

ASSOCIATED CORPORATIONS AND IMPLICATIONS

Why is association is important?

1. **The Small business deduction limit*** is shared amongst associated corporations e.g. if 2 corporations are associated than they need to share the \$500,000 SBD limit between them.
2. The small Business Deduction gets reduced if the **taxable capital employed in Canada** exceeds \$10 Million. Associated corporation capital is combined to calculate for this limit. Therefore Consider the taxable capital limit for the associated group. i.e. after 10 million it start reducing and nil at 15 million... Taxable capital = retained earnings + long-term debt (including current portion) + share capital + bank overdraft
3. **The Specified Investment Business Income and Personal Service Business Income** received from associated corp. is deemed to be considered as Active Business Income and hence qualifies for the small business rate
 - Specified Investment Business Income = interest, dividends, rent, royalty
 - Personal Service Business Income = Salary/Wages earned by a corporation

*Who gets Small Business Deduction?

- Must be a CCPC throughout the year
- Reduced if taxable capital employed in Canada exceeds \$10Million
- Available on ABI up to 500K and shared between associated companies

How do we determine if two corporations are associated?

- Whether one corporations is associated with another corporation is determined using the concept of control and related party. There are 5 tests (below) to determine association under section 256(1)
- Related = Related persons include relationship between individuals, between individual and corporations, between corporations. Related individual includes spouse, parents, siblings, parents in law etc. NOTE that uncle, aunts, nieces, nephews, and cousins are not considered related.
For corporations to be related to individual and other corporations, the concept of control is important.
- Control = Control refers to **owning more than 50%** of the voting shares of the corporation

Determining association:

4. **256(1) (a)** – One corporation directly or indirectly control the other one E.g. ABC controls DEF by holding 50% or more shares – Both ABC and DEF is associated because of section 256(1)(a)
5. **256 (1) (b)** – Both corporations are controlled by the same person or group of persons

6. **256(1) (c)** - One corporation is controlled by one person and that person is related to the other person who controls the other corporation and one of them owns more than 25% shares of the non-specified class* of the other corporation
7. **256 (1) (d)** – One corp. is controlled by one person and other is controlled by unrelated/related group. That one person should be related to all the persons (in the group) controlling the other corporation and must own at least own 25% shares of the non-specified class* of the other corporation
8. **256 (1) (e)** – Both corporations are controlled by related groups. Each member of one of the corporations must be related to each of the members of the other group and they individually or combined own at least 25% shares of the non-specified class* of the other company.

*What is **specified class shares**?

- Non-voting shares and cannot be convertible into voting shares
- The amount of dividend is fixed predetermined amount

Triangle rule:

- Two corporations (otherwise not associated per the test above) will be deemed to be associated if they are both commonly associated with a third corporation
- However there is an option to elect out of this deemed association – the corporation that is commonly associated with the other corporations (without the triangle rule) has an option to elect out of the deemed disposition
- **Example:**
 - Suppose you have three corporations A, B, and C. Suppose A and B are not associated based on the tests above 256(1)(a)-(e)
 - A and C are associated based on 256(1)(a)-(e)
 - B and C are associated based on 256(1)(a)-(e)
 - Per the triangle rule, A and B will be deemed to be associated because they (A and B) are both commonly associated with C
 - Since A, B and C are all associated they must share the \$500,000 small business deduction limit
 - However, C can opt out of the deemed association
 - If C opts out, C will have NO small business deduction (it will lose its small business deduction and will be subject to tax at the general rate); while each of A and B will have its own \$500,000 small business deduction limit and do not have to share