
- However, current rules do not fully respond to many income sprinkling strategies

First Strategy: Income Sprinkling – Proposed Measures

- The Government proposes to extend the existing tax on split income for minors to apply to adults in certain circumstances
 - Dividends and other amounts received from a business, by an adult family member of the principal of the business, may be subject to a reasonableness test, which will be stricter for 18-24 year olds
 - Reasonableness will be based on the contributions made by the family member to the business
 - To the extent the amount is not reasonable, top-rate tax will apply
- Measures are also proposed to address other income sprinkling issues, including the multiplication of claims to the Lifetime Capital Gains Exemption

Second Strategy: Passive Investment Income - Context

- Corporations can earn “**active business income**” (income earned from conducting a business) and/or “**passive income**” (e.g., derived from portfolio investments)
- Proposed measures deal with passive income only and will not affect the taxation of active business income

Second Strategy: Passive Investment Income - An example

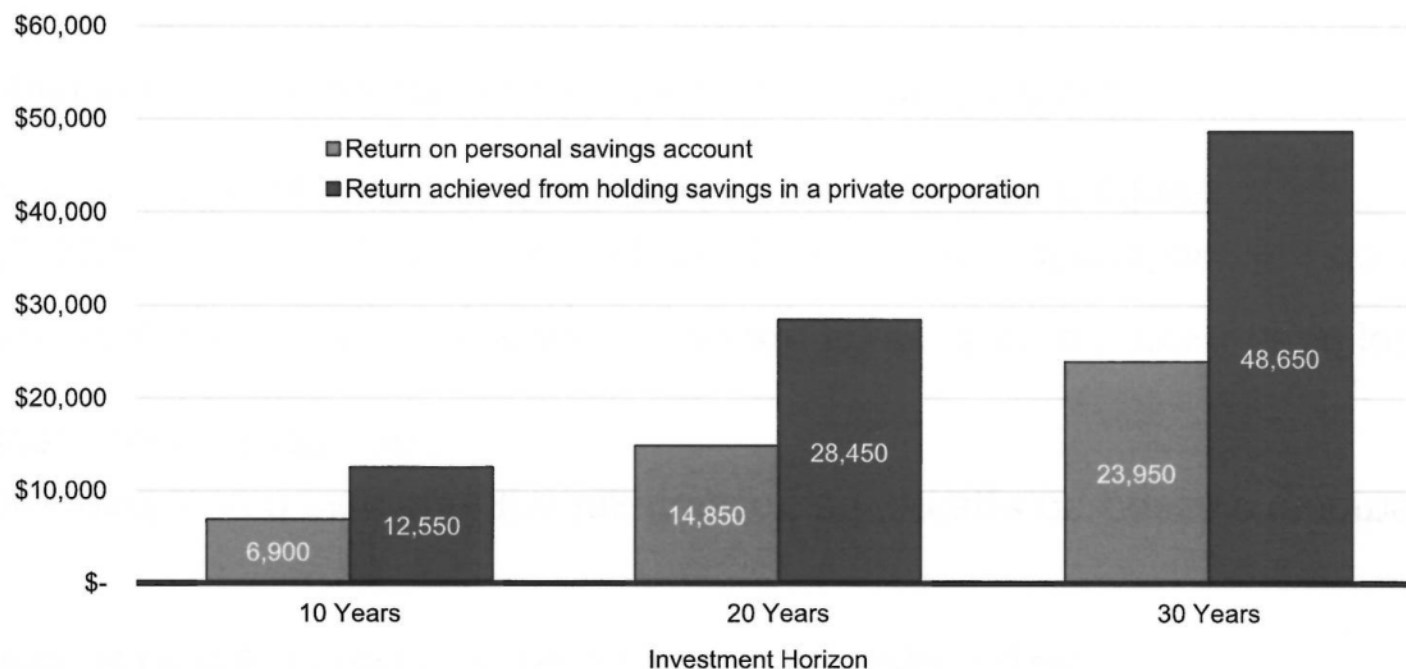
- An employee and a corporate owner each make one-time investments from \$100,000 of pre-tax income, and hold them for ten years

