Canadian Federation of Apartment Associations –
Fédération Canadienne Des Associations De Propriétaires Immobiliers

The proposed federal corporate tax changes — Sept 20, 2017

The proposed federal corporate tax changes only apply to people who receive income as dividends derived from private corporations, or who hold real estate through corporations. **There are apparently no plans to affect people who hold real estate in their own name (or with their spouse), or public companies or REITs.** Investors who currently pay tax at the top personal rate on passive income should also not be affected.

It is somewhat uncertain whether the proposed changes would immediately end the use of family trusts to achieve income splitting. However, it is likely that if the proposed corporate tax changes are adopted, a reform of the rules on family trusts will follow.

The government consultation paper is called "Tax Planning Using Private Corporations": A google search of that name will pull it up. The consultation on the proposed reforms is currently to close on October 2, but the lobbying around the reforms will certainly continue after Oct 2, and probably right up to the 2018 Budget is decided (usually in February.)

In the *Financial Post*, Jack Mintz wrote two helpful articles on the unfairness of the proposed tax reforms, one on Sept 6, and one on Sept 20.

Some basic facts on the two key reforms are set out below. Member associations and landlords are invited to check CFAA's website for the latest information, and are invited to email communications@cfaa-fcapi.org with their issues and concerns. Please also send us any letter of submission you send to the Minister of Finance, the Department of Finance or the government on the tax issue.

Current combined tax rates (federal with average provincial rate)

The four main types of corporate income are:

Type of income	Combined Tax Rate Federal & Provincial – on average	Comments
1. active business income up to the small business limit ($500,000 federal limit)	13.5%	For landlords, this rate is only available for the income that results from management activities or fees.
2. active business income in excess of the small business limit;	27%	Includes rental income earned by corporate rental housing providers with more than 5 full-time employees
3. Passive income	50%	Includes rental income of corporations and rental housing businesses with fewer than 6 full-time employees
4. Portfolio dividend income	38%	This tax is refundable when the dividends are paid out, since they are then taxed in the hands of the payees.

TOP PERSONAL TAX RATE	50%	Or slightly higher in some provinces

Income sprinkling (also called income splitting)

Current regime – with the right corporate set-up, some business income can be directed to a spouse or adult children (who have low incomes), thus reducing the total tax paid by a family. (That typically works best with active business income, but it can work with rental income in some situations.)

Proposed regime – preventing income sprinkling by tests of reasonableness of the payouts compared to the capital and work contributed to the business. See govt consultation paper at pages 18 – 28.

Issues and implications – this is an area on which the doctors and other professionals are up in arms. It may affect relatively few landlords as landlords. Those affected have created Canadian controlled private corporations ("CCPCs") to collect a management fee, thus turning some rental income (which would usually be passive income) into active business income to gain the small business rate. The consultation paper says the government expects to gain $250M of tax revenue per year by stopping income sprinkling. That is a small part of these proposed reforms, but it is the part that has generated most of the heat.

Taxing passive income earned within a corporation

Current regime – corporations which earn income typically do one or two or three things with the income: namely, reinvest it into the business, distribute it (as dividends or salary), or invest it in other businesses or investments. Some of those investments produce passive income: e.g. real estate. That passive income is taxed at the high rates, but the objection is that the active income that went into the investment was taxed at lower rates, and that gives those owners an advantage over other people who paid tax on their incomes at the higher rates.

Proposed regime – increase the tax rate on such "second generation" income above normal rates, potentially to 73%. The stated goal is to be fair between income which received the favourable rates, and income which did not. The government proposes a tracking system [which may be an accounting nightmare]. For more details, see govt consultation paper at pages 32 – 53.

Apparently, for pure holding companies (which did not receive tax-preferred income) no increases will apply, and they will be able to avoid the tracking system. That would save many people who hold rental property through corporations from being negatively affected by the proposed reforms.

Implications – The higher taxes could apply to the "second generation income" of landlords who receive the active business tax rate on rental income, (because of having five or more full time employees.) That could affect mid-size landlords significantly.

Reports say the government is looking to gain $1B to $2B of tax revenue per year by taxing passive income in corporation. That is almost certainly the largest part of these proposed reforms, but it is a part that has generated little public heat so far.