Proposed Federal Tax Changes Could Significantly Hit Small Business and Communities

By D. James Leier

According to a July 18, 2017 release form the Department of Finance, the Government of Canada intends to "create a healthy and growing economy in which businesses generate well-paying jobs, and where the middle class, and those working hard to join it, have confidence that they can succeed." Clearly the importance of economic activity is a good thing.

The release goes on to state, "the Government is taking action to improve the fairness of Canada's tax system by closing tax loopholes and amending existing rules to ensure that the richest Canadians pay their fair share of taxes and that people in similar circumstances pay similar amounts of tax." This sounds fine as well.

In particular the focus of these changes are geared to incorporated Canadian Businesses. So individuals doing business outside of a company are not impacted. Here is what the government is targeting to change for incorporated businesses:

1. ***<u>Making changes to Income Sprinkling</u>*** - this is to address previous splitting of income among family members to reduce taxes
2. ***<u>Making changes to Passive Investment Income</u>*** - this is to address incorporated businesses generated investment income off of retained earnings or as holding companies
3. ***<u>Conversion of Income to Capital Gains</u>*** - this is to address incorporated businesses receiving capital gains exemptions at a lower tax rate than say dividend income based on the disposal of assets or investment holdings

It is understandable that utilizing businesses to spread income over individuals not involved with the business or not paying taxes needs to be addressed through income sprinkling.

The materials from the federal Department of Finance provide an example of personal taxes on extra earnings in the 50% bracket compared to a business with a 15% initial rate for corporate taxes which is taxes at about 35% as the money is drawn out of the company through dividends. In the example the same level of taxes is collected from the government upon distribution to the individual corporate business owner. The issue the government is concerned with is the ability to grow the money within the company as passive investment income prior to distribution to the individual at a later date.

The capital gains area focuses on the different tax rates for Capital Gains versus other income.

The problem is some of the options on the table could have a devastating impact on a range of businesses and communities across the country.

So here are some of the impacted parties from the proposed changes that should be of concern to our communities and small businesses in Canada:

- ***Small Businesses with Family ownership and operation*** - regardless of who does what, if both are involved in the business and one spouse takes on more parental and household responsibilities, should there be restrictions on how earnings are transferred to the owner / operators? Capital gains are likely a factor for farms and non-farm family businesses.

- ***Family Farms*** - a classic example of families operating a business. Many of these are trending to larger corporate entities. For the family owned and incorporated businesses, should family owner / operators be penalized from growing their business with higher taxes?
- ***Retired Business Owners*** - if a business made money and built up equity over 30 or more years should it be a big liquidation sale and tax bill upon retirement?
  - What could this do to succession of the business to the next generation of owners?
  - What could this do to the sale and continued operation of the business by other owners?
- ***Future Generations of Business Owners*** - should family enterprises and other businesses be depleted of value and capital to give the government more money now?
  - Does government want to discourage bringing in future generations into family businesses or buying other established businesses by taxing away value and opportunity?
- ***Passive Investment Holdings*** - Are passive investment holding companies bad for the economy? The taxes are paid as money is taken out personally, so what is the problem? Is it an issue with low interest rates and periods of market volatility for people to seek ways to maximize investment growth?
- ***Professionals*** - Is there an oversupply of professionals globally, or has allowing doctors, dentists, and even lawyers & accountants to incorporate helped address a skill shortfall? What will it cost taxpayers to increase taxes on professionals? More money for the same services? Or is there a risk of losing these services to other countries.
- ***Global Competitiveness*** - How does this impact the competitiveness of Canadian businesses with firms in other jurisdictions?

Small business should be encouraged by government and not discouraged. The main factor is there is a significant amount of risk owning a business be it a farm, a business on main street, or even a professional practise. A business does not have a guarantee of sales or profits.

What are the implications for Rural and Urban Canada, many of these communities are doing all they can to attract, retain, and grow businesses in their communities? How does this impact your community and the businesses in your community?

The Government of Canada is looking for impact by October 2, 2017 on these measures prior to making changes effective January 1, 2018. This is a complex area with many factors to examine and review. Information on the changes and the input process is contained at http://fin.gc.ca/n17/17-066-eng.asp. Concerned parties should talk with their accountants and financial advisors for additional information.

Here is your chance to have your say before significant tax changes are made to impact a significant amount of businesses across the country.

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