***KASB Announcement October 25th, 2017***

The week of October 16th, 2017 Bill Morneau and the Department of Finance made a series of announcements in response to feedback regarding the July 18th, 2017 proposed tax changes. These announcements made general statements and details were not given, therefore, *our comments below are accompanied with the heavy caveat that we need details before we can provide concrete feedback*. Further, no clarification was provided as to the effective date for any of the revised tax proposals. Regardless of the many questions that KASB still has, our initial observations are:

***Family Succession of Businesses and Farms (Converting Dividends into Capital Gains)***

- Finance stated that it "will not be moving forward with measures relating to the conversion of income into capital gains".

- It seems that Finance is continuing to evaluate the provisions that affect family succession as Finance also stated, "In the coming year, the Government will continue its outreach to farmers, fishers and other business owners to develop proposals to better accommodate intergenerational transfers of businesses while protecting the fairness of the tax system".

***KASB's View:*** The elimination of the proposed tax changes that would have hurt the succession of family businesses and farms (modification to paragraph 84.1(2)(a) and new section 246.1) would be very good news for family run businesses. However, KASB is looking for confirmation from Finance and our government that it will not pursue tax changes that would hurt family farm or business succession. The second statement above provides uncertainty as to whether a different impact on family businesses or farms might be forthcoming. KASB is requesting clarification from our government and the Department of Finance.

***Passive Income***

- In the context of passive income earned by a private company, Finance stated that it is considering that:

i) All past investments and the income earned from those investments will be protected;
ii) Businesses can continue to save for contingencies or future investments in growth;
iii) A $50,000 threshold on passive income in a year

***KASB's View:*** KASB has many questions about this complex topic. Our main concern is that this proposed system that would seem to 'grandfather' all existing wealth that is held in a private company and would seem to provide a significant advantage to those who have existing wealth, as compared to those that are trying to accumulate wealth. Because further details were not provided we are not certain, however, it seems like Finance is proposing a two-tiered tax system for passive income earned inside a private company that disadvantages younger Canadians and middle-class Canadians that are trying to build wealth. KASB strongly discourages Finance from pursuing such a biased tax system.

Secondly, the announcement did not state what tax system new small businesses would be subject to if their passive income exceeded $50,000 in a given year. Overall, it seems that tracking such a two-tiered tax system would be incredibly complex and result in increased compliance costs.

Thirdly, Finance made no comment as to whether it would eliminate the capital dividend account as it suggested in the July 18th, 2017 discussion paper. KASB wants clarification from Finance as to its intention in this respect. KASB believes that the capital dividend account should not be eliminated as it is used to ensure tax integration between individuals and Companies. Further, it is relied upon for life insurance policies that are used to facilitate family business/farm transfers and have been set up for many years as part of succession plans.

This is very complex topic and very few details were provided, therefore, it is difficult for KASB to provide further comment in addition to what we submitted to the Department of Finance on October 2nd. However, we believe that there will be many negative consequences if last week's announcements provided by Finance represent a framework for a new passive income tax system including significant complexity in tracking various 'pools' of investments. Further, as this new passive income tax system would disproportionately disadvantage young Canadians we believe that such Canadians will view the system as 'stacked against them' when they learn that they are disadvantaged.

**Tax on Split Income (TOSI)**

- The government announced an intention to simplify the proposal that would limit the ability to pay dividends to family members who are not contributing to a business.
- The announcement said that if a family member is making a 'meaningful' contribution will not be impacted by the income splitting rules.

***KASB's View:*** KASB has significant questions and concerns regarding the income splitting rules. It seems that the majority of businesses would not be impacted by new laws regarding dividends paid to family members, however, we will reserve our judgment for the revised legislation. Further, the July 18th, 2017 draft legislation had significant wording issues and was generally complex and not workable.

Further, KASB communicated to Finance that we had a significant concern of the impact of these rules on the sale of a family business in that it would seem to trap many sales into a top-rate dividend tax situations, rather than realizing a capital gain or being able to utilize the lifetime capital gains exemption.

Another key concern from KASB was to ensure that the income splitting rules would not be 'retroactive in impact' and unwind years of retirement planning or education planning. The announcements from the Department of Finance last week did not provide any further clarity in this respect. KASB will be watching very closely whether this concern has been heard and will be addressed once revised draft legislation is released.

Our overriding concern about the income splitting rules was that they are overly complex and would result in increased complexity and compliance fees for taxpayers. We will monitor any new legislation to determine if this concern has been addressed.

***Decrease in the Small Business Tax Rate from 15% to 13.5% (Ontario Tax Rates)***

- Finance announced that it will be reducing the small business tax rate for Canadian-controlled Private Corporations by 0.5% in 2018 and a further 1% in 2019. This tax rate reduction is affected through the 'small business deduction'. This will mean that the first $500,000 of active business earnings will be subject to the reduced rate. This translates to $150 for each $10,000 of business income or a maximum savings of $7,500.

- Finance said it will be increasing the tax rate on dividends paid by private companies that benefited from the lower corporate tax rate (i.e. a 'non-eligible dividend'). This tax increase is effected by reducing the dividend tax credit on non-eligible dividends. The reduction in corporate tax is roughly offset by the increase in personal tax such that the total tax is the same. The purpose of lowering the small business tax rate is allow the business to have more funds available for the business, while not allowing the owner of the business to be advantaged after factoring in personal taxes.

***KASB's View:*** This tax reduction was announced at a time when Canadians are looking for answers to the questions raised in respect of the proposed tax changes. KASB hopes that this announcement was not an attempt to distract the public from what the real issues are with the proposed tax changes.

Regardless, lowering the small business tax rate will leave more funds in small businesses, however, for many middle-class business owners this will have minimal impact. The reason is that many middle-class business owners are already spending all excess funds. An increase to the personal tax rate on dividend income will result in the owner taking the additional funds from the business to pay the additional personal tax. Overall, we think the impact on middle-class business owners will be nominal, but for those business owners that are not requiring all business funds personally, they will have additional funds to invest in their business.

KASB will continue to monitor progress in respect of the proposed tax changes very closely and continue to engage in dialogue with other tax professionals from across Canada to make sure the concerns we have are being addressed. Again, we caution any reader that our views are based on Finance information releases that were vaguely worded, therefore, our views cannot be construed as provide any certainty as we are still in a period of significant tax uncertainty.

We also strongly urge MP's across the country to urge the Department of Finance open dialogue with the Joint Committee before releasing any new draft legislation so we can avoid the confusion that was created this past summer. With sufficient dialogue in advance of issuing draft legislation we believe that many unintended consequences can be identified before draft laws are issued to the public.

***Who is Kingston Advocacy for Small Business?***

KASB is not political, we did not exist in any form prior to the July 18th, 2017 and our group consists of 59 Kingston and local area accountants, lawyers and academics who specialize in tax and business matters. Our group solely formed in response to the July 18th, 2017 Department of Finance documents released. Our purpose is to educate and inform our community in respect of the proposed tax changes.