December 8, 2021

As we approach the end of the year, now is a good time to start thinking about tax planning so that you make the most of opportunities available to you, as well as be prepared when deadlines are due.

Please contact our office if you have any questions, we are always happy to help!

Important dates:

Personal tax:

- Last day to contribute to RRSP in order for it to be deductible for the 2021 tax year is March 1, 2022. This may also assist in managing income for the year to avoid a clawback of Canada Recovery Benefit (CRB). Also consider having the higher income earning individual contributing to their spouse's RRSP via a "spousal RRSP" for greater tax savings.
- Last day to realize capital losses to be able to offset capital gains from the 2021 tax year is December 29, 2021, to account for the settlement period of two business days.

Corporation tax:

- Filing for wage and rent subsidies:
  - Period 17 – December 30, 2021
  - Period 18 – January 27, 2022
  - Period 19 – February 24, 2022
- Payroll remittances for bonuses paid in December 2021 may be due shortly after the year-end depending on your remitter status, don't forget to remit on time!

UPDATES AND REMINDERS FOR 2021

Individuals:

- **Tax on Luxury Goods -** The tax is slated to come into effect on January 1, 2022, and it will apply to purchases and leases of new luxury vehicles and aircraft priced over $100,000, and new boats for personal use priced over $250,000. Certain exemptions apply.
- **Top-up of the Ontario Child Care Tax Credit (CARE) -** The Government announced in their 2021 budget that they will provide an automatic top-up of 20% of the credit entitlement for the 2021 taxation year. The Ontario Child Care Tax Credit is calculated as a percentage of your Child Care Expense Deduction.
- **COVID Emergency or Recovery Benefits** – If you received amounts under the following programs; Canada Recovery Benefit (CRB), Canada Recovery Sickness Benefit (CRSB) or Canada Recovery Caregiving Benefit (CRCB) in 2021, you will receive a T4A slip. You must report these amounts on your 2021 income tax return. In many cases, while some tax was withheld on these benefits, it will not be sufficient to cover the tax owing.
- **2020 Tax Extension for Certain Individuals -** Some individuals who received certain COVID-19 benefits in 2020 and whose income was below $75,000 were effectively provided with a one-year extension to their personal tax payment deadline. Individuals who enjoyed this temporary relief should ensure that they have the funds to pay their 2020 and 2021 personal tax liabilities when they come due on April 30, 2022.

- **Canada Recovery Benefit (CRB) and Employment Insurance (EI) Clawback** – Amounts received under the Canada Recovery Benefit (CRB) program are subject to a clawback of $0.50 for every dollar of your Net Income in excess of $38,000. The clawback is $0.30 of every dollar earned over $70,375 for EI.
- **Old Age Security (OAS) Clawback -** A senior whose 2021 net income exceeds $79,845 will lose all, or part, of their OAS pension. Senior citizens will also begin to lose their age credit if their net income exceeds $38,893. Consider limiting income over these amounts. Another option would be to defer receiving OAS receipts (for up to 60 months) if it would otherwise be eroded due to high-income levels.
- **COVID Emergency or Recovery Benefits Repayment** – Amounts repaid under the Canada Emergency Response Benefit (CERB), Canada Emergency Student Benefit (CESB), Canada Recovery Benefit (CRB), Canada Recovery Sickness Benefit (CRSB) or Canada Recovery Caregiving Benefit (CRCB) are deductible. You can choose to claim the deduction in the year you made the repayment or in the year you received the benefits.
- **Foreign Property Reporting** – If you held specified foreign property (examples – tangible property, funds deposited outside of Canada, shares of a company that is non-resident in Canada such as US public companies) with a total cost in excess of $100,000 at any time during 2021, you are required to file form T1135 – Foreign Income Verification Statement.
- **Foreign Affiliate Reporting** – If you and those related to you, combined, owned at least 10% of any class of shares of a foreign corporation, you are required to complete form T1134. A new T1134 form has been released by CRA earlier this year, you must use the new form for tax years that <u>*began after*</u> December 2020.
- **Voluntary Disclosure -** If income, forms, or elections have been missed in the past, a voluntary disclosure to CRA may be available to avoid penalties.
- **Reporting the Sale of Your Principal Residence** – You are required to report basic information when you sell your principal residence (date of acquisition, proceeds on sale and address).
- **Recordkeeping -** Certain expenditures made by individuals by December 31, 2021 will be eligible for 2021 tax deductions or credits, such as digital news subscriptions, moving expenses, childcare expenses, charitable donations, political contributions, registered journalism organization contributions, medical expenses, alimony, eligible employment expenses, union, professional or like dues, carrying charges and interest expense. Ensure you keep all receipts that may relate to these expenses.
- **Non-deductible Interest -** Consider restructuring your investment portfolio to convert non-deductible interest into deductible interest. It may also be possible to convert personal interest expense, such as interest on a house mortgage or personal vehicle, into deductible interest.

