

NEW TAX MEASURES FOR CORPORATIONS – AND PLANNING TO ADDRESS THEM

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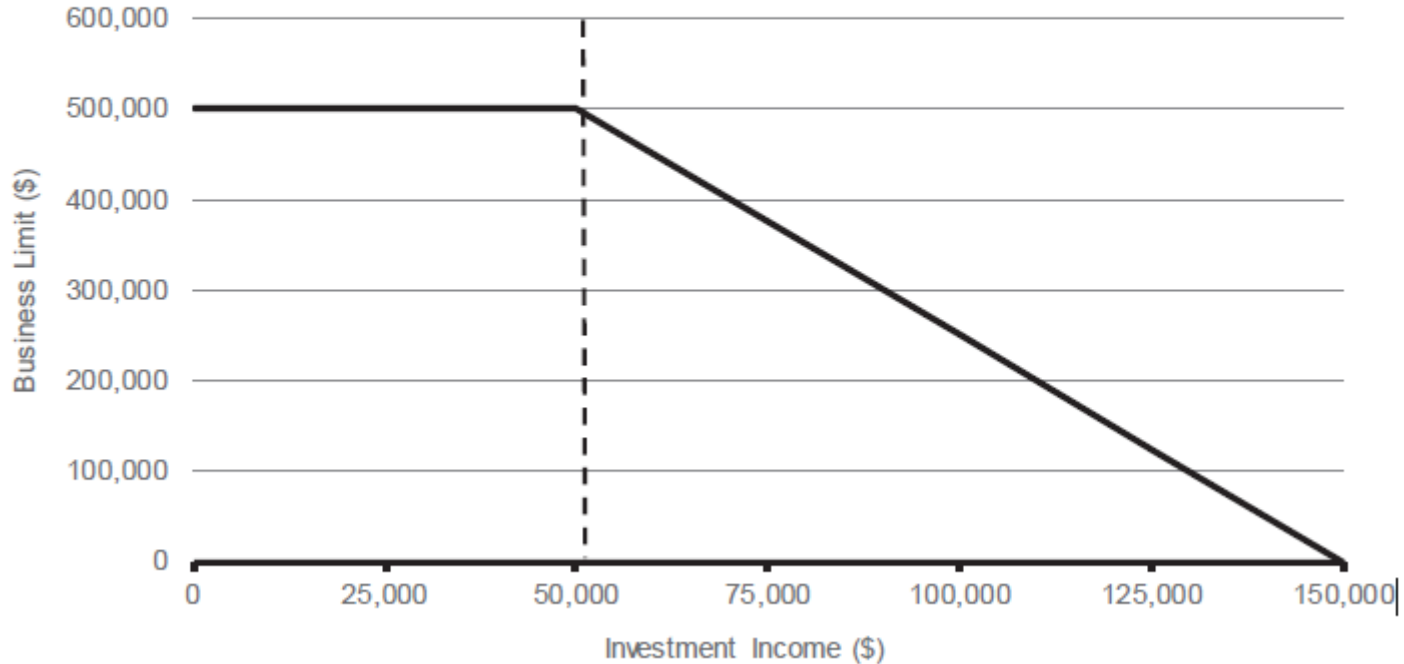
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Investments IN A CHANGING WORLD

2018 FEDERAL BUDGET CHANGES TO THE SMALL BUSINESS LIMIT

- ▶ Small business limit will be reduced when passive income in a CCPC (and any associated corporation) exceeds \$50,000
- ▶ \$500K small business limit reduced by \$5 for every \$1 of investment income above \$50,000
- ▶ Small business limit reduced to \$0 once passive income exceeds \$150,000
- ▶ New concept of “adjusted aggregate investment income” (AAII) used to calculate reduction in the small business limit. This includes, but is not limited to;
 - Rent, Interest, foreign income, taxable capital gains & eligible dividends
- ▶ Applicable for taxation years beginning after 2018, but based on prior years passive income

Chart 1.8

Reduction in the Small Business Deduction Limit Based on Passive Investment Income



BUSINESS LIMIT REDUCTION – AN EXAMPLE

- ▶ In 2019, Active Inc. has business income of \$700,000.
- ▶ Its fiscal year ends on December 31. It is not associated with any corporation at any time during its fiscal year beginning on January 1, 2019.
- ▶ For several years, it has invested its retained earnings in a balanced portfolio generating the following investment income for 2018.
 - Eligible dividends: \$50,000
 - Taxable capital gains: \$30,000
 - Deductible current year capital losses: \$10,000
 - Interest income: \$60,000
 - The balance of its deductible capital losses from past years is \$20,000.