	Employee	Corporate Owner
Gross Income to Invest	\$100,000	\$100,000
Corporate Income Tax	-	\$15,000
Personal Income Tax	\$53,550	-
Net Income Available to Invest	\$46,450	\$85,000

Passive Investment Income – Illustration of the Advantage

Comparison of After-Tax Passive Investments Returns

*Individual Investing After-Tax Proceeds on \$100,000 of Earnings, Directly or Through a Corporation
(interest income, 3% return), over a Specified Investment Horizon*



Passive Investment Income – Proposal

- The proposal would eliminate the tax deferral advantage on passive income earned by private corporations and
 - Preserve the intent of the lower corporate taxes: support growth and jobs
 - Re-establish fairness by ensuring that private corporations' owners do not have access to tax preferred savings options not available to others
- The objective is to make the system neutral on a **go-forward** basis

Third Strategy: Converting Income into Capital Gains

- For higher-income individuals, dividends are taxed at a higher tax rate than capital gains, which are only one-half taxable
- As a result, income taxes can be reduced by converting dividends (and salary) that would otherwise be received from private corporations into lower-taxed capital gains
- There is an anti-avoidance rule that deals with transactions among related parties aimed at converting dividends and salary into lower-taxed capital gains
- This rule is being circumvented
- It is proposed to amend the income tax rules to address such tax planning

Tax Planning Strategies: Conclusion

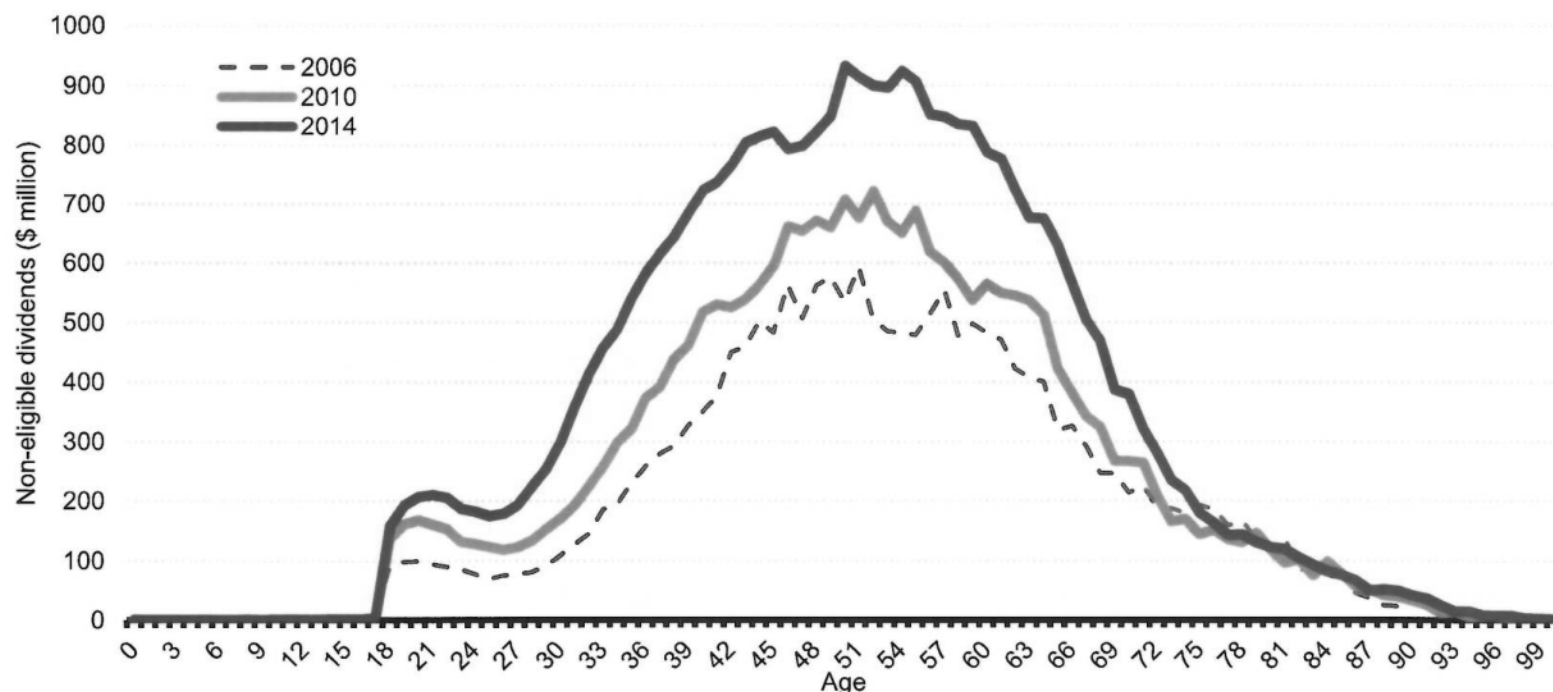
- Tax planning strategies by private corporations undermine the progressivity of the personal income tax system and raise fairness issues
- The Government is consulting Canadians on measures to close tax loopholes and tax planning by private corporations
 - Strategy 1 – Income Sprinkling: Detailed legislative proposals released for comment in conjunction with paper
 - Strategy 2 – Passive Investment Income: Seeking input on possible approaches. Potential directions outlined in paper
 - Strategy 3 – Conversion of Income to Capital Gains: Detailed legislative proposals released for comment in conjunction with paper

