How to keep income splitting with family members in 2018 and beyond [Oct 04, 2018]

The new income sprinkling rules mean it no longer makes sense for incorporated professionals and many business owners to income split with their families. That’s because dividends paid to a spouse or child will now be taxed at the top marginal rate unless the shareholder receiving the dividend can show specific labour or capital contributions to the business’s operations.

Taxpayers will be responsible for demonstrating in their tax returns that a family member meaningfully contributes to the business. It’s up to CRA to decide if the compensation is reasonable.

If only one shareholder is considered the legitimate owner of the business, he or she is only allowed to income split with:

· a spouse, once the owner turns 65;

· adults aged 25 or older who hold a 10% voting share in a non-professional corporation that earns less than 90% of its income from services; and

· adults aged 18 or older who have averaged 20 hours of work in the business per week during the year, or any of the five previous years.

Shareholders who do not fit perfectly into one of these categories won’t know whether their 2018 dividend compensation will be taxed at the highest marginal rate (49.80% in B.C.) until mid-2019 when they receive their Notices of Assessment.

This is an unacceptable risk for most small business owners.

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