- **Allowable Business Investment Loss (ABIL) -** If you have equity investments or loans made to a Canadian small business that has become insolvent or bankrupt, an ABIL may be available. For loans to corporations to be eligible, the borrower must act at arm's length. ABILs can be used to offset income beyond capital gains, such as interest, business, or employment income.
- **Tax-Free Savings Account (TFSA) -** Individuals 18 years of age and older may deposit up to $6,000 into their TFSA in 2021. An additional $6,000 may be contributed starting on January 1, 2022.
- **Canada Education Savings Grant (CESG)** for registered education savings plan (RESP) contributions equal to 20% of annual contributions for children (maximum $500 per child per year) is available. In addition, lower-income families may be eligible to receive a Canada Learning Bond.
- **Registered Disability Savings Plan (RDSP)** may be established for a person who is under the age of 60 and eligible for the disability tax credit. Non-deductible contributions to a lifetime maximum of $200,000 are permitted. Grants, bonds, and investment income earned in the plan are included in the beneficiary's income when paid out of the RDSP.
- **Canada Pension Plan (CPP)** receipts may be **split** between spouses aged 65 or over (application is required). Also, consider if there are benefits to receiving CPP early or late.
- **U.S. Residents** – Consider your U.S. filing obligations, information exchange agreements have increased the flow of information between CRA and the IRS.

<u>Corporations</u>:

- **Canada Emergency Wage Subsidy (CEWS) and Canada Emergency Rent Subsidy (CERS)-** If your corporation had received the wage and/or rent subsidies, these are deemed to be taxable on the last date of each claim period and are required to be included in the corporate tax return which includes these respective claim periods.
- **Canada Emergency Business Account (CEBA)** – The forgivable portion of the interest-free loan under CEBA is taxable in the period you received the loan.
- **Canada Recovery Hiring Program (CRHP)** – Beginning for claim period 17, eligible employers who had increased total remuneration compared to claim period 14 may be eligible to recover up to 50% of this increase. Filing deadlines are posted at the end of this newsletter.
- **Tax on Split Income [TOSI]** – Any income taxed under the TOSI rules is subject to tax at the highest personal marginal tax rates, eliminating any advantage achieved from income splitting.
- **Accelerated Depreciation -** Consider making a capital asset purchase by the end of the year. Most capital assets purchased in 2021 will be eligible for an accelerated depreciation deduction. For example, a piece of equipment normally eligible for a 10% deduction in the first year (Class 8) would be entitled to a 30% deduction. This benefit is available even if purchased and made available for use just before year-end. Some zero-emission electric vehicles purchased by businesses may be eligible for a 100% write-off (limited in some cases to the first $55,000). Alternatively, zero-emission vehicles purchased in 2021 may be eligible for a federal incentive rebate of up to $5,000.

- **Immediate Expensing of Capital Property of CCPC's (proposed)** – Budget 2021 proposed that fixed asset additions of up to $1.5 million per tax year may be immediately expensed for eligible property acquired by CCPC's after April 18, 2021. This limit is shared amongst the associated group of companies. However, this change has not been passed into legislation, as a result this is not yet available. We will provide more information as it becomes available.
- **Intergenerational Transfers** – Bill C-208 were enacted in June 2021 to provide tax relief for intergenerational transfers of small businesses and family farm and fishing corporations. However, the government intends to bring amendments to this Bill because it may allow for artificial tax planning. If you are considering a transfer of your business to your children, please contact our office and we will be pleased to assist.
- **Loan Forgiven -** This may result in additional taxes or other adjustments to the tax return.