For illustrative purposes only.

BUSINESS LIMIT REDUCTION

Question:

- ▶ What is the company's adjusted aggregate investment income for the purposes of reducing the BL?

Answer:

- ▶ $AAll = \$130,000$ (\$50,000 dividends + TCG of \$30,000 - DCL of \$10,000 + \$60,000 in interest income)
- ▶ $BL\ reduction = \$400,000$ (surplus of \$80,000 * \$5)
- ▶ $BL\ reduced\ to\ \$100,000$ (\$500,000 - \$400,000)

For illustrative purposes only.

BUSINESS LIMIT REDUCTION

Calculation of the corporate income tax of Active Inc. for 2019

	Before the new measure	After the new measure
ABI eligible for the small business rate	\$500,000	
Federal Small Business Tax rate (2019)*	9%	
Tax	\$45,000	
ABI not eligible for the small business tax rate	\$200,000	
Federal General Tax Rate	15%	
Tax	\$30,000	
Total tax	\$75,000	

* Illustration does not incorporate provincial tax implications

For illustrative purposes only.

BUSINESS LIMIT REDUCTION

Calculation of the corporate income tax of Active Inc. for 2019

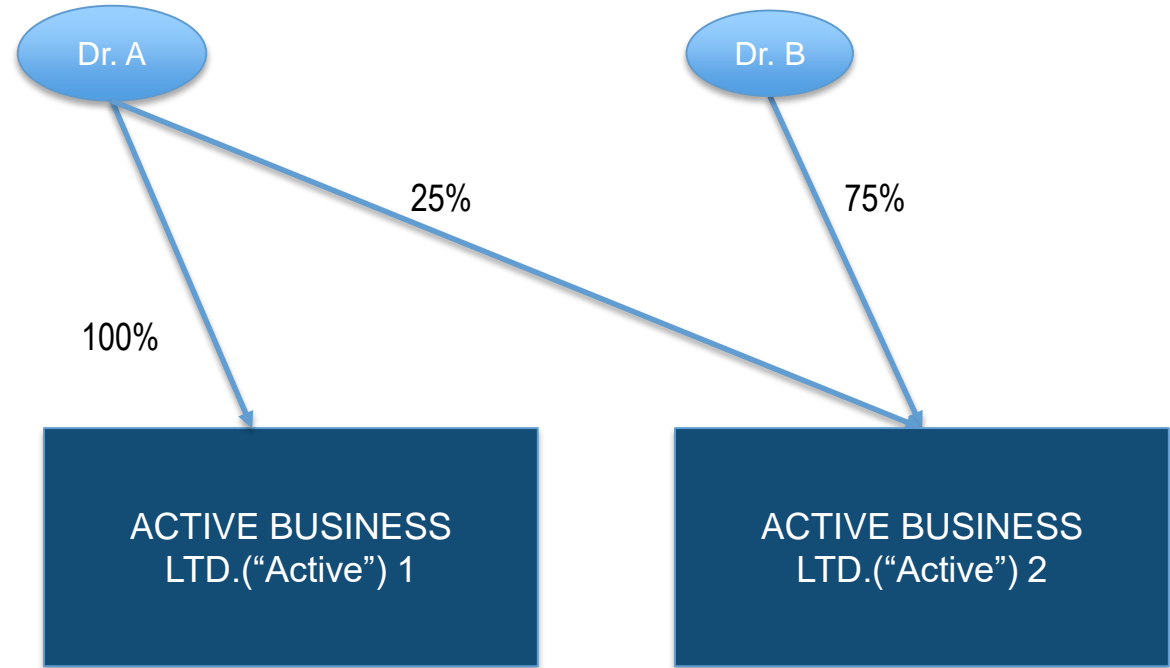
	Before the new measure	After the new measure
ABI eligible for the small business rate	\$500,000	\$100,000
Federal Small Business Tax rate (2019)*	9%	9%
Tax	\$45,000	\$9,000
ABI not eligible for the small business tax rate	\$200,000	\$600,000
Federal General Tax Rate	15%	15%
Tax	\$30,000	\$90,000
Total tax	\$75,000	\$99,000

 \$24,000

* Illustration does not incorporate provincial tax implications

For illustrative purposes only.

