Year-End Planning

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Year-End Planning

1. Capital Gains / Losses

- Trigger capital losses to offset current year gains / 3-year carryback
- Losses on stocks, be careful of superficial loss rules (if buy back within 30 days)
- Strategy – sell Oilco A, buy Oilco B

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Year-End Planning

1. **Capital Gains / Losses** ***(Continued)***

   - Need good estimate of tax position
   - Be careful of exchange gains / losses (Cdn./US exchange rate 69¢ to 83¢)

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2. **ABIL Claims**

   - For debt, can elect if bad
   - For shares, need disposition to arm's length person unless corporation bankrupt / insolvent
   - Be careful, CRA audits ABIL claims, document

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3. Pay Out ERDTOH / NERDTOH

- ➢ Why
  - possible tax increase in 2022 (?)
- ➢ Incremental cost to pay out ERDTOH is small (about 1%) at top bracket
- ➢ Cost to pay out NERDTOH about 9% at top bracket / needs more careful thought

Check ERDTOH transition.

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4. Realize Capital Gains

- ➢ Why
  - possible tax increase in 2022 (?) either by moving 50% inclusion rate up (75%?) and/or tax rate increase
- ➢ Strategy
  - realize gains in 2021
  - use rollover so reversible
  - sale or gift to spouse

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4. Realize Capital Gains *(Continued)*

- Strategy
  - transfer to corporation with section 85 election
  - if no change, elect at cost later

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5. Capital Gains Strip

- Why
  - possible tax increase
  - better remuneration strategy to extract corporate funds
  - may not be able to do if legislative change

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5. Capital Gains Strip *(Continued)*

- Strategy
  - deliberately realize capital gains in holding company
  - pay out CDA and taxable dividend
  - overall tax about 29% v. 39% or 47%

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6. Increase Remuneration

- Why
  - possible tax increase
- Strategy
  - increase remuneration in 2021, prepay tax but at lower rate if tax increase in 2022
  - do in moderation

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7. Switch Salary to Dividend

- Why
  - overall tax about the same
  - if future losses in corporation, leaves income for loss carryback
  - case by case, very fact specific

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A Look to the Future

2020

- disaster, unprecedented, not foreseen
- some winners, lots of losers, lots of disasters
- very industry specific

Permanent Changes

- working remotely, less need for office space, changing roles

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A Look to the Future *(Continued)*

Permanent Changes

- some businesses will fail close
- lasting impact

But

- M&A business very active
- stock market at or close to record high
- very low interest rates
- lots of liquidity, money on the sidelines

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A Look to the Future *(Continued)*

2021

- long cold miserable winter
- spring, beginning of return to new normal
- vaccine program, numbers drop, restrictions ease
- pent up demand for hospitality, spending, with less supply, lots of liquidity, low interest rates
- leads to major rebound, lots of new businesses, acquisitions, uplift in real estate values

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A Look to the Future ***(Continued)***

2021

- demand may exceed supply, leading to inflation then higher interest rates

And What Happened?

Some people made fortunes!

Owner-Manager Remuneration

Summary of Major Points

Personal Tax Rates

- Modest rates to around $89,000
- Reasonable rates to $150,000
- Avoid taxable income over $150,000 if possible
- Low rate taxpayers may waste dividend tax credit if very low income
- Bigger rate spread on eligible v. ineligible dividend at lower brackets

Tax Deferral

- Major tax deferral on low rate ABI
- Large tax deferral on high rate ABI

Corporate Tax Rate

Rates 12.2% (ABI, low rate)

26.5% (ABI, high rate)

50.2% (RDTOH)

Corporate Tax Rate *(Continued)*

- Now a new hybrid rate on low rate ABI and passive income. No federal SBD but Ontario SBD. 18.2% rate and eligible dividend
- Passive income grind can be a benefit

Small Business Reduction

- More complex than ever
- Specified partnership and specified corporate income limit restrictions
- Passive income grind

Integration

- No major salary / dividend bias on active income
- Higher overall tax on passive income (58% v. top rate on salary at 53.53%)
- No overall cost to leaving high rate active income in corporation, pay later as dividend

Passive Income

- Incremental cost under the NRDTOH and ERDTOH system – 1% for eligible and 9% for ineligible
- Income splitting to take advantage of low tax brackets of shareholders. Need to watch for TOSI

Passive Income *(Continued)*

- Royalty income from own activities should be considered be active business income. Relevant for copyright royalties
- Property Management Services:
  - Management fee can be considered active even if rental is passive

RDTOH

Breaks down in the following areas:

- FTC reduces RDTOH, leads to double taxation
- Overpay dividends – match the RDOTH which dividends paid out
- Loss carry back – RDTOH recalculated and personal tax on dividend remains