2021 Remuneration Planning

Higher personal income levels are taxed at higher personal rates; therefore, you may wish to adjust income out of high-income years and into low-income years. This is particularly useful if you are expecting a large fluctuation in income, for example, an impending

- maternity/paternity leave.
- large bonus/dividend; or
- sale of a company or investment assets.

Individuals should consider other costs of additional income, for example an individual with a child may receive reduced Canada child benefit (CCB) payments. Excessive personal income may reduce receipts of OAS, GIS, GST/HST credit and other provincial/territorial programs.

There are a variety of ways to smooth income over several years to ensure an individual is maximizing access to the lowest marginal tax rates. For example,

- Taking more, or less, earnings out of the company.
- Realizing investments with a capital gain/loss.
- Deciding whether to claim RRSP contributions made in the current year or carry forward the contributions.
- Withdrawing funds from an RRSP to increase income. However, care should be given to the loss in the RRSP room based on the withdrawal.
- Deciding on whether to claim CCA on assets used to earn rental/business income.

Dividends paid out to shareholders of a corporation that do not "meaningfully contribute" to the business may result in higher taxes due to the "tax on split income" rules.

Year-end planning considerations not specifically related to changes in income levels and marginal tax rates include:

1) Corporate earnings in excess of personal requirements could be left in the company to obtain a tax deferral (the personal tax is paid when cash is withdrawn from the company).

2) The effect on the "qualified small business corporation" (QSBC) status should be reviewed before selling the shares where large amounts of capital have accumulated. In addition, changes that may limit access to the small business deduction where significant corporate passive investment income is earned should be reviewed.
3) If dividends are paid out of a struggling business with a tax debt that cannot be paid, the recipient could be held liable for a portion of the corporation's tax debt, not exceeding the value of the dividend (Section 160 assessments).
4) Year-end bonuses can affect the business' Canada emergency wage subsidy (CEWS) and Canada recovery hiring program (CRHP) and the recipient's Canada recovery benefit (CRB). If the bonus partially relates to a claim period, it could increase entitlement to CEWS or CRHP. On the other hand, it could clawback your CRB claim if it pushes your annual net income (excluding CRB) above $38,000.
5) Individuals that wish to contribute to the CPP or an RRSP may require a salary to generate "earned income." RRSP contribution room increases by 18% of the previous years' "earned income" up to a yearly prescribed maximum ($27,830 for 2021; $29,210 for 2022).
6) Dividend income, as opposed to a salary, will reduce an individual's cumulative net investment loss balance, thereby potentially providing greater access to the capital gain exemption.
7) Consider paying taxable dividends to obtain a refund from the "refundable dividend tax on hand" account in the corporation. The refund amount may be restricted if "eligible" dividends are paid. Eligible dividends are subject to lower personal tax rates.
8) It is costlier, from a tax perspective, to earn income in a corporation from sales to other private corporations in which the seller or a non-arm's length person has an interest. As such, consideration may be given to paying a bonus to the shareholder and specifically tracking it to those higher-taxed sales. Such a payment may reduce the total income taxed at higher rates.
9) Careful tracking of an individual shareholder's labour and capital contribution to the business, as well as risk assumed in respect of the business, should be maintained in a permanent file. Dividends paid that are not reasonable in respect of those contributions may be considered "split income" and taxed at the highest tax rate. Several other exceptions may also apply.
10) Access to the corporate federal small business deduction is reduced where **more than $50,000 of passive income** is earned in the corporation. Consider whether it is appropriate to remove passive income-generating assets from the corporation and whether a shift in the types of passive assets held is appropriate. In some provinces, it may actually be beneficial to have access to the federal small business deduction restricted.
11) If you provide services to a small number of clients through a corporation (that would otherwise be considered your employer), CRA could classify the business as a **personal services business**. There are significant negative tax implications of such a classification, but there are risk and exposure minimization strategies. Please consult with us for more information.

HVGP Hufton Valvano Grover Philipp LLP
CHARTERED PROFESSIONAL ACCOUNTANTS

TAX TICKLERS… SOME QUICK POINTS TO CONSIDER…

- CRA recently sent out processing review letters in error to some taxpayers rather than their authorized representative. If you received a letter from CRA that appears unusual, please contact us.
- A Court recently denied an individual's travel expenses as no log was maintained in respect of the travel. The Court did not accept an estimate of business travel based on the locations where contracts were signed.
- A recent report found that more than 80% of Canadian parents do not understand the benefits of Registered Education Savings Plans (RESPs). That said, nearly half of adult Canadians currently contribute or have contributed to an RESP.