EXAMPLE – SMALL BUSINESS LIMIT REDUCTION



SMALL BUSINESS LIMIT “REDUCTION” – DR. A&B EXAMPLE

Passive Income	\$125,000
Less: Exemption	<u>(\$50,000)</u>
Net Passive income	\$75,000
Reduction (\$5 to \$1)	\$375,000
Small Business Limit	\$500,000
Reduction (from above)	<u>(\$375,000)</u>
Available Small Business Limit	\$125,000

PASSIVE INVESTMENTS - PLANNING OPPORTUNITIES

- 1) Individual Pension Plans
- 2) Retirement Compensation Arrangements
- 3) Corporately owned “exempt” insurance (i.e., UL) policies
- 4) Corporate Class Mutual Funds
 - Minimize “adjusted aggregate investment income”

INDIVIDUAL PENSION PLAN (IPP)

- ▶ Defined benefit registered pension plan for 1 (or a few) members
- ▶ Alternative to RRSP – provides increased retirement savings
- ▶ Provides pre-determined retirement benefit
- ▶ Investment account that accumulates over time to provide retirement benefits on a tax-deferred basis
- ▶ Established by incorporated company for benefit of employee
- ▶ Employee must earn T4 income from company to qualify

WHY AN IPP?

- ▶ Greater tax deductible contributions to the Company
 - Reduces the tax burden of the new rules for passive investments
- ▶ Creditor protection
 - No deemed disposition of plan assets at death, and assets remain in the plan to provide benefits to surviving members
- ▶ All costs associated with the pension plan are tax deductible to the company
- ▶ Investment returns balanced by contributions – average 7.50% return over a three-year period

INDIVIDUAL PENSION PLAN (IPP)

Who are typical IPP candidates?

- ▶ Incorporated business owners / professionals (and families)
- ▶ Key Employees / Executives
- ▶ 40 years of age or older
- ▶ Have maximized RRSP contributions over the years
- ▶ Well established practice / business that generate consistent profits annually

THE PROPORTIONAL ADVANTAGE

First year advantage for an individual with earnings \$151,278 and service from 1991

Age	2019 IPP	2019 RRSP	2019 IPP
2019	Contribution	Contribution	Advantage
40	\$123,571	\$26,500	\$97,071
45	\$202,084	\$26,500	\$175,584
50	\$288,209	\$26,500	\$261,709
55	\$382,985	\$26,500	\$356,485
60	\$487,066	\$26,500	\$460,566
62	\$531,475	\$26,500	\$504,975

Source: Lesniewski Moore Consulting Group Inc

THE PROPORTIONAL ADVANTAGE

Subsequent 3 year contribution

Age	2020	2021	2022
2019	Contribution	Contribution	Contribution
40	\$29,526	\$31,823	\$34,106
45	\$32,398	\$34,854	\$37,481
50	\$35,590	\$38,390	\$41,212
55	\$39,102	\$42,094	\$45,297
60	\$43,091	\$46,303	\$49,738
62	\$44,687	\$47,987	\$51,692

RRSP	2020 Maximum	2021 Maximum	2022 Maximum
	\$27,230	Indexed	Indexed

Source: Lesniewski Moore
Consulting Group Inc

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RETIREMENT COMPENSATION ARRANGEMENTS (RCA)

- ▶ Non-registered plan (i.e., trust) funded by company contributions designed to provide supplemental retirement benefits to owner-manager
- ▶ Contributions to RCA are based on “reasonable” limits
- ▶ Subject to 50% refundable tax, refunded when distributions are made to the trust beneficiary (i.e., owner-manager)
- ▶ Opportunity to extract passive investments for;
 - Increased retirement funding
 - Creditor proofing
 - Reduced corporate value / LCGE planning
 - Investment income earned in the RCA excluded from AAI (protect SBD limit)

(UNIVERSAL) LIFE INSURANCE

Invest some business profits into a tax-exempt permanent policy. **WHY?**

- Guaranteed coverage for life
- Both insurance protection and a tax-deferred investment component
- Includes a cash value component that accumulates over time and can be used as collateral for borrowing
- Policy is voluntarily terminated before death or maturity, cash surrender value is paid by the insurer to the policyholder
- Can be used as part of estate planning to build value in long run and cover estate taxes

