
TAX TICKLERS... some quick points to consider...

- CRA has required PayPal to disclose sales and other transaction records for Business Account Holders from January 1, 2014 to November 10, 2017. It is expected CRA will review records for unreported sales.
- Employers can now provide a tax-free party or social event to employees where the cost per person is \$150 or less (the limit was previously \$100).
- Although such cases are rarely successful, two taxpayers were awarded nearly \$1.7 million in relation to CRA's malicious prosecution.

FAMILY MEMBERS: Can I Pay Them a Salary?

For a small business, whether operated as a corporation, proprietorship or partnership, it is quite possible that relatives of the owners or partners may be engaged as employees. Due to the closer familial relationship between employer and employee, CRA pays particular attention to ensure that the salary is truly an eligible deduction to the business.

According to CRA, salaries to children and spouses are deductible as long as all of these conditions are met:

- the salary is actually paid;
- the work the family member does is necessary for earning business or professional income; and
- the salary is reasonable when considering the family member's age and the amount one would pay someone else.

CRA also states that T4s are required for all employees, including family members, and subject to payroll deductions, as appropriate. Payment in the form of room and board is not accepted by CRA.

CRA suggests that the average salary for an arm's length person providing similar services under similar conditions would provide guidance as to reasonableness.

Action Item: Consider whether family members can perform services for one's business, and what level of income is reasonable.

CORPORATE PASSIVE INVESTMENT INCOME: Proposed Changes

A new passive investment tax regime for Canadian Controlled Private Corporations (CCPCs) is proposed to apply to taxation years commencing after 2018. Passive income may include interest, rental, royalties, dividends from portfolio investments and taxable capital gains.

Two significant changes are proposed. First, a limit to the small business deduction for CCPCs generating significant income from passive assets, and second, a new regime to stream the recovery of refundable tax to the payment of specific types of dividends (eligible versus non-eligible).

Access to the Small Business Deduction (SBD)

The first prong of the proposals will reduce access to the SBD for CCPCs having more than \$50,000 of passive income. CCPCs with passive income in excess of the threshold will incrementally lose access to their SBD, until \$150,000 of passive income is reached, at which point the entire SBD will be lost. The prior year's passive income will determine the current year's SBD limit.

For purposes of these new rules, capital gains on certain types of property will be excluded from being considered passive income. These are as follows:

- Capital gains realized on the disposition of property used principally in an active business carried on in Canada. The active business could be carried on by the owner of the asset, or by a related party. Examples include gains on the sale of the goodwill of an active business, and gains on the real estate from which the active business operates.
- Capital gains realized on shares of another CCPC all or substantially all of whose assets are used in an active business carried on in Canada, provided the seller has a significant interest (generally over 10%) in that corporation.
- Similarly, capital gains realized on an interest in a partnership all or substantially all of whose assets are used in an active business carried on in Canada will generally be excluded where the seller has a significant interest (generally over 10%) in the partnership.

Capital losses realized in a different taxation year that are applied to offset capital gains realized in the current year will not reduce passive income for these new rules.

Consistent with the existing SBD rules, the sum of passive income of all associated corporations will determine the reduced business limit available to the associated group.

Access to the Small Business Deduction (SBD) (Continued)

The total advantage or disadvantage of earning passive investment income in a corporation, after considering personal and corporate tax costs, will depend on a number of factors such as the individual's marginal tax rate, rate of return on the investment and the province or territory of residence.

Recovering Refundable Taxes

Passive income is subject to a high corporate tax rate. However, a portion of these taxes are refunded when the CCPC pays taxable dividends.

The second prong of the passive income proposals will add a new restriction. Recovering refundable taxes will generally require the CCPC to pay out non-eligible dividends. These carry a higher personal tax cost than eligible dividends. The exception will be where refundable taxes arise from the CCPC's receipt of eligible dividends. Dividends received from most Canadian public corporations are eligible. This portion of the refundable tax can then be recovered when the CCPC pays out eligible dividends.

Action Item: If your corporation has passive earnings in excess of \$50,000 and is also earning active business income, prepare for a potentially higher corporate tax bill in the coming years.

