TD Wealth

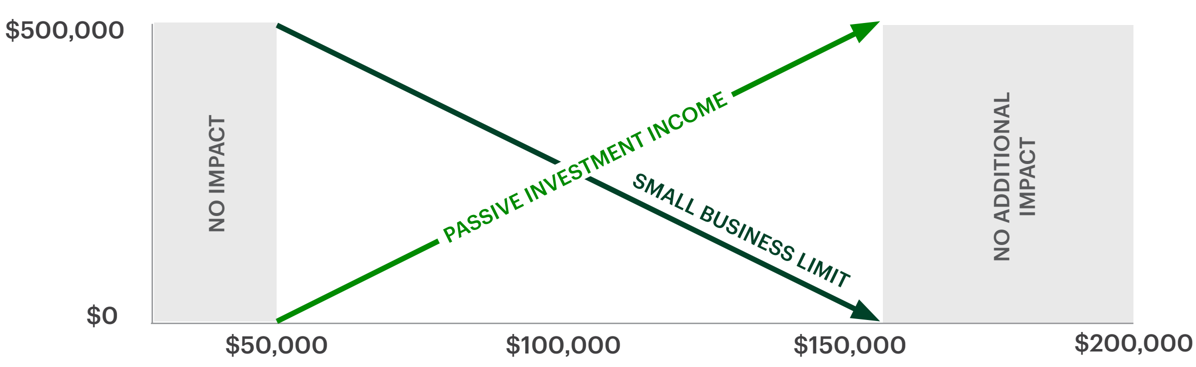
How Does **Passive Investment Income** in Your Company Grind the Small Business Limit?

What you need to know

From the 2019 tax year onward, certain Canadian Controlled Private Corporations (CCPCs) will have their small business limit reduced by $5.00 for every $1.00 of passive investment income that exceeds $50,000. The small business limit allows a portion of a CCPC's active business income to be taxed at a lower rate up to a certain limit.

Please note that not all provinces have adopted the small business limit and passive investment income rules at the provincial level. Currently, Ontario and New Brunswick have not adopted the rules at the provincial level so it is possible for CCPCs in these provinces to have their federal small business limit reduced while the provincial small business limit remains intact.

This is visually illustrated by the following[1,2]:



[1] Once passive investment income among associated CCPC's reaches $150,000 annually, the Small Business Limit is zero and the small business deduction available for that tax year is zero. All active business income for CCPC's in the group would be taxed at the higher general corporate tax rate.

[2] Small Business Limit of $500,000 is shared between associated CCPC's. Similarly Passive Investment Income is aggregated between associated CCPC's.

A detailed numerical example:

Consider a corporation with active business income (e.g.: net sales income, net consulting fees, etc.) of $350,000 and passive investment income of $100,000. This would result in the corporation's small business limit being reduced by $250,000 (computed as: $50,000 of passive investment income in excess of the $50,000 threshold = $50,000 x $5 for a reduction = $250,000 from the $500,000 limit). As a result, $250,000 of the corporation's $350,000 of active business income will be taxed at the small business corporate tax rates. The remaining $100,000 would be taxed at general corporate tax rates.