Annex: Proposed Measures to Address Income Sprinkling

- Under the proposed changes to the tax on split income (TOSI) rules, an amount paid to an adult family member will be considered reasonable if it is consistent with what a person who is not an adult family member would receive having regard to:
 - the **labour contributions of the individual** to the activities of the business;
 - the **assets contributed or risks assumed** by the individual in respect of the business; and
 - the **previous returns/remuneration** paid to the individual in respect of the business
- In recognition of the particular concerns with income sprinkling involving family members aged 18-24 under the current rules, the proposed reasonableness test is stricter for amounts paid to these family members

Annex: Income Sprinkling – Low-Rate Dividends

Low-Rate Dividends Reported on T1 Returns, By Age of Filers (\$million)



- For high-income earners, benefits of income sprinkling are higher when adult children are younger

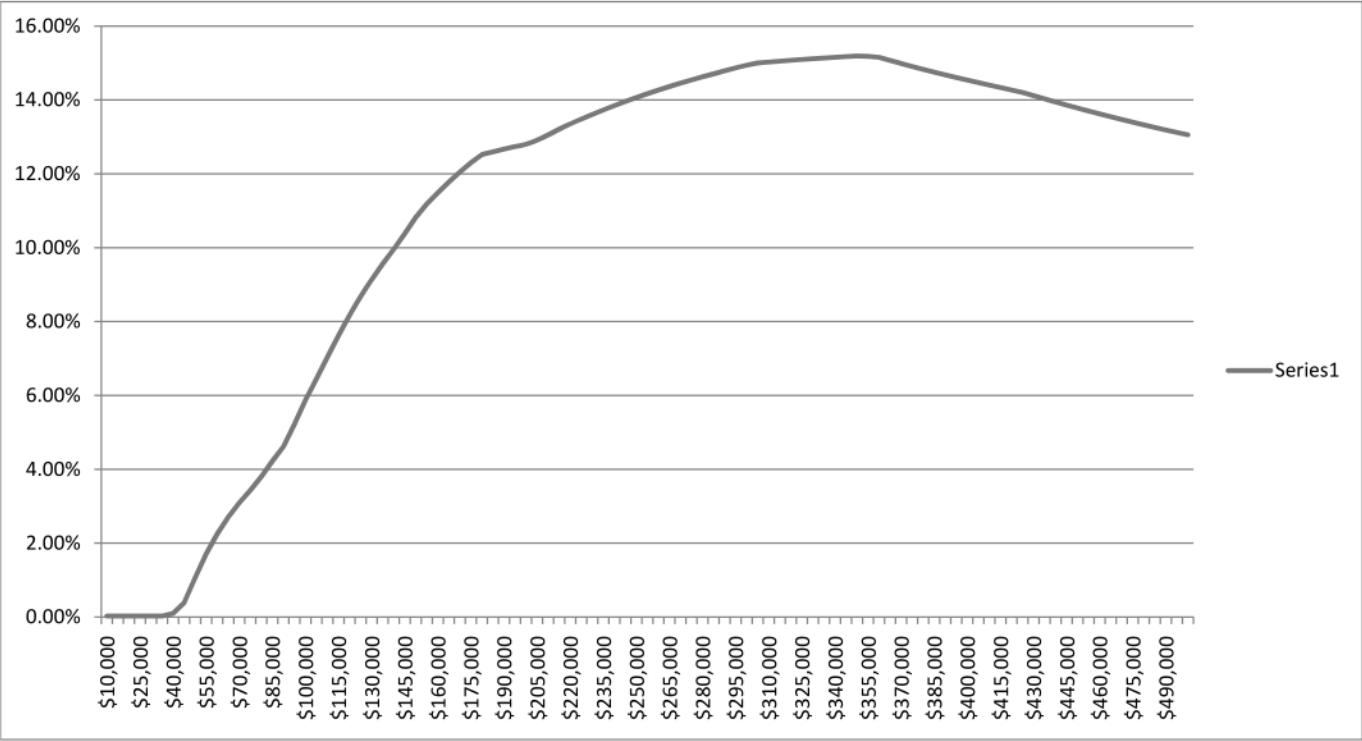
Income	\$ 300,000
Number of family members	4
CIT	\$ 37,875
After-tax income for sprinkling	\$ 262,125
Grossed-up amount	\$ 44,561
Per-person income	\$ 76,672
Income tax before credits (from tax calculator)	\$ 15,630
Federal dividend tax credits (per person)	\$ 8,067
BC dividend tax credits (per person)	\$ 1,671
Income tax per person after credits	\$ 5,892
Total income tax	\$ 23,567

