

TAX TIPS & TRAPS

THIRD QUARTER • 2016

TAX TICKLERS

some quick points to consider

- **Government of Canada cheques never expire** and can be cashed at any time. CRA can issue **replacement cheques** if the original was lost, destroyed, stolen or missing.
- All **Government of Canada websites**, including CRA's, are being **migrated** to a new **website** (www.Canada.ca). The merging is intended to be completed **by the end of 2016**. Current registration and log-in information for your CRA account is expected to be valid in the new website.
- In 2014-2015, 95.9% of taxpayer **service complaints** were resolved within 30 business days.

DIRECTOR LIABILITY

Reliance on the Active Shareholder

In a May 5, 2016 **Tax Court of Canada** case, at issue was whether the taxpayer (a **director** and 50% shareholder of the **Corporation**) was **liable** for the Corporation's **unremitted payroll deductions and tax**. A **director would not be held liable** if he/she had exercised the **degree of care, diligence and skill** of a reasonably prudent person in comparable circumstances in order to prevent the corporation's failure to remit.

In this case, the taxpayer was **informed** by the other **50% shareholder**, who was involved in the day-to-day operations, that the **business was doing well**. In reality, the Corporation was in **financial difficulty** and

remittances were not being made.

On receiving **correspondence from CRA** regarding **arrears** with its **GST and payroll deduction** remittances, the taxpayer turned his attention to the corporation's failures. He spoke to the other 50% shareholder about the **need to be diligent**, as well as **stopping by** the business every two or three weeks to **check on matters**. However, he continued to **rely on** assurances provided by the **other 50% shareholder**, even after receiving additional correspondence regarding outstanding source deductions.

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SELLING YOUR BUSINESS

Do It Before 2017?

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DIRECTOR LIABILITY (continued)

Director loses – personally liable for corporate remittances
The Court found that **reliance** on the other shareholder's **word** was **not acting diligently** given the taxpayer's **knowledge of the Corporation's financial state**. The Court suggested a reasonable person would **independently verify** that **remittance payments** were being **made**, whether by direct contact with CRA, review of the Corporation's bank account, or other approaches. As a result, the Director was **personally liable** for the unremitted corporate GST/HST and source deductions.

Action Item: *Especially in times of corporate financial difficulty, review source documents to ensure that payments to CRA are being made appropriately.*

LOSING THE SMALL BUSINESS DEDUCTION (SBD)

Partnerships

Similar to limitations on accessing the SBD on payments amongst certain corporations, the 2016 Federal Budget also proposed changes when payments are made from a partnership. The measures will apply to **taxation years that begin on or after March 22, 2016**.

Currently, a **corporation** which is a **member of a partnership** may claim the SBD on active business income it receives from the partnership up to its pro-rata share of a notional \$500,000 business limit determined at the partnership level (its **specified partnership income limit**, or "SPI"). For example, if \$500,000 or more of ABI is earned by a partnership with 10 equal partners, the SPI of each partner would be \$50,000.

A corporation's SPI is added to its active business income from other sources, if any, and the corporation can claim the SBD on the total (subject to its annual business limit).

Some business **structures circumvent** the application of the **SPI rules**. In one

structure, a **shareholder of a corporation** is a **partner** and the **partnership pays the corporation** as an **independent contractor** under a contract for services separate from the Partnership Agreement. As a result, the **corporation** claims a **full SBD** in respect of its active business income earned in respect of the partnership because the corporation itself is not a partner. A number of **professional services firms**, such as those of lawyers and medical professionals, use a structure like this.

To address this, and other similar strategies, the 2016 Federal Budget proposed to **extend the SPI rules**. Basically, the amount paid to a corporation available for the SBD will be restricted if the corporation has a **shareholder** who is a **partner**, or, if it **does not deal at arm's length** with a partner.

Action Item: *Consider whether your current partnership structure achieves your goals. Be prepared to pay a higher corporate tax rate if affected by these changes.*

CRA INSTALMENT NOTICES

Do I Have to Pay Them?

Many individuals received **unusually high incomes** in 2015 as a result of triggering capital gains or taking extra dividends and/or salary from their corporation to avoid being subject to the higher tax rates taking effect in 2016. When tax returns for 2015 were filed, many of these individuals would have been required to make a substantial tax payment in April of 2016 since their 2015 withholdings and instalment payments were not sufficient to cover the additional income. In general, if that **April payment upon filing** was greater than **\$3,000**, CRA will request those individuals to make **instalment payments** during the 2016 year.