Before

Tax years before 2019

After

Tax years including 2019 and onward

Active Business Income: $350,000

+Passive Investment Income: $100,000

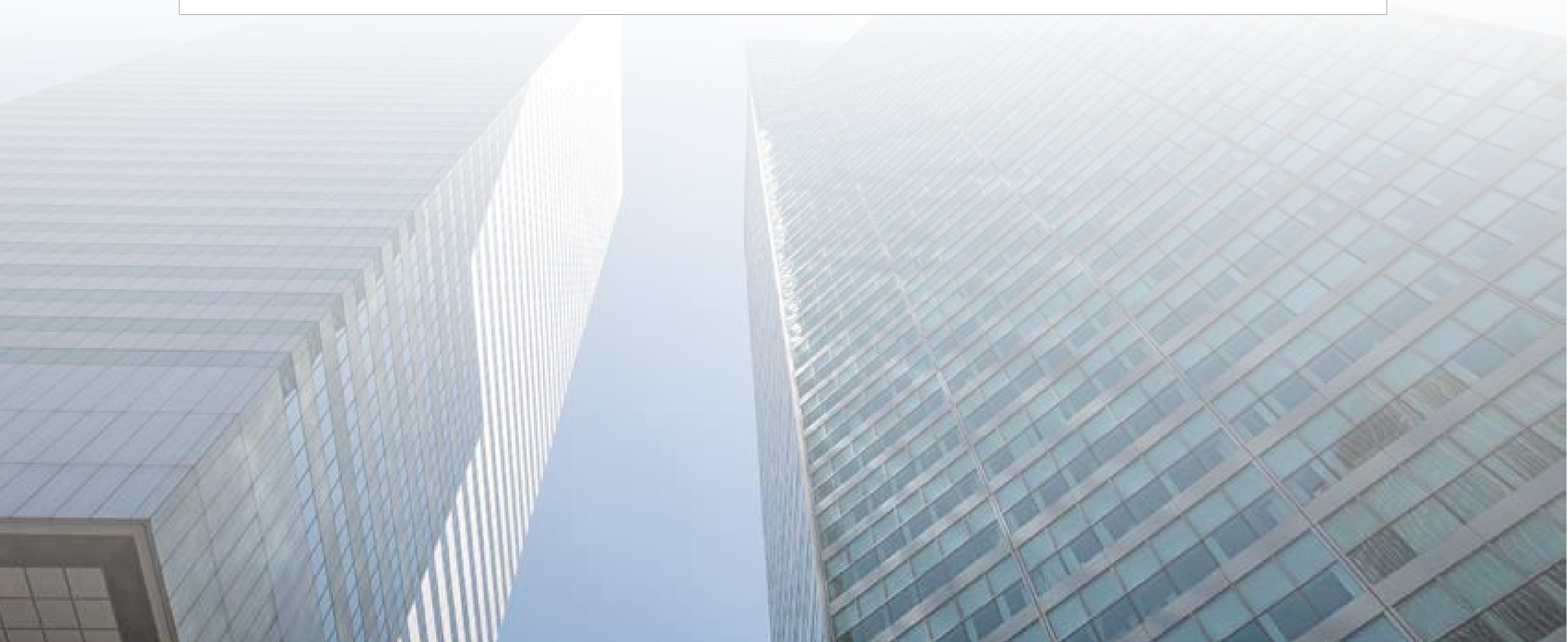
~$93,000
in taxes payable

(Assuming a small business tax rate of 12% and a 51% tax rate on passive investment income)

~$15,000
more in taxes due to passive investment income rules

~$108,000
in taxes payable

(Assuming a small business tax rate of 12%, a general corporate tax rate of 27% on active business income in excess of the reduced small business limit and a tax rate of 51% on passive investment income)



Impacted CCPCs	Non-impacted CCPCs
Canadian corporations (along with any "associated corporations" such as a holding company) that utilize the small business limit and generate combined passive investment income above the $50,000 threshold. **Passive investment income** generally includes, but is not limited to, interest income, dividends, capital gains, and rental income.	**Investment holding companies** are not directly impacted as only active business income benefits from the small business limit. A holding company typically does not generate active business income. **Corporations that only hold passive real estate** would not be affected unless the business is a larger operation with more than five full-time employees and has access to the small business limit.

Potential planning opportunities to discuss with your tax advisor include:

- **Reducing your corporation(s) net passive investment income** through:
  - Generating expenses which may help reduce gross passive investment income such as interest expenses.
  - Utilizing deductions to reduce net passive investment income such as reasonable management fees.
  - Reviewing the types of passive investments held inside your corporation (and its associated corporations, if any). For example, growth investments may generate less annual taxable income compared to interest or dividend paying investments.
- **Reviewing your Capital Dividend Account (CDA) balance** to determine whether a tax-free capital dividend can be paid.
- **Making charitable donations** through your corporation.
- **Reinvesting back into your business** by acquiring assets used in your day-to-day operations.
- **Funding a corporately owned life insurance policy.**
- **Funding an Individual Pension Plan** with corporate earnings that would otherwise have been directed towards passive investments.

Speak to your TD Wealth Advisor or TD Senior Private Banker.

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