ENHANCING THE VALUE OF OWNER-MANAGED BUSINESS: STARTING THE TRANSITION EARLY

Many owner-managers are shocked at both the difficulties in finding a buyer for their business and the low prices an owner-managed business often commands.

A recent Intelligent Work article (How Does 10x-ing Value Work in an Owner-Managed Business?, John Mill) discussed guidance provided to Harvard MBA students regarding investing in owner-managed businesses. That guidance included the reality that these businesses with earnings between $750,000 and $2 million tend to be priced at 3x to 5x earnings before interest, taxes, depreciation and amortization (EBITDA), as compared to 6x to 12x earnings for larger companies with EBITDA of more than $5 million. In addition, most owner-managers are forced to sell due to age or health issues and such distress sales generally result in lower multiples.

Often, investors do not want to be owner-managers, and as such, will employ another individual to run the business. This further reduces the value of owner-dependent businesses.

Some strategies to grow the value by focusing on the qualities that command higher multiples include the following:

- competent management that is not owner-dependent;
- lean systems;
- engaged employees; and
- a solid track record of EBITDA growth.

The article suggested a 10-year track record of 18% EBITDA growth (an average for the successful expanding of small businesses) as an appropriate target.

ACTION ITEM: Starting the discussion on how to maintain and enhance the value of an owner-managed business should be commenced many years before the anticipated sale or transition.

SALARIES TO FAMILY MEMBERS: AMOUNTS PAID MUST BE TRACEABLE

Oftentimes, family members of the owner of a business will work for the business. However, these arrangements can be somewhat informal, and amounts paid may be denied as a business expense if the work performed and amounts paid to the worker are not properly documented.

A June 10, 2021 Court of Quebec case provides one such example of this issue. An individual (P) owned and operated a corporation (Pco) that provided trucking services. Pco deducted $46,000 over three years for amounts paid to P's father-in-law and mother-in-law for filing and driving services. Pco also deducted approximately $11,000 over two years for payments to P's spouse for filing services. P was assessed with income on all of these amounts.

The Court reviewed whether Pco actually paid the amounts to the family members.

TAXPAYER LOSES

The taxpayer argued that, while P's father-in-law and mother-in-law never cashed the cheques provided by Pco, these payments represented their contributions to household expenses. However, the Court found that the amounts were never paid.

All payments to P's spouse were made to a joint bank account with P, but the payments did not specifically correspond with the amounts P's spouse was allegedly paid for her services. P argued that funds from the joint account (reflecting her compensation) were used to pay off P's spouse's credit card bills. Again, the Court found that no payments were actually made to P's spouse.

The Court noted that it believed P's spouse did provide services and that the result would have been different if the bank statements had shown amounts paid directly to her for her services.

As no payments were determined to have been made to P's spouse or his in-laws, no amounts were permitted to be deducted. Further, the Court determined that these assessments could be made outside the normal reassessment period and that the assessed gross negligence penalties were justified.

ACTION ITEM: Family members should be paid for work done for the business in the same manner as other non-family members.

DIRECTOR LIABILITY: PROPERLY RESIGNING

Directors can be personally liable for unremitted employee source deductions and GST/HST unless they exercise due diligence to prevent failure to remit these amounts on a timely basis. CRA cannot personally assess the director more than two years after the individual properly resigns as a director.

In an August 11, 2021 Tax Court of Canada case, the Court reviewed whether the individual properly resigned as a director. CRA assessed the taxpayer as a director personally for $305,390 of unremitted source withholdings for the 2008 to 2014 years on the basis that he never properly resigned.

The taxpayer was appointed as a director in 1999 at the commencement of his employment as a programmer. In 2011, the taxpayer sent an email resigning his employment to the corporation's owner, followed by a phone call. The taxpayer provided nothing in writing to the corporation (as a legal entity separate from its owner). The taxpayer asserted that as the assessment was issued in 2016, more than two years after he allegedly resigned as a director, the assessment should be vacated.