EXEMPT CORPORATE LIFE INSURANCE

1) Tax – sheltered growth

- significant cash values can accumulate on a tax-deferred basis (within limits)

2) Tax – free distributions on death

- Death benefit proceeds credited to CDA – tax free dividend to shareholder
- Credit to CDA is reduced by ACB of the policy
- Goal is to have the ACB of the policy decrease to zero as soon as possible

3) Passive income earned within exempt insurance policies not included in AAI

PASSIVE INVESTMENTS & CORPORATE CLASS

A WINNING COMBINATION

3 Main Benefits that Corporate Class Investments Offer:

- Lower taxable distributions relative to the trust equivalent over the long term
- More tax efficient distributions
- Focus on tax deferred growth

Additional benefits for active businesses that invest passively:

- Lower overall corporate taxes on passive income
- Maximize Capital Dividend Account
- Protect the \$500,000 Small Business Limit

PASSIVE INVESTMENTS & CORPORATE CLASS - EXAMPLE

- ▶ Alex, a dentist resident in B.C. owns 100% of the outstanding common shares of Profco, with an December 31 year-end
- ▶ Annual Net Professional Income: \$1,200,000
- ▶ Corporate investment portfolio value: \$4M (January 2, 2018)
- ▶ Invested in a conservative stock / bond model portfolio that earns 4% per year. Therefore during 2018, the investment earnings were as follows:
 - Interest & Foreign Dividends =1.0% (\$40,000)
 - Canadian Eligible Dividends =1.5% (\$60,000)
 - Realized Capital Gains =0.75% (\$30,000)
 - Unrealized Capital Gains =0.75% (\$30,000)

2019 SMALL BUSINESS LIMIT “REDUCTION”– ALEX’S PROFCO

Adjusted Aggregate Investment Income (AAIL) ¹	\$115,000
Less: Annual Passive Income Exemption	<u>(\$50,000)</u>
Net AAIL	\$65,000
Reduction (\$5 to \$1)	\$325,000
Small Business Limit	\$500,000
Reduction (from above)	<u>(\$325,000)</u>
Available Small Business Limit for 2019²	\$175,000

1. AAIL is comprised of interest/foreign dividends (\$40,000), Canadian eligible dividends (\$60,000) plus the taxable portion of capital gains (\$15,000)
2. Federally + B.C. for 2019, Profco. is subject to tax at the low rate (11%) on the first \$175,000 of professional income. Income in excess of \$175,000 is taxed at the higher general corporate tax rate (27%)

PASSIVE INVESTMENTS & CORPORATE CLASS - EXAMPLE

	PROFCO. INVESTMENT PORTFOLIO COMPARISON		
	Stock/Bond Model Portfolio	Symmetry Conservative Income Portfolio Class (F)	Tax Savings
(Adjusted) Aggregate Investment Income	\$115,000		
Part I & IV Corporate Tax (no dividend refunds)	\$50,865		
Incremental Federal / B.C. Income Tax On Professional Income	\$52,000		

PASSIVE INVESTMENTS & CORPORATE CLASS - EXAMPLE

	PROFCO. INVESTMENT PORTFOLIO COMPARISON		
	Stock/Bond Model Portfolio	Symmetry Conservative Income Portfolio Class (F)	Tax Savings
(Adjusted) Aggregate Investment Income	\$115,000	\$29,230	
Part I & IV Corporate Tax (no dividend refunds)	\$50,865	\$13,720	\$37,145
Incremental Federal / B.C. Income Tax On Professional Income	\$52,000	0	\$52,000

Potential Tax Savings in One Year: \$89,145

Symmetry Conservative Income Portfolio Class (Series F) distribution data from 2018 used for the illustration. Investment made on January 2, 2018 and held throughout 2018. For illustrative purposes only. History is not an indication of future results. Performance and distributions may vary from year to year. Ignores possible capital gains on the sale of stock / bond portfolio in order to reinvest in the Symmetry portfolio. This may impact results

The non-taxable portion of the capital gain dividend from the Symmetry Conservative Income Portfolio Class is approximately \$20,406, which is credited to the corporations Capital Dividend Account (CDA) and may be paid out as a tax-free capital dividend to the individual shareholder

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