REASONABLE AUTOMOBILE ALLOWANCES: GST/HST Claim

A travel allowance paid to an employee for the use of their personal vehicle for business purposes will be non-taxable if it is reasonable.

Where such reasonable allowances are paid, an input tax credit (ITC) may be claimed by the employer. The ITC is computed as the imputed GST/HST in the allowance, without adjustment for the fact that some costs likely did not attract GST/HST. In non-harmonized provinces/territories (such as Alberta and B.C.), the ITC would be 5/105 of the allowance. The ITC in a harmonized province is different. For example, in Ontario, with 13% HST, the ITC would be 13/113 of the allowance. Other HST provinces would apply this formula to their respective rate.

In a November 10, 2017 Tax Court of Canada case, CRA denied ITCs of \$4,935 related to motor vehicle allowances paid to employees that were also shareholders. CRA argued that the allowances were not reasonable.

Taxpayer wins

The allowances were based on the maximum per kilometre rates that the employer could deduct. The accounting for the allowances was complicated by the use of fuel cards provided and paid by the customer of the taxpayer. However, a detailed review of the accounting records demonstrated that:

- detailed logbooks of business and personal driving had been maintained;
- allowances were paid for business kilometres only, with careful tracking of personal use;
- fuel paid by the corporate customer had been charged back to the taxpayer; and
- the allowances paid to the shareholder-employee were effectively reduced by the customer's fuel payments.

Although the accounting for the allowances was quite complicated, the Court concluded that it complied with the law and ensured the employees received reasonable allowances limited to business driving. The ITCs were, therefore, properly claimed.

Action Item: If paying reasonable allowances to employees, consider claiming an input tax credit in respect of the payment.

CONSTRUCTION ACTIVITIES: Reporting Obligations for Subcontractors

A July 17, 2017 Technical Interpretation examined the conditions which would require the filing of a T5018, Statement of Contract Payments.

Where a person or partnership primarily derives their business income from construction activities for a reporting period, a T5018 should be filed for any subcontractor payment or credit made relating to goods or services received in the course of construction activities. The reporting period may be a calendar or fiscal year but cannot be changed once selected (unless authorized by CRA).

The term “construction activities” is broadly defined. It includes, for example, the erection, excavation, installation, alteration, modification, repair, improvement, demolition, destruction, dismantling or removal of all or any part of a building, structure, surface or sub-surface construction, or any similar property. Such activities are considered to be those normally associated with the on-site fabrication and erection of buildings, roads, bridges, parking lots, driveways, etc. which are intended to be permanently affixed to the land on which they are built.

It is a question of fact as to whether a particular activity is a construction activity, and whether the business income for the reporting period is derived primarily from such activity. If a T5018 is not required, consideration should be given to the requirement of a T4A, Statement of Pension, Retirement, Annuity, and Other Income.

CRA has also noted that there are businesses that have a significant amount of construction done for them or by them, but the activity is not their principal business. For example, a natural gas company may do a large amount of construction to install pipelines, however, its principal business is gas transmission, not constructing pipelines. It would not be required to file T5018s.

Penalties are levied on the payer when T5018s are not timely filed. Penalties range from \$100 to \$7,500, depending on the number of T5018s and the number of days they are late.

Action Item: If you are in the construction industry, ensure you are filing T5018s appropriately.

U.S. CITIZENS: Risks of Tax Non-Compliance

Commencing January 1, 2016, the U.S. State Department was able to deny or revoke passports to U.S. citizens having a “seriously delinquent tax debt” or no Social Security Number associated with their passport. A “seriously delinquent tax debt” is one where the taxpayer owed more than \$51,000, after January 1, 2018 (indexed going forward), in tax, interest and penalties.

An Alert on the IRS website recently noted that commencing January 2018 the IRS will begin certifying tax debts to the State Department. After receiving certification from the IRS, the State Department will not generally issue a passport.

In addition to passport denial and revocation, several states impose non-monetary non-criminal sanctions for certain taxpayers who are sufficiently delinquent on their taxes. For example, New York, California, Louisiana and Massachusetts may revoke driving privileges.

Action Item: If you have an outstanding U.S. tax liability, or are concerned you may not be compliant with your U.S. tax obligations, contact us to discuss options.