BC						Fed		Max Tax	Cumulative Max Tax					
			Max Tax	Cumulative Max										
					\$	-	\$	45,916.00	15.0%	\$ 6,887.40	\$	6,887.40		
\$	-	\$ 38,898.00	5.06%	\$ 1,968.24	\$	1,968.24	\$	45,916.01	\$	91,831.00	20.5%	9412.573	\$	16,299.97
\$	38,898.01	\$ 77,797.00	7.70%	\$ 2,995.22	\$	4,963.46	\$	91,831.01	\$	142,353.00	26.0%	13135.717	\$	29,435.69
\$	77,797.01	\$ 89,320.00	10.50%	\$ 1,209.91	\$	6,173.37	\$	142,353.01	\$	202,800.00	29.0%	17529.627	\$	46,965.32
\$	89,320.01	\$ 108,460.00	12.29%	\$ 2,352.30	\$	8,525.68	\$	202,800.01			33.0%			
\$	108,460.01		14.70%											

Income Input	\$	40,000
Corp Tax (SBR)	\$	5,000.00
After Tax Income	\$	35,000.00

Income To Split	\$					35,000		Self Employed Income	\$	40,000
	Earner	Spouse		Child 1	Child 2			BC Tax Payable	\$	2,053.09
Dividend Received (including Gross-Up)								Fed Tax Payable	\$	6,000.00
	\$	10,237.50	\$	10,237.50	\$	10,237.50			\$	8,053.09
DTC	\$	223.13	\$	223.13	\$	223.13				
FED DTC	\$	1,077.16	\$	1,077.16	\$	1,077.16		Income Split Advantage	\$	39.64
BC Tax Payable	\$	518.02	\$	518.02	\$	518.02				
BC Tax minus DTC	\$	294.89	\$	294.89	\$	294.89				
Plus Share BC Corp Tax	\$	494.89	\$	494.89	\$	494.89	\$	1,979.57		
Fed Tax Payable	\$	1,535.63	\$	1,535.63	\$	1,535.63				
Fed Tax minus DTC	\$	458.47	\$	458.47	\$	458.47				
Plus Share of Fed Corp Tax	\$	1,508.47	\$	1,508.47	\$	1,508.47	\$	6,033.88		
Total Fed + Prov Tax Paid	\$	2,003.36	\$	2,003.36	\$	2,003.36	\$	8,013.45		

