**<u>December 19, 2017</u>**

On December 13, 2017, the Department of Finance released draft legislation and explanatory notes to revise the tax proposals for private companies previously issued on July 18, 2017. These proposals, if implemented, will significantly limit the ability to use private companies to share income with family members in a lower marginal tax bracket.

**Current Rules**

There are currently rules in place to limit salaries paid to family members. These rules apply where the amount paid is in excess of what would reasonably be paid to a third party performing the same work. There are no proposed changes to these rules.

Existing rules concerning "kiddie tax" or **<u>"tax on split income" (TOSI)</u>** have been in place for many years. These rules apply the top tax rate to payments of dividends from private corporations, trust income and partnership allocation to anyone under 18 years of age. There are few other restrictions that apply to these types of payments made to family members 18 and older.

**New Rules Proposed December 13, 2017**

The new rules, which will be effective January 1, 2018, will extend the TOSI rules to catch payments to family members who are not significantly involved in the business.

The following payments should be safe from TOSI treatment:

- amounts received by the spouse of a business owner who was actively involved in the business and is <u>aged 65 or older</u>

- amounts received by a family member 18 or older who has worked an average of <u>20 hours per week</u> in the business in the current year or any of the previous five years

- dividends or gains on shares owned by individuals 25 years or older that represent <u>10% or more of the total value and total votes</u> of of a corporation provided that the corporation:
    - earns less than 90% of its income from the provision of services,
    - is not a professional corporation, and
    - does not have income derived from another related active business.

Individuals age 25 and over who do not meet any of the above exclusions will be subject to a reasonableness test to determine the amount of income that may be subject to TOSI, and taxed at the top marginal tax rate. This test will consider the labour efforts, risk taken as well as the capital contributed.

For payments to individuals age 18 to 24 who do not meet the minimum labour contribution above, the reasonableness test will not be applied and the entire amount will be subject to TOSI.

**Standing Senate Committee on National Finance**

On the same day as these amendments to the proposed rules were released, a Report of the Standing Senate Committee on National Finance was also released. This report recommended that the Finance Minister withdraw the proposed tax changes and that the government undertake a comprehensive review of the tax system. Further, it recommended that if the Minister chooses to go ahead with any of the changes, that they be delayed until 2019.

It remains to be seen if these recommendations will have any impact on the proposed rules.

**The Takeaway**

Family members receiving dividends from a private corporation who may be subject to TOSI next year under the proposed rules may wish to take a higher dividend in 2017 to protect against the implementation of these tax changes. This may be of benefit where the individual is not in the highest personal tax bracket (taxable income exceeding $220,00) for 2017, but will result in the acceleration of the personal taxes to the 2017 year, and will increase the personal tax instalments requirements for 2018.

If we have not spoken to you since the introduction of these proposed rules in July and you suspect this increased dividend in 2017 will benefit you, please contact us to discuss.