TAXPAYER LOSES – RESIGNATION

In referencing the Ontario Corporations Business Act, the Court reiterated that the resignation of a director is effective at the time a written resignation is received by the corporation or at a time specified in the resignation. As no written resignation of his position as a director was sent by the taxpayer or received by the corporation, the Court ruled that the taxpayer had not resigned. In other words, as the taxpayer was both an employee and a director, resigning as an employee was not automatically a resignation as a director.

TAXPAYER WINS – CRA'S ASSESSMENT

After reviewing testimony and various documents, the Court found that the underlying assessment was overstated. As the Court did not have evidence to reduce the assessment to the proper amount, the appeal was allowed in full.

While this was an Ontario case, similar rules regarding resigning as a director exist in other jurisdictions.

ACTION ITEM: If you intend to resign as a director, ensure that the resignation of yourself as a director is received by the corporation.

LIFE INSURANCE POLICIES: USING TRACKING SHARES

When a shareholder passes away, their shares are deemed to be disposed of at fair market value (FMV) unless a tax-free rollover is available and used. This can cause a tax liability at a time when no cash is available. Holding a life insurance policy in the corporation in respect of the owner-manager can fund these tax liabilities or provide cash to buy out the shares from the estate.

In some cases, whole-life insurance policies are used as tax-sheltered investment tools. However, a problem may arise in that the FMV of the insurance policy is deemed to be its cash surrender value (CSV) for the purpose of determining the FMV of the shares of the corporation. In other words, obtaining such a policy potentially increases the gain experienced on the shares upon deemed disposition at death. Also, the insurance proceeds may not go to the desired party.

Insurance tracking shares can be used to address these issues. They are essentially shares whose value is directly attached to a policy's CSV, death benefit, or both. They can be issued as preferred shares without access to voting rights, dividends from business profits, or participation in value growth of the rest of the business. If obtained at the initiation of the life insurance policy, the shares can be purchased for nominal consideration because the FMV of the policy should also be nominal. The insurance tracking shares could be redeemed after death, with the related dividend being tax-free by using the increased capital dividend account from the payout of the insurance policy.

As the policy increases in value due to the investments, so do the tracking shares, which would be held by the specific parties intended to benefit from the increases, such as the individual's children. Two May 19, 2021 Technical Interpretations confirmed CRA's 2005 position that the CSV would be allocated between the common shares and the insurance tracking shares based on the rights and attributes of each class, using the same valuation principles that would guide the allocation of the value of other corporate assets.

If done correctly, the proceeds of the common shares on death would not be affected by the increase in insurance policy value. However, it is important to note that a specialist should be used in setting up these shares as significant precision in the share attributes is required to ensure that it functions as intended.

ACTION ITEM: Holding a life insurance policy in a corporation can be a useful tool to assist with continuity upon death of an owner-manager. The use of insurance tracking shares can mitigate increases in capital gains upon death when using such policies.

HOLDING DIGITAL ASSETS IN RRSPS: PITFALLS AND POSSIBILITIES

Recently, individuals have become more interested in investing in digital assets such as cryptocurrencies (Bitcoin, Ethereum, Dash etc.); cryptocurrency liquidity mining and yield farming; and non-fungible tokens (NFTs). The next question often asked is whether such items can be held in tax-advantaged accounts such as an RRSP.

An RRSP's tax-preferred treatment only extends to "qualified investments." Broadly speaking, qualified investments only include money and securities that are listed on a designated stock exchange. As such, digital assets like cryptocurrencies and NFTs are not qualified investments, so they cannot be held in an RRSP.

However, the investment market has seen a recent surge in cryptocurrency-based exchange-traded funds (ETFs). Many of these are traded on designated stock exchanges, so these cryptocurrency ETFs may be qualified investments. A September 20, 2021 Walletbliss article (Best Crypto ETFs in Canada (2021): Cryptocurrency For All, Simon Ikuseru) lists Canadian Bitcoin and Ethereum ETFs noted as being eligible RRSP and TFSA investments.

Caution must be afforded as a penalty tax applies if the RRSP acquires a non-qualified investment, with the penalty tax equal to 50% of the fair market value of that investment. In addition, the RRSP is taxable on any income from the non-qualified investment and on any capital gain (not the normal 50% taxable capital gain) from disposing of the non-qualified investment.