Income		Tax Savings	Tax Savings / Income
\$	10,000	2.637672414	0.03%
\$	15,000	3.956508621	0.03%
\$	20,000	5.275344828	0.03%
\$	25,000	6.594181034	0.03%
\$	30,000	7.913017241	0.03%
\$	35,000	9.231853448	0.03%
\$	40,000	39.64348966	0.10%
\$	45,000	172.9623259	0.38%
\$	50,000	530.9011621	1.06%
\$	55,000	939.2199983	1.71%
\$	60,000	1347.538834	2.25%
\$	65,000	1755.857671	2.70%
\$	70,000	2164.176507	3.09%
\$	75,000	2572.495343	3.43%
\$	80,000	3042.497409	3.80%
\$	85,000	3590.816246	4.22%
\$	90,000	4151.306032	4.61%
\$	95,000	4963.417818	5.22%
\$	100,000	5876.236654	5.88%
\$	105,000	6789.05549	6.47%
\$	110,000	7738.987098	7.04%
\$	115,000	8772.305934	7.63%
\$	120,000	9805.62477	8.17%
\$	125,000	10838.94361	8.67%
\$	130,000	11872.26244	9.13%
\$	135,000	12905.58128	9.56%
\$	140,000	13938.90011	9.96%
\$	145,000	15051.62635	10.38%
\$	150,000	16234.94519	10.82%
\$	155,000	17336.70782	11.18%
\$	160,000	18384.89166	11.49%
\$	165,000	19433.0755	11.78%
\$	170,000	20481.25933	12.05%
\$	175,000	21529.44317	12.30%
\$	180,000	22544.022	12.52%
\$	185,000	23310.67459	12.60%
\$	190,000	24077.32718	12.67%
\$	195,000	24843.97976	12.74%
\$	200,000	25610.63235	12.81%
\$	205,000	26465.28204	12.91%



\$	210,000	27431.93462	13.06%
\$	215,000	28398.58721	13.21%
\$	220,000	29365.23979	13.35%
\$	225,000	30331.89238	13.48%
\$	230,000	31298.54497	13.61%
\$	235,000	32265.19755	13.73%
\$	240,000	33231.85014	13.85%
\$	245,000	34198.50273	13.96%
\$	250,000	35165.15531	14.07%
\$	255,000	36131.8079	14.17%
\$	260,000	37098.46048	14.27%
\$	265,000	38065.11307	14.36%
\$	270,000	39031.76566	14.46%
\$	275,000	39998.41824	14.54%
\$	280,000	40965.07083	14.63%
\$	285,000	41931.72341	14.71%
\$	290,000	42898.376	14.79%
\$	295,000	43865.02859	14.87%
\$	300,000	44831.68117	14.94%
\$	305,000	45768.77584	15.01%
\$	310,000	46592.10343	15.03%
\$	315,000	47415.43101	15.05%
\$	320,000	48238.7586	15.07%
\$	325,000	49062.08618	15.10%
\$	330,000	49885.41377	15.12%
\$	335,000	50708.74136	15.14%
\$	340,000	51532.06894	15.16%
\$	345,000	52355.39653	15.18%
\$	350,000	53160.24657	15.19%
\$	355,000	53891.94853	15.18%
\$	360,000	54556.22869	15.15%
\$	365,000	55006.3994	15.07%
\$	370,000	55456.57011	14.99%
\$	375,000	55906.74082	14.91%
\$	380,000	56356.91153	14.83%
\$	385,000	56807.08224	14.76%
\$	390,000	57257.25296	14.68%
\$	395,000	57707.42367	14.61%
\$	400,000	58157.59438	14.54%
\$	405,000	58607.76509	14.47%
\$	410,000	59057.9358	14.40%
\$	415,000	59508.10651	14.34%

\$	420,000	59958.27722	14.28%
\$	425,000	60378.23747	14.21%
\$	430,000	60705.04631	14.12%
\$	435,000	61031.85515	14.03%
\$	440,000	61358.66398	13.95%
\$	445,000	61685.47282	13.86%
\$	450,000	62012.28166	13.78%
\$	455,000	62339.09049	13.70%
\$	460,000	62665.89933	13.62%
\$	465,000	62992.70816	13.55%
\$	470,000	63319.517	13.47%
\$	475,000	63646.32584	13.40%
\$	480,000	63973.13467	13.33%
\$	485,000	64299.94351	13.26%
\$	490,000	64626.75235	13.19%
\$	495,000	64953.56118	13.12%
\$	500,000	65280.37002	13.06%

