INVESTMENT EXECUTIVE

Tax Matters
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Act now to avoid losing out on the small business deduction in 2019

It's important to be aware that the new rule limiting access to the small business deduction for CCPCs in 2019 is based on 2018 income

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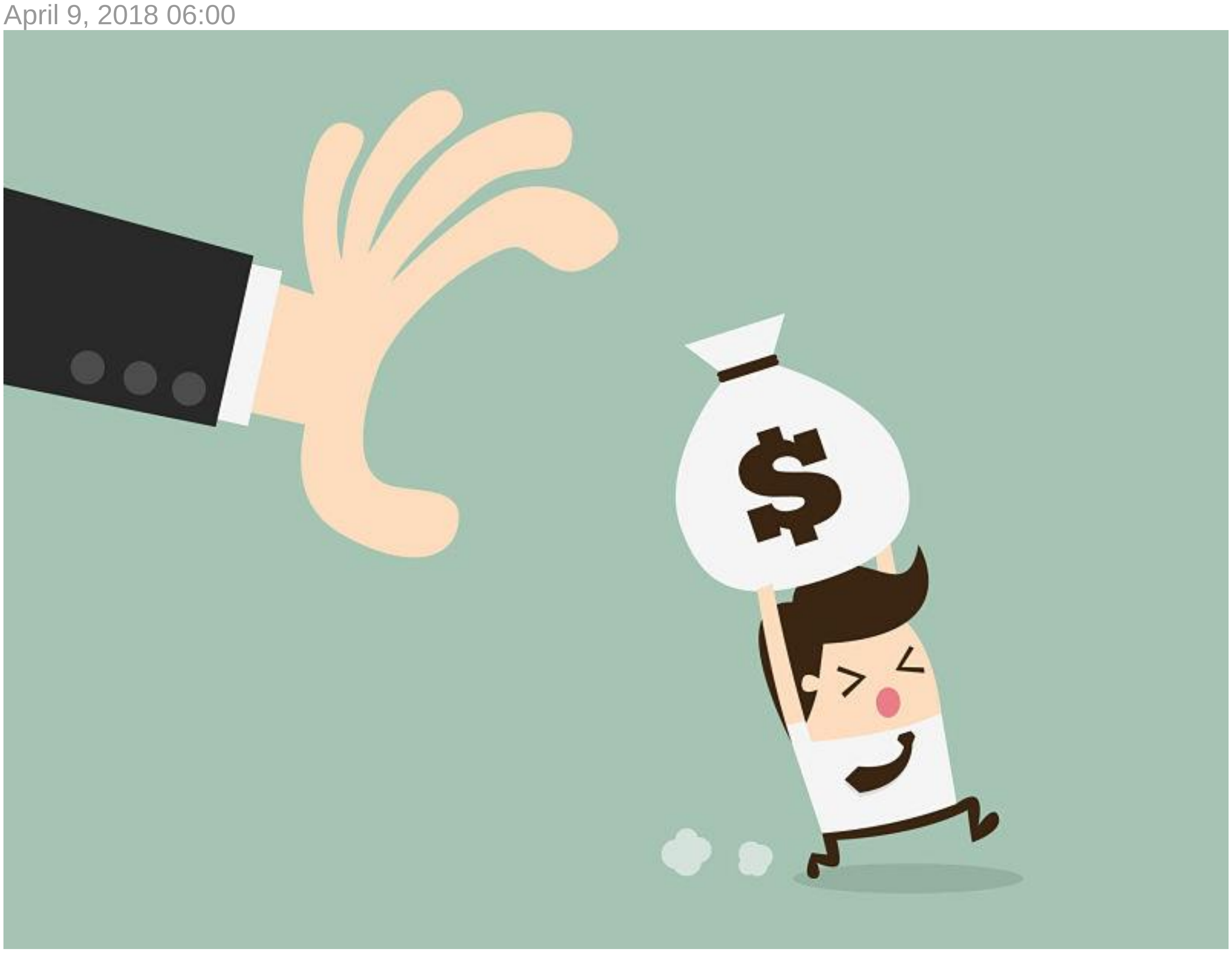

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Now that the federal government has introduced draft legislation for this year's federal budget, which spells out how Ottawa will deal with passive investment assets held by Canadian controlled private corporations (CCPCs), it's time to consider some strategies for clients who are impacted by these changes.

Specifically, the government announced in the budget that it would restrict access to the lower small business deduction (SBD) tax rate based on passive income earned within a corporation starting in 2019. But what incorporated small business owners, doctors, lawyers and other professionals may not realize is that the new restriction for the SBD rate in 2019 is based on CCPCs with more than $50,000 of "adjusted aggregate investment income" (AAII) in the "prior year"; that would be 2018.

So, if a CCPC has AAII of more than $50,000 in 2018, its 2019 business limit will be reduced by $5 for each dollar over this amount until it's reduced to zero once $150,000 of AAII is earned.

To avoid the reduction in the amount of income eligible for the SBD rate, business owners need to act now to minimize AAII or keep the amount below $50,000 in 2018, where possible. Here are a few ideas on how to do that:

1. Invest to earn (deferred) capital gains.

Capital gains are only 50% taxable; thus, only 50% of capital gains are included in the definition of AAII. Furthermore, if capital gains are not realized on an annual basis and are deferred, they don't form part of the AAII calculation in the current year. That would happen only when the capital gains — or losses — are realized.

2. Pay sufficient salary/dividends to maximize RRSP and TFSA contributions.

Business owners, in general, should pay themselves enough in salary annually to maximize their RRSP contributions. A salary of $145,722 in 2017 will allow the maximum 2018 RRSP contribution of $26,230 (18% of $145,722). Moving the money out of the corporation and contributing to an

RRSP means that investment income earned on the distributed funds is excluded from AAII.

Similarly, business owners should be paying themselves sufficient salary/dividends annually to maximize their $5,500 annual TFSA contributions. Extracting funds to invest into a TFSA means that investment income earned on those funds will also be excluded from AAII.

3. Corporate-owned life insurance.

A corporation may choose to invest its after-tax income in a permanent life insurance policy that insures the life of someone, typically the owner-manager. Although the federal budget captures income from a non-exempt policy in the $50,000 annual passive income test specifically, it appears that an “exempt policy” — in which no income is required to be included in the holder’s income over the life of the policy — does not appear to come under the ambit of these new proposed rules. This could be a strategy for business owners and other professionals to consider in consultation with their tax advisors.

4. Individual Pension Plans.

An individual pension plan (IPP) is created for one person rather than a large group of employees. As the corporation contributes to the IPP, and the income earned in the IPP does not belong to the corporation, the IPP also should not be subject to the proposed rules. An IPP could be a strategy to consider once AAII exceeds the $50,000 threshold.

*For more on this topic, read Jamie’s previous column,*Making sense of the new passive income rules