ACTION ITEM: If interested in holding digital assets in a tax-sheltered savings account such as an RRSP, make sure that item is a qualified investment.

WITHDRAWING FROM FAMILY RESPS: FLEXIBLE PLANNING POSSIBILITIES

A July 21, 2021 Money Sense article (My three kids chose different educational paths. How do I withdraw RESP funds in a way that's fair to them and avoids unnecessary taxes?, Allan Norman) considered some possibilities and strategies to discuss when withdrawing funds from a single RESP when children have different financial needs for their education. Some of the key points included the following:

- There is likely a minimum educational assistance payment (EAP) withdrawal that should be taken, even by the child that needs it least.
- The EAP includes government grants (up to $7,200) and accumulated investment earnings on both the grants and taxpayer contributions.
- The grants can be shared, but only up to $7,200 can be received per child, with unused amounts required to be returned to the government.
- Only $5,000 in EAPs can be withdrawn in the first 13 weeks of consecutive enrollment.
- The withdrawal amount is not restricted by school costs.
- The children are taxed on EAP withdrawals.
- It is generally best to start withdrawing the EAP amounts as early in the child's enrollment as possible, when the child's taxable income is lowest. If the child is expected to experience lower income in later years, there is flexibility to withdraw EAP amounts in those later years instead.

WITHDRAWING FROM FAMILY RESPS: FLEXIBLE PLANNING POSSIBILITIES (-CONTINUED-)

- The level of EAP withdrawn for each child can be adjusted. As individuals are taxed on the EAP withdrawals, planning should consider the children's other expected income (e.g. targeting less EAPs for years in which they will be working, perhaps due to co-op programs or graduation). Consider having the EAP completely withdrawn before the year of the last spring semester as the child will likely have a higher income as they start to work later in the year.
- To the extent that investment earnings remain after all EAP withdrawals for the children are complete, the excess can be received by the subscriber. However, these amounts are not only taxable, but are subject to an additional 20% tax. Alternatively, up to $50,000 in withdrawals can also be transferred to the RESP subscriber's RRSP (if sufficient RRSP contribution room is available), thus eliminating the additional 20% tax. An immediate decision is not necessary as the funds can be retained in the RESP until the 36th year after it was opened.

ACTION ITEM: The type, timing, and amount of RESP withdrawals can significantly impact overall levels of taxation. Where an RESP is held for multiple children, greater flexibility exists. Consult a specialist to determine what should be withdrawn, at what time, and by whom.

WORKSPACE IN HOME CLAIMS: CRA REVIEWS

For the 2020 year, many employees were required to work from home due to the COVID-19 pandemic. Those employees generally had two deduction possibilities: using the flat method of claiming $2/day the individual worked from home, or doing a detailed calculation to claim the actual costs associated with working from home. While the first option was only a temporary relieving measure for the 2020 year, the Liberal election platform promised to extend access to this deduction for the 2021 and 2022 years.

In the summer of 2021, CRA started to review these claims. A tax journalist from the Financial post, was one of the individuals selected for review. He discussed his experiences in an August 5, 2021 article (What you need to know if the CRA reviews your home office expense claims, Jamie Golombek). The author had used the detailed method to claim actual workspace in home expenses and was asked to provide (among other items):

- an employer-signed Form T2200 and a Form T777 setting out the claims;
- receipts and supporting documents, noting that credit card statements, bank statements, or cheques would not be sufficient support;
- for the workspace itself, the calculation details for the percentage claimed, including space used for employment and personal purposes and a copy of the floor plan of the residence with the home office; and
- for cell phone expenses, CRA requested copies of the mobile contract, monthly account summaries, proof of payment, and a breakdown of the minutes and data used to earn employment income.

Similar to other deductions against income, not all claims are reviewed; nonetheless, taxpayers should be prepared to provide this level and type of detailed support.

Also, in a Technical Interpretation, CRA confirmed that the temporary flat-rate claim of $2 per day (maximum $400) can be deducted by adult children living at home provided that they contribute towards the payment of eligible home office expenses and meet the relevant eligibility criteria.

ACTION ITEM: Be prepared to provide detailed supporting documentation for workspace in home claims made under the detailed method.