

## July 18, 2017 Department of Finance Proposed Changes On Limitations on Lifetime Capital Gains Exemptions

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### Overview of Proposed Changes

The Department of Finance proposals include measures to limit the ability to claim the lifetime capital gains exemption (LCGE) on dispositions after 2017.

The LCGE is an exemption available to Canadian residents in respect of capital gains realized on the disposition (sale or transfer) of certain types of property. On the disposition of a qualified small business corporation shares the exemption is up to a lifetime limit of \$835,716 (2017) of capital gains. On the disposition of qualified farm and fishing property the lifetime limit is up to \$1 million.

The proposals are intended to target common planning strategies that multiply the LCGE, whether through a family trust or otherwise, by having shares held by family members.

The proposals introduce significant restrictions to the circumstances in which the LCGE is available. Under the proposed measures, the LCGE would be denied or reduced in the following situations:

- Individuals under the age of 18 will no longer qualify for the LCGE in respect of capital gains that accrued prior to the year the individual turns 18.
- Where the individual is an adult, no LCGE would be available on taxable capital gains from dispositions subject to the expanded Tax on Split Income (TOSI) rules.<sup>i</sup>
- Capital gains that accrue during the period a Trust holds the property will not qualify for the LCGE, subject to certain exceptions.<sup>ii</sup> This would include property that was previously held by the Trust that was distributed to a beneficiary of the Trust on a rollover basis.

The proposals include a transitional rule that would permit an election in 2018 to realize a capital gain in respect of eligible property held at the end of 2017 (similar to the 1994 election rules). This election provides an opportunity to lock in the capital gain before the end of 2018 where the ability to use the LCGE would otherwise be lost.

### Potential Impact of the Changes

If these measures, along with the additional restrictions on income splitting with individuals aged 18 to 24, are implemented, the ability to include younger family members in tax planning will be significantly restricted after 2017.

The ability to allocate accrued gains in value of the property held by a Trust will also be eliminated. While these proposals may achieve the intended government objectives (prevent multiplication of the LCGE with non-active related individuals) it will also (likely inadvertently) frustrate legitimate estate planning measures which are currently in place.

The proposals will impact not only many of the current Trust structures, but also structures where related individuals directly hold shares of property that would otherwise qualify for the LCGE. In these cases, the ability to claim the LCGE would be restricted under the expanded TOSI<sup>i</sup> rules.

The proposed rules include the additional complexity of determining reasonability of an individual's efforts in the operations of the business, or the risk associated with the capital they contributed to the company.

### What Should You Do Now?

First, the earliest these proposed amendments will be formally tabled will not be until after the end of the 75-day consultation period ending October 2, 2017. There is time for us to make a case against these measures.

If the proposals go ahead as stated, consider taking advantage of the 2018 election to crystallize the accrued capital gains. To use the LCGE it is imperative that the property is qualifying at the time of the election. This may require some planning to ensure surplus assets are extracted from the corporation prior to the election.

The 2018 election to use the LCGE will not be available to minor beneficiaries of Trusts. A minor child is eligible to claim the exemption only if an actual disposition takes place in 2018.

For an active beneficiary of the Trust (perhaps in a business succession scenario where an adult child is taking over the business) the cost of losing access to the LCGE may exceed other benefits such that you should consider having the beneficiary hold the growth shares directly.

### **Other Benefits of the Use of a Trust That Remain in Place**

As access to multiple LCGE's is only one benefit of the use of a Trust in a corporate structure, we caution that a thorough review and understanding of the objectives of your structure should be undertaken before any actions are taken. For example, the use of a Trust to hold your operating company is commonly used to achieve certain other objectives (tax and non-tax), including but not limited to:

- *To maintain control over Trust property;*
- *To allow for movement of surplus funds from one corporation to another related corporation;*
- *Allow flexibility in transfer of ownership of the company at a later date without being bound to a decision made today;*
- *Allow flexibility of income determination for family members who are actively engaged in the business.*

As each situation is unique, we recommend that you speak with your advisor to determine the best approach for you.

### **What Are We Doing?**

As part of DFK Canada, we are pro-actively seeking changes to these proposals by discussing their impact with our clients and contacting local MP's to advise them of the far reaching impact these rule changes will have on all clients. Those most impacted by the proposals are being portrayed as the wealthiest of Canadians. We know otherwise. We will continue to keep our clients up to date as we learn more about the proposed changes.

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<sup>i</sup> Generally, the "tax on split income" rules would apply if the income is not "reasonable" in the circumstance. See our related article "Payments to Shareholders of Private Companies." Stricter requirements will be imposed on payments to individuals between the ages of 18 and 24.

<sup>ii</sup> The exceptions include spousal or common law partner trusts, alter ego trusts and certain employee share ownership trusts.