WeirFoulds LLP

Proposed Tax Measures to Limit Deferral Benefits of Acquiring Passive Investments in Private Corporations

October 18, 2017

By Ryan Morris

On October 18, 2017, the Federal Government announced its intention to introduce measures to *limit* the deferral advantage associated with a private corporation using active business income to make passive investments (the "**Announcement**"). To see our prior Client Alert concerning the Government's announcements earlier in the week, click here.

The Government's July 18th consultation paper (summarized here) seemingly reflected an intention to introduce rules to *remove* the above referenced deferral advantage. However, after considering feedback received during the consultation process (the Government received a staggering 21,000 plus submissions), the Government indicates in the Announcement that the rules will include a safe harbor amount such that passive income of up to $50,000 (equivalent to a 5% return on $1 million of passive assets) earned by a corporation in a taxation year will not be subject to increased taxes.

The Government indicates that it will protect the ability of businesses to save the funds they need for contingencies (e.g., sick leave or parental leave) or future investments, such as the purchase of equipment, hiring and training of staff or business expansion. Seemingly, the safe harbor amount is the Government's way of achieving this aim, however draft legislation has not been introduced and the Announcement is short on details for such a major legislative change.

Beyond the safe harbour amount, the Announcement did not provide details into operational aspects of the rules. In the consultation paper, the Government indicated it was considering an approach the cornerstone of which would involve taxing – on a non-refundable basis – passive income earned in a corporation at top personal tax rates to the extent that earnings used to fund passive investments held by the corporation were derived from active business income of the corporation (which would have only been taxed at low corporate tax rates). The consultation paper then outlined two possible approaches to track whether the funds used to make a passive investment were taxed at the small business rate or the active business rate, or were contributed by a shareholder from after-tax personal income. It is not clear from the Announcement how (or if) the Government's thinking on these matters has progressed.

The Announcement indicates that the Government will release draft legislation as part of Budget 2018 and that the measures will only apply on a go-forward basis (i.e., that it will not impact existing investments, including the future income earned from such investments).

Ryan Morris, Co-Chair, Tax, WeirFoulds LLP
Phone: 416.947.5001
Email: rmorris@weirfoulds.com

Ryan Morris is co-Chair of the Tax Group at WeirFoulds LLP. He regularly advises clients on various areas of domestic and international taxation, including advising on mergers and acquisitions, structured investment products, financings, estate plans, withholding tax, employment issues and a broad range of corporate tax matters. Ryan also represents clients with audits, voluntary disclosures and appeals and has represented clients as lead counsel at every level of court, including Canada's highest court, the Supreme Court of Canada. In 2016, Ryan was recognized as one of Canada's Lexpert® Rising Stars: Leading Lawyers Under 40. More recently, he was named a Corporate Lawyer to Watch in the 2017 Lexpert Guide to the Leading US/Canada Cross-Border Corporate Lawyers in Canada.

For more information or inquiries:

Ryan Morris

Toronto
416.947.5001

Email:
rmorris@weirfoulds.com

Ryan Morris is a tax partner and Chair of the firm's Tax Group. His legal practice focuses on various areas of domestic and international taxation, including advising on mergers and acquisitions, structured investment products, financings, estate plans, employment tax issues and a broad range of corporate tax matters. Ryan also represents clients with voluntary disclosures, audits and appeals, and he has been lead counsel at every level of court, including the Supreme Court of Canada.