

Federal Small Business Tax Changes

Ontario Health Policy Education Initiative | Ontario Medical Students Association

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Here is a primer to the Government of Canada's proposed federal tax changes: what's changing? What's happening now? And how do these changes affect physicians and medical students?

The debate over federal taxes began on July 18, 2017, when the Liberal government announced its plan to update the *Income Tax Act*. The rationale was to “improve the fairness of Canada’s tax system by closing tax loopholes and amending existing rules to ensure that the richest Canadians pay their fair share of taxes” ([Finance Canada](#)). Specifically, these proposed tax changes would affect many small businesses, which includes two-thirds of physicians ([CMA](#): 66% of Canadian doctors are incorporated). Below are the three key changes that were first proposed:

- 1. Restricting the use of income sprinkling.** Income sprinkling refers to the transfer of money from a family member in a high tax bracket to another individual in a lower tax bracket, a strategy to lower the total tax paid, regardless of whether or not that individual contributes to the corporation. The government intends to impose a “reasonableness” test, so that income sprinkling is only used when the other family member is working for the corporation ([Global News](#)). Further details on these rule changes were announced in December, which will exclude spouses aged 65 or over and adults who contribute at least 20 hours a week ([Finance Canada](#)).
- 2. Limiting the use of passive investments.** Currently, profits invested passively (i.e. stocks, real estate; contrast with active investments such as new equipment) are taxed at a lower rate for small businesses than with individuals. The government wishes to remove this disparity, arguing that the gap provides tax advantages that favour the wealthy. Many small businesses believe that the tax advantage is essential for encouraging entrepreneurship. Passive investments are also used as savings, such as for maternity leave or retirement. Recently, the Liberal government responded to concerns by allowing a maximum of \$50 000 of passive income per year that would be exempt from new legislation, while also grandfathering all previous investments. Critics on all sides have called that amount to be too much or too little.
- 3. Discouraging the conversion of income to capital.** Capital gains are taxed at a lower rate than personal income, leading some corporations to label some of their income as capital gains. The government aimed to discourage this practice by a combination of restricting the conversion of income to capital gains and by increasing the tax rate for capital gains. Due to pressure, the government has announced that they will no longer pursue this tax change ([CBC](#)).

Many individuals and organizations have voiced their opposition to these changes, including the Ontario Medical Association and Canadian Medical Association. In response, the government has stepped back on some of its tax changes ([CBC](#)) and proposed a lower small business tax rate ([Globe and Mail](#)), though many advocates are still critical of the currently proposed rules.

As of December 14, 2017, full legislation is yet to be announced (i.e. the proposed policies have not yet been formalized as a bill), leaving details lacking and subject to change. Once introduced, the bill will then undergo a second reading, committee review, and a third reading. Amendments may be passed during this process, though the support of the opposition parties is not required in the House of Commons given the Liberal majority government. After the House of Commons, the legislation will then be reviewed by the Senate. Notably, a December 2017 review by the Senate finance committee recommended the withdrawal or delay of the tax proposals, suggesting that the Senate may approach the legislation with caution. Once the bill passes both houses and receives Royal Assent, it will become law.

In Ontario, these tax proposals come at a time of heightened tensions between the province's physicians and the Ontario Liberal Party, where physicians and the provincial government have been without an agreement for over three years. During this time, many Ontario physicians have seen unilateral pay cuts, making Ontario physicians disproportionately affected by the potential federal tax changes. Many doctors, and the Ontario Medical Association, have also argued that the Ontario government had offered and recommended that physicians incorporate in lieu of increased pay, a benefit that now being taken away ([Ottawa Sun](#)).

OMSA recognizes that its members may have many different views on matters of personal finance. This legislation will have wide-reaching implications not only for physicians and their families, but also for the larger community of small-business owners and the overall tax system. While many physicians and physician organizations have been very vocal in their opposition to tax changes, some physicians have also supported these tax proposals as a step towards both an improved, tax system and a modernization of physician compensation ([CBC](#), [open letter](#)). OMSA will continue to monitor the tax situation and regularly update this document.

Timeline of events and some key articles:

July 18, 2017: Finance Minister Bill Morneau announces the government's intent to amend the Income Tax Act ([Globe and Mail](#), [CBC](#)). The government legislation may take effect retroactively as of this day ([Globe and Mail](#)). The consultation period begins.

August 30, 2017: The Canadian Medical Association meets with Finance Minister Bill Morneau to discuss the concerns of physicians.

August 31, 2017: The Coalition for Small Business Tax Fairness is formed, with 35 organizations including the Canadian Medical Association, the Ontario Medical Association, the Coalition of Ontario Doctors, and the Ontario Association of Radiologists ([CFIB](#)). The coalition now exceeds 70 member organizations ([Coalition for Small Business Tax Fairness](#)).

September 25, 2017: The Finance Committee initiates a brief study of the tax proposal, hearing from stakeholders. The Canadian Medical Association presented its concerns on September 28 ([CMA](#)).

October 2, 2017: Consultation period ends. The government received more than 21000 submissions ([Financial Post](#)). The government announces its next steps the following day ([Finance Canada](#)).

October 16, 2017: The government announces that the small-business tax will be reduced from 10.5% to 10% by 2018 and 9% by 2019 ([Globe and Mail](#), [Finance Canada](#)).

October 18, 2017: The government announces that up to \$50 000 of annual passive income will not be subject to new tax rules ([Financial Post](#), [Global News](#))

November 22, 2017: The Coalition of Small Business Tax Fairness publishes a letter regarding its concerns regarding the proposed tax changes despite recent adjustments and the ongoing lack of details ([Coalition for Small Business Tax Fairness](#)).

December 13, 2017: The government releases specifics regarding their draft legislation for income sprinkling ([Finance Canada](#), [CBC](#)). On the same day, the Standing Senate Committee on National Finance releases its report on the tax changes, recommending that the government withdraw proposed changes or at least delay its implementation until January 2019 after undertaking thorough consultations and economic impact assessments ([Standing Senate Committee on National Finance](#)).

January 1, 2018: The government has suggested that some of its policies (yet to be written) will come into regulation starting at the beginning of 2018, though this may be unlikely given that no legislation has been introduced as of late November.

Other resources:

- [Canadian Medical Association: Tax Issues](#)
- [Canadian Medical Association: Submission to the Department of Finance](#)
- [Coalition for Small Business Tax Fairness](#)
- [Coalition of Ontario Doctors](#)
- [Finance Canada: Tax Planning Using Private Corporations](#)
- [Finance Canada: Government Simplifies Measures to Restrict Income Sprinkling](#)
- [Ontario Medical Association: Proposed Federal Tax Changes](#)

- [Ontario Medical Association: Submission to the Department of Finance](#)
- [Open Letter to Minister Morneau from physicians and medical students with a shared perspective on the proposed tax changes](#)
- [Standing Senate Committee on National Finance: Fair, Simple and Competitive Taxation: The Way Forward for Canada.](#)