Page 1 to/à Page 2

Withheld pursuant to/removed as

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Spilker, Robyn FIN:EX

From: Howlett, Tim GCPE:EX
Sent: Monday, October 16, 2017 9:31 AM
To: Gillezeau, Rob FIN:EX; Spilker, Robyn FIN:EX
Subject: RE: Fed tax changes note

Looks like no new details today on the changes to the reforms: https://beta.theglobeandmail.com/news/politics/liberal-mps-confirm-small-business-tax-rate-to-drop-to-9-per-cent/article36598289/?ref=http://www.theglobeandmail.com&utm_medium=Referrer:+Social+Network+/+Media&utm_campaign=Shared+Web+Article+Links

Revised tax proposals will likely appear in budget update, with a new draft version of income sprinkling reforms to come prior.

From: Gillezeau, Rob FIN:EX
Sent: Monday, October 16, 2017 9:05 AM
To: Howlett, Tim GCPE:EX; Spilker, Robyn FIN:EX
Subject: Re: Fed tax changes note

Digging it up. Just a caution that it's basically out of date as of today.

Sent from my Samsung Galaxy smartphone.

----- Original message -----

From: "Howlett, Tim GCPE:EX" <Tim.Howlett@gov.bc.ca>
Date: 2017-10-16 8:59 AM (GMT-08:00)
To: "Spilker, Robyn FIN:EX" <Robyn.Spilker@gov.bc.ca>, "Gillezeau, Rob FIN:EX" <Rob.Gillezeau@gov.bc.ca>
Subject: Fed tax changes note

Hi guys,

Would one of you be able to send me a copy of the Ministry note on federal small business tax changes?

Adding background to the Premier QP note

Thanks,

Tim Howlett
Issues Manager
Strategic Issues Division, GCPE
250.208.4828

From: [Wood, Heather FIN:EX](#)
To: [Michell, Jennifer FIN:EX](#); [Wanamaker, Lori FIN:EX](#)
Subject: FW: Info Note: Fed Tax Changes
Date: Thursday, October 5, 2017 10:21:40 AM
Attachments: BN - Fed Lib Tax Changes 2017 Summary for QP draft 2.doc

Lori – this is a note we were asked to do for the Minister, and then it turned out the Premier also wanted this information. This is final as far as I am concerned (it is an excellent note) unless others want more information.

From: Spilker, Robyn PREM:EX
Sent: Thursday, October 5, 2017 10:14 AM
To: Flanagan, Paul FIN:EX; Wood, Heather FIN:EX; Gillezeau, Rob PREM:EX
Subject: FW: Info Note: Fed Tax Changes

Thank you for pulling this together quickly. I will share the draft with the PO, and we can send the final version when it's ready.

Robyn Spilker

Senior Ministerial Assistant
Minister of Finance and Deputy Premier
250-952-7627

From: Flanagan, Paul FIN:EX
Sent: Thursday, October 5, 2017 10:12 AM
To: Spilker, Robyn PREM:EX; Wood, Heather FIN:EX
Subject: FW: Info Note: Fed Tax Changes

From: Avis, Andrew FIN:EX
Sent: Thursday, October 5, 2017 9:53 AM
To: Flanagan, Paul FIN:EX
Cc: Karp, David FIN:EX
Subject: Info Note: Fed Tax Changes
Hi Paul,

Here is the electronic copy of the note I just handed to you.

Andrew Avis

Strategic Advisor | Policy & Legislation Division | Ministry of Finance
105 – 617 Government Street, Victoria, BC V8W 9V8
Tel. 250-356-6004 Email: Andrew.Avis@gov.bc.ca

Ministry of Finance
BRIEFING DOCUMENT

To: Honourable Carole James
Minister of Finance

Date Requested:
Date Required:

Initiated by:

Date Prepared:

**Ministry
Contact:**

Phone Number:
Email:

Cliff #:

TITLE: Federal Government's Income Tax Changes for Small Business:
Tax Planning Using Private Corporations

PURPOSE:

(X) FOR INFORMATION

COMMENTS: This note provides a description of the federal government's proposals to eliminate tax planning using private corporations.

