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Fact Sheet – 2018 Income Sprinkling Rules

Family income sprinkling rules came into effect January 1, 2018, and unless a family member can show active involvement within the business using reasonableness tests, distributions of income from private family businesses will be taxed at top tax rates.

This will now require that many business owners re-think their structures and improve the detail of their record keeping procedures for family members who work in the business, own shares, or lend money to the business.

Split into four components, the "Reasonableness Criteria" will be assessed by CRA on the facts of each situation and will apply if the income does not qualify under the "Excluded Shares" and "Excluded Business" definitions.

The following are examples of the detail which would have to be met by the taxpayer:

A Labour Contribution will now require detailed notes of every employed family member's labour contributions including:

- the nature of the tasks performed for the business
- the hours necessary to complete those tasks
- what the competitive salary/wage is for those tasks in similar businesses in the marketplace
- the family member's knowledge, experience, education and training, skills and know-how, as well as past performance

Property Contributions will require family members to provide comprehensive logs of their exclusive intellectual and financial contributions to the family business including:

- details on the amount of capital or loans contributed to the business
- fair market value of tangible and intangible property transferred to the business including experience, knowledge, and skill
- whether there were other readily available sources of capital, loans, and/or comparable property and whether that property was unique or personal to the individual
- "opportunity costs"
- past property contributions

Risk Assumption, past and/or ongoing, will be considered by:

- the extent to which the individual is subjected to the financial risks or the liabilities of the company (including statutory liabilities)
- the degree to which the contributions could be lost
- whether the risk is indemnified
- whether the individual's reputation or personal goodwill is at risk

Total Amounts Paid to a family member must be reasonable. To determine reasonableness, the following will be considered:

- amounts paid previously, including salary or other remuneration
- interest
- dividends paid out
- proceeds and fees
- benefits and deemed payments

Lastly, for those aged 18 – 24, a "Safe Harbour Capital Return" will need to be calculated on capital contributions made to the business.