Instalment reminders are sent out by CRA (usually in August) and may ask for **large amounts** to be paid in September and December of 2016. Those amounts are based on the **income from the 2015 year**. The first few instalment requests in 2017 may also be based on 2015 income levels. If the taxpayer's income in 2016 is, or will be lower than 2015, the instalments per the notices may significantly **exceed** the taxpayer's **expected 2016 liability**. It is important to note that there are **alternatives** to paying the recommended instalment amount included on the notice.

One such possibility is to pay instalments **based on the expected tax liability** for the 2016 year. If there has been a **significant decrease in income**, this method may free up large amounts of cash that may otherwise have been tied up in instalment payments and only returned upon CRA processing of the 2016 personal tax return.

Where CRA's requested instalments are remitted, no instalment interest will be charged. Instalments **based on 2016 taxes** must be made equally by March 15, June 15, September 15 and December 15 to avoid instalment interest. If no payments were made for March and June, remitting payments for September and December **can offset the late payment** of the earlier amounts. Paying early, and/or paying more than the expected 2016 taxes, will reduce the potential of interest for late payments, and provide a cushion in case actual 2016 taxes exceed the estimated amount.

Action Item: *Review your 2015 and expected 2016 tax situation to determine appropriate instalment payments.*

LOSING THE SMALL BUSINESS DEDUCTION (SBD)

Intercompany Payments

The 2016 Federal Budget proposed a number of measures to **prevent the ability to multiply access** to the \$500,000 SBD limit, addressing several strategies which the Government perceived as inappropriate. Broad restrictions in eligibility for the SBD on **payments between private corporations** in general have been introduced. The restrictions as proposed are so **broad** that they will affect many corporations and structures where multiplication of the SBD was not a goal or even a consideration.

The measures will apply to **taxation years that begin on or after March 22, 2016**. For example, a corporation with a December 31 fiscal year-end will first be subject to these restrictions in the year ending December 31, 2017. A corporation with a March 31 fiscal year-end will first be affected in the year ending March 31, 2017.

In general, these new **Specified Corporate Income (SCI)** rules will restrict access to the SBD on any **active business income (ABI)** earned from providing services or property to another **private corporation (PayerCo)** where there is **common ownership**. Such income will not be eligible for the SBD.

Consider the situation where ServiceCo provides services to PayerCo, and PayerCo pays a fee back to ServiceCo.

Payments will be restricted by the SCI rules where **an interest in PayerCo is held by any of:**

- **ServiceCo** (the corporation providing the service and receiving the fees);
- **any shareholder** of ServiceCo; or,
- **any person** who does not deal at arm's length with any shareholder of ServiceCo.

There is **no de minimis ownership** interest threshold – based on the draft legislative proposals of July 29, 2016, even one share of thousands will cause these restrictions to apply. In addition, even **indirect interest** can trigger the SCI rules. For **example**, if you own 10% of ServiceCo, and your **brother-in-law** owns one share of thousands issued by PayerCo, these rules could apply.

An exception: if **all or substantially all** of **ServiceCo's active business income** (which CRA generally considers to be 90%) is earned

from providing **services to arm's length persons** other than PayerCo, ServiceCo will not be subject to the SCI rules.

The Budget also proposed that PayerCo may be permitted to **assign** a portion of its own **unused SBD** limit to ServiceCo to make the payments SCI (a special form must be filed to make the assignment).

Examples of Corporations Potentially Affected

Consider a corporation, **OpCo**, held by **four unrelated** shareholders which pays **management fees** (or some other type of active income) to **four HoldCos** each **owned** by one of the four shareholders (whether in whole or in part).

Under the **proposals**, the management **fees** earned by the four HoldCos would **not generally be eligible for the SBD**, unless OpCo allocated a portion of its own \$500,000 limit amongst the HoldCos. In other words, OpCo and the four HoldCos must now **share access to a single business** limit, assuming the HoldCos do not have ABI from other sources. Historically, each of the five corporations (OpCo and the four HoldCos) may each have had full access to the \$500,000 SBD depending on their ownership and business structure.

As a second example, consider **Dr. A**, whose **professional corporation (PC)** carries on a dental practice. **Dr. A's spouse** owns a **second corporation (HyCo)**, which carries on the hygiene practice at the PC's dental clinic. PC and HyCo are **not associated**, either by share structure or by de facto control. Currently PC and HyCo each have full access to the SBD. Under the **proposals**, if **HyCo provides** its **services** to the PC, HyCo's income would **be ineligible for the SBD**, unless one of the exceptions noted above applies.