DATE PREPARED:

TITLE: Federal Government's Income Tax Changes for Small Business: Tax Planning Using Private Corporations

ISSUE: The federal government has proposed changes to limit tax planning opportunities using private corporations.

BACKGROUND:

On July 18, 2017, Finance Canada released a consultation paper with proposed tax measures to address specific tax planning strategies used by private corporations: income sprinkling, passive investments, and surplus stripping.

1) Income Sprinkling:

Income sprinkling (also known as income splitting) is achieved by distributing (or "sprinkling") a corporation's income among family members through dividends or other payments, rather than distributing the corporation's income entirely to the owner/operator(s). By sprinkling corporate earnings among family members with low taxable income, income that would otherwise be taxed at high rates of tax in the hands of the owner/operator will be subject to lower rates of tax.^{s.13}

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For example, a BC individual who has \$300,000 of employment income in 2017 would pay approximately \$113,000 in federal and provincial income tax. A BC individual who earns \$300,000 in a small business corporation, and then uses dividends to "sprinkle" the income equally to their spouse and two adult children, would face a total tax bill of approximately \$24,000.

The federal government cracked down on income sprinkling in 1999 with the introduction of the tax on split income. Any payments that are received by minor children from a parent's corporations are automatically subject to tax at the highest marginal personal income tax rates. The federal government is proposing to extend the tax on split income to adult children, spouses and other related individuals unless the amounts paid to family members are reasonable based on the recipient's capital or labour contributions to the company.

BC has a tax collection agreement with the federal government, under which the province agrees to accept the federal government's calculation of taxable income.

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Budget 2017 Update introduced a new personal income tax rate of 16.8 per cent for incomes in excess of \$150,000 for the 2018 and subsequent taxation year. ^{s.13}

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2) Investing the Corporation's Retained Earnings in Passive Investments:

Income earned by a corporation will be taxed twice; once at the corporate level and then again at the personal level when it is distributed to shareholders. The dividend tax credit ensures that the total tax paid at the corporation and personal level is roughly equivalent to the tax paid on income earned outside a corporation. However, owners of privately held corporations can defer the tax at the personal level by retaining the earnings of the corporation within the company and instead investing in a portfolio of passive investments (e.g. stocks, bonds and mutual funds). This allows owners of corporations to have a higher initial investment than taxpayers that earn their income directly (employees and sole proprietors).

A business owner who earns income through a corporation will have a total tax bill of corporate income tax plus personal income tax. The dividend tax credit mechanism ensures that the total tax bill of a business owner that earns income through corporation is roughly equivalent to a business owner that does not earn income through a corporation. ^{s.13}

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The federal government is proposing to levy an additional tax on the passive investment income of a corporation in order to place all Canadians that make passive investments on a level playing field. ^{s.13} the federal government is seeking feedback from stakeholders.

3) Converting Regular Earnings into Capital Gains ("Surplus Stripping"):

Surplus stripping refers to a variety of techniques by which owners of private companies extract value from their corporation as a capital gain rather than as income. The incentive to engage in these transactions exists since capital gains receive favourable tax treatment: capital gains are generally taxed at half the rate of ordinary income, and in certain circumstances are exempt from tax through the lifetime capital gains exemptions. There are many specific anti-avoidance rules targeting such transactions and a general anti-avoidance rule that has been used to prevent surplus stripping transactions, but court decisions have narrowed the scope of both tools.

The federal government is proposing to ^{s.13} introduce a new specific "anti-stripping" rule that would apply whenever it is reasonable

to consider that the taxpayer undertook a transaction to remove a corporate surplus as a capital gain.

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DISCUSSION:

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On October 3, 2017, the Department of Finance Canada stated that any future decisions regarding these proposals would be based on the following five key principles:

1. Support small businesses and their contributions to our communities and our economy.
2. Keep taxes low for small businesses, and support owners to actively invest in their growth, create jobs, strengthen entrepreneurship and grow our economy.
3. Avoid creating unnecessary red tape for hard-working small businesses.

4. Recognize the importance of maintaining family farms, and work with Canadians to ensure we don't affect the transfer of a family business to the next generation.
5. Conduct a gender-based analysis on finalized proposals, to ensure any changes to the tax system promote gender equity.

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