# Federal Budget 2016

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## Small Business Taxation – Small Business Tax Rate

- Budget 2016 reverses the phased-in increase of the SBD and preserves the reduction of the overall federal tax rate on small business income to 10.5%, but the previously-legislated reductions for 2017, 2018 and 2019 have been eliminated.
- As a result, the rate of tax on income eligible for the SBD will remain at 10.5% for 2016 and future years.

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## Small Business Taxation – Small Business Tax Rate

- Corresponding to the changes to SBD rates, changes to the "gross up and credit" rates were also announced.
- For 2016 and later years, the gross-up on dividends (other than eligible dividends) received from a corporation resident in Canada will remain at 17%, and the phased-in reduction to 15% is eliminated.
- Tax credit available on dividends (other than eligible dividends) received by an individual resident in Canada from a Canadian corporation: previously-enacted change to 9/13 by 2019 is eliminated; the credit rate will remain at 21/29ths of the gross up for 2016 and future years.



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## Small Business Taxation – Avoidance of the Business Limit

- Budget 2016 contains anti-avoidance measures aimed at certain structures that circumvent the rules limiting access to the SBD among associated corporations to the first $500,000 of ABI earned in Canada among the associated group.
- The amendments seek to address structures that utilize subsections 256(2) and 129(6) of the Act in a manner perceived by the government to be abusive.
- Changes:
  - new subsection 256(2) having broader application
  - amendment to subparagraph 125(1)(a)(i).

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## Small Business Taxation – Avoidance of the Business Limit

- 256(2) is the so-called “connectivity rule”.
- If Aco is associated with Bco, and Bco is associated with Cco, even though Aco and Cco may not otherwise be associated under any other rule, Aco and Cco will be deemed to be associated under subsection 256(2).
- Old rule provided that where Bco is a non-CCPC, or files an election, Bco is deemed not to be associated for purposes of s. 125 with either of Aco or Cco and Bco’s SBD business limit is nil.
- Finance’s concern:
  - Taxpayers using 256(2) to “break” association for business limit purposes but relying on association to “double” the SBD through the use of s. 129(6)
  - Relying on 256(2) to avoid the $15M taxable capital limit for the associated group



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## Small Business Taxation – Avoidance of the Business Limit

- Example:
  - Three brothers own a large real estate corporation, taxable capital well exceeds $15M, so per 125(5.1), no SBD is available.
  - Each brother incorporates a holding company, rolls Realco shares into their respective holdco.
  - Each holdco would be associated with Realco (256(1)(d) and 256(1.2)(d)), but not otherwise associated with each other.
  - Therefore under 256(2), each holdco deemed associated by virtue of association with Realco.
  - Realco pays $10,000,000 dividend to each of the holdcos out of safe income.
  - Holdcos loan back funds to Realco at 5% interest, generating $500,000 in income – Assume 129(6) applies to deem interest to be ABI.

## Small Business Taxation – Avoidance of the Business Limit

- Old rule: 256(2) deems holdcos not to be associated with Realco for purposes of s. 125, therefore each has full small business limit and "only" $10M in capital, therefore SBD available on all $1,500,000 of interest paid to three corps.
- New rule: 256(2) deems holdcos not to be associated with **each other** for purposes of s. 125, therefore each has to aggregate Realco's taxable capital. SBD will be fully ground.
- Also, amendment to s. 125(1)(a)(i) deems 129(6) income not eligible for SBD where 256(2) applied.





## Small Business Taxation – Multiplication of the SBD

- Budget 2016 proposes new measures aimed at eliminating the use of certain structures to "multiply" the availability of the SBD in certain situations that the government considers inappropriate.
- Budget 2016 seeks to eliminate the so-called "multiplication" of the SBD using partnership structures. A new definition will be added to subsection 125(7) of the Act, "designated member" which will deem a CCPC to be a member of a partnership that the CCPC is not otherwise at law a member of where certain conditions are met.

## Small Business Taxation – Multiplication of the SBD

- Specifically, the income of a CCPC will be SPI if:
  - (i) the CCPC provides services or property to the particular partnership at any time in the CCPC's taxation year,
  - (ii) the CCPC is not a member of the particular partnership, and
  - (iii) either:
    - (x) one of the shareholders of the CCPC holds a direct or indirect interest in the partnership, or
    - (y) the CCPC does not deal at arm's length with a person that holds a direct or indirect interest in the partnership, and the CCPC does not derive all or substantially all (generally understood to be 90%) of its income from an active business from providing services or property to arm's length persons or partnerships (excluding any partnership in which a non-arm's length person to the CCPC holds a direct or indirect interest).
- Other Changes:
  - New paragraph 125(8)





## Small Business Taxation – Multiplication of the SBD

- Budget 2016 also introduces new measures to prevent taxpayers from using corporations to avoid inappropriately the SBD limitations. For instance, structures where a CCPC earns active business income from providing property or services to a private corporation in which the CCPC, a shareholder of the CCPC or a person who does not deal at arm's length with such shareholder has a direct or indirect interest in the private corporation.
- Changes:
  - Act will be amended to include a new concept of "specified corporate income" ("SCI"), which will be defined in subsection 125(7) of the Act.
    - Deems any income of a CCPC from the provision of services or goods to a private corporation to be SCI where certain conditions are met
  - New paragraph 125(3.2) – CCPC assignment of any or all of business limit to another CCPC.

## Life Insurance Policies

- Budget 2016 addresses the government's concerns about partnerships and corporations in respect of life insurance policies.
- Changes:
  - reduction of ACB of partnership interest by policyholder's interest and amount that FMV of consideration given in respect of a disposition of an interest in a policy exceeds the cash surrender value of the policy.
  - CDA of a corporation will be reduced by the ACB of any policyholder's interest in the policy.
  - Replacement of subsection 148(7).





## Eligible Capital Property

- Budget 2016 proposes to repeal the rules in respect of eligible capital property and replace them with a new regime that treats these amounts as depreciable capital property subject to the capital cost allowance rules.
- Amounts formerly treated as ECP will now be added to new Class 14.1 of Schedule II of the Income Tax Regulations effective January 1, 2017.

# Questions?

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