The proposals are quite **broad** and there are many **existing corporate structures** which are, or could be, **exposed** to these provisions. While the proposals may change during the process of becoming law, it is clear that many existing structures will be affected.

Action Item: *Review your current corporate structures to determine if the small business rates will remain applicable, and whether any change in historical planning is appropriate.*

CANADA CHILD BENEFIT

Get Yours Today!

A well-publicized aspect of the **Liberal election platform** was the replacement of the Canada Child Tax Benefit, National Child Benefit Supplement, and the Universal Child Care Benefit with the **Canada Child Benefit**. This new program commenced in July 2016, with payments determined from the **family's 2015 personal income tax returns**. The family income used in the calculation consists of the net income (not including Universal Child Care Benefits and Registered Disability Savings Plan Income) of the **person primarily responsible** for the care and upbringing of the child, plus that person's **spouse or common-law partner**, but not the net income of the child.

Families may be eligible for the maximum annual benefits of **\$6,400 per child under age 6** and **\$5,400 per child age 6 to 17**. Benefits will be phased out based on **family income** in excess of **\$30,000** with a reduced phase-out rate applied to incomes over \$65,000, as follows:

# of Children (for phase-out rates)	Phase-Out Rates (%)	
	\$30,000 to \$65,000	Over \$65,000
1	7.0	3.2
2	13.5	5.7
3	19.0	8.0
4 or more	23.0	9.5

For example, the payment for a family with \$75,000 of income and a 4-year old would be:
 $\$3,630 = \$6,400 - (10k \text{ (income over 65k)} \times 3.2\%) - ((65k - 30k) \times 7.0\%)$.

A further benefit of **\$2,730 per disabled child** may apply, with the phase-out rates generally aligning with the Canada Child Benefit.

For a **tool** which will calculate an individual's **entitlement** to the Canada Child Benefit, go to <http://www.budget.gc.ca/2016/tool-outil/ccb-ace-en.html>. For a tool which will consider additional benefits available for those with children, go to <http://www.cra-arc.gc.ca/benefits-calculator/>.

Action Item: Ensure that your children are registered in order to receive payment. If you were previously receiving the Canada Child Tax Benefit, you are already registered.

SELLING YOUR BUSINESS

Do It Before 2017?

Some of the most valuable business assets that can be sold are the **intangibles** such as **goodwill** and customer lists. These types of assets are presently classified as "**Cumulative Eligible Capital**" (CEC). When sold, there is often a **large gain** on these assets because their value has been built up over time and there is very little, or no, original cost. The corporate tax rates applicable to this type of gain for **2017 onwards** will **change significantly**.

Half of the gain is currently **tax-free**, and can be distributed to the corporation's shareholders, still tax-free, as a **capital dividend**. This will not change. The tax changes relate to the **taxable half of the gain**.

For sales occurring **before 2017**, the taxable half of the gain on CEC sales would be considered "**business income**". It may be eligible for the small business deduction which equates to a **corporate tax rate** around **15%**. Even where the small business deduction is not available, the rate would only be approximately **27%**. Specific rates vary by province/territory.

In 2017, these **assets** will be converted from this special CEC class to a regular asset class thereby creating "**capital gains**" rather than

"**business income**" upon sale. The initial corporate **tax rate** on the taxable half of the gain for these assets is **approximately 51%**, but again, ranges by province/territory. The cash left in the corporation after taxes will be significantly less if the sale occurs in 2017 or later.

All is not lost, however, since a large portion of the 51% in corporate taxes will be refunded when the **cash is paid out** to the individual shareholder as a **taxable dividend**. Once all of the sale proceeds have been distributed to the individual shareholder, the after-tax cash remaining will be **roughly the same** whether the asset sale occurred in 2017 or prior.

In other words, realizing the gain **prior to 2017** will leave **more cash available** to the corporation. This deferral of taxes will be particularly **beneficial** where the shareholder does **not require all of the sale proceeds immediately** for personal use. The funds left in the corporation can often be invested for many years.

Action Item: If you would like to retain the proceeds of a sale in the corporation for the long term, consider whether a close before the end of 2016 is preferential. Also consider whether planning should be undertaken to trigger the gains now.