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THE SMALL BUSINESS DEDUCTION

The small business deduction is a boon to individuals setting up business in Canada through corporations. Whereas the federal tax rate, not including surtaxes, for most corporations under the Canadian Income Tax Act is 28%, some corporations can use the small business deduction to reduce this rate to 12% on up to \$200,000 of active business income.

The small business deduction has made many guises over the years, from limitations as to the total amount of deduction available to the kind of corporation which could take the deduction. However, it is one thing which the tax simplification process a few years ago actually resulted in simplifying. Now, it is available on the first \$200,000 of active business income earned in Canada by a Canadian-controlled private corporation.

Active Business Income
The term active business income is defined in the Tax Act not by what it is, but by what it is not. It is not, for example, income from property such as interest, dividends, rents or royalties. It is the job of the courts to judge whether or not business income falls into the active category, however it can probably be said that it is generally income from a business which involves effort on the part of its employees to produce and/or sell its goods or services.

Canadian Controlled Private Corporations ("CCPCs")
A CCPC is defined under the Act as a corporation which is resident in Canada and usually incorporated here. It may not be controlled by one or more public corporations. It may not be controlled by a non-resident. To meet these requirements, at least 50% of the shareholders holding voting rights in the company must be Canadians which are not public companies. Where, however, non-residents or public corporations which hold less than 50% of the voting rights of the corporation can exercise direct or indirect influence that would result in

control in fact, the company will not meet the requirements of being a CCPC.

Associated Corporations
Generally, associated corporations are groups of two or more corporations which are controlled by the same person or related group of persons. Where two corporations which would otherwise meet the test of being CCPCs are associated, they must share the \$200,000 limit on income eligible for the small business deduction. For example, each could apply the small business deduction to \$100,000 worth of income.

Provincial Small Business Deduction
The provinces also reduce their tax rates for some small businesses. For example, in Ontario, the general rate imposed on corporations is 15.5%. This is reduced for small corporations to 10% on the first \$200,000 of earnings. Federally, all businesses, no matter how much they earn, are eligible for the small business deduction provided that they otherwise meet the requirements of being CCPCs earning active business income in Canada. In its latest budget however, Ontario proposed to impose a claw-back on the deduction for corporations which would otherwise be eligible but which earn more than \$200,000 of active business income. The province plans to impose a surtax of 3.7% on taxable income in excess of \$200,000 until the full small business deduction is recovered. This will happen if the corporation earns taxable income of about \$500,000 or more. As well, because the small business deduction must be shared among associated corporations, the deduction will be diminished and lost where associated corporations altogether earn over \$200,000. The surtax will be effective January 1, 1992.

The implementation of any tax saving strategy is based on your personal financial situation. Professional advice should be obtained before implementing any of the suggestions contained herein.

GARY A. DYKSTRA
ACCOUNTING & TAX PROFESSIONAL

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