RDTOH SYSTEM

Planning Ideas

- Real estate rented to active business, make companies associated to make rental payments active
- Rental Group – merge to have over 5 full-time employees
- Non-CCPC status

RDTOH SYSTEM *(Continued)*

Planning Ideas

- Stay in low brackets – taxable income below $150,000 (RDTOH is favourable) but watch for TOSI
- Two companies, take dividends from RDTOH source if cash required and choice between ABI and RDTOH

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GRIP - Rules

- Cannot consolidate GRIP of subsidiaries must pay up the chain
- Must make a designation in writing to ensure dividends are eligible
- Late designation up to three years
- Can designate a dividend to be partially eligible
- Excessive eligible dividend can be designated as ordinary dividend within 90 days of NOA

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Common Mistakes to Avoid

GRIP and Eligible Dividends

- Dividends from foreign affiliates not being added to GRIP balance
- Sufficient GRIP balance at year-end
- Cannot allocate eligible dividend to a non-resident

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Common Mistakes to Avoid *(Continued)*

GRIP and Eligible Dividends

- Eligible dividends to low income taxpayers as long as DTC used
- Eligible dividends paid to taxpayers with losses carried forward

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Planning Ideas - GRIP

- Two class of shares – pay eligible to Canadian residents and ineligible to non-residents
- In trust sandwich, if GRIP is scarce, save it for individuals
- If only one class of shares issued, you can look to redeem shares (not used as often) to designate and allocable eligible dividend to chosen individuals

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Common Mistakes to Avoid - CDA

- ABIL should be deducted from CDA
- 100% of capital gain on donation of public stock added to CDA
- Gain on disposal of life insurance policy (except on death) not capital gain no CDA addition
- Overpayment can be elected as taxable dividend

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Remuneration
Business Owners

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Non-Active Business Income

- Bonus to active owner, no problem with deduction
- Investments – avoid bonuses as shareholder not active, not deductible

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Salaries Considerations

- SRED no longer a factor (used to bonus income to $500,000)
- Maximize RRSP contribution, pay enough bonus in prior year to make maximum RRSP contribution
- Tax deferral up to 180 days (it is less than six months), pay late not deductible until next year
- Cost of not bonusing is minimal

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Salaries Considerations *(Continued)*

- Deferral of personal tax if funds left in the corporation
- Retained earnings becoming capital gain on death (postpone tax and tax rate at 26.5% is lower than on a dividend @ 39% or 47%)
- Pipeline strategy for ultimate capital gain strategy

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Ineligible Dividends

- Does not eliminate AMT
- Triggers dividend refund
- TOSI sensitive
- Offsets CNIL and debit balances

Eligible Dividends

- Especially good result in taxable income under $150k
- Triggers dividend refund only in ERDTOH
- TOSI and AMT sensitive
- Offsets CNIL and debit balances

CDA

- Tax-free and always pay out
- Not TOSI sensitive
- Effective against debit balances
- Offsets CNIL

Interest on Shareholder Loan

- Must have legal obligation to pay interest or not deductible
- Reasonable interest rate
- Effective for CNIL and AMT
- Be careful of income attribution on loan gifted to spouse

Capital Gain

- Lower tax but it could be aggressive
- CDA not TOSI sensitive

Summary

- Pay eligible dividends if the taxpayer is not a very low rate taxpayer
- Capital gain strategies
- Income split subject to TOSI
- If RDTOH and active sources, trigger RDTOH by dividend

Capital Gain Strategies

Internal share re-organization	Holdco exchanges shares for separate classes (Section 85) and triggers a capital gain and pays out CDA and taxable dividends.
Drop down of shares / assets	To subsidiary (Aggressive but no specific anti-avoidance rules, some GAAR risk).
Pipeline	Capital gain personally high ACB and transfer into a corporation (CG at personal level). Post-mortem plan ok (as per CRA if paid over say 3 years). Risk of dividend result if part of capital gains strip.
Deemed capital gain	Spousal rollover not to apply, 21 year rule for trusts, gifts to children, can use for creating capital gain, then pipeline but caution.
Acquisition of control election	Real acquisition or artificial (Anti avoidance rules for losses but not for gains). Aggressive strategy to create capital gains.

Structures - Analysis

- **Creditor Proofing Structure:** Dividend from Opco to Holdco and loan back dividend to Opco for security interest. **Issues:** TOSI exception not available and qualifying for CGE is problem.
- **PC:** Loan to Investco and avoid personal tax on withdrawing funds. **Issues:** Passive income rule will be triggered and associated for passive income grind.
- **Non-CCPC:** Create non-CCPC by issuing voting preferred shares to Fco.
- **CGE:** Holdco has excess investments or owns multiple companies, won't be able to claim CGE – Butterfly structure (Transaction won't be tax free if done before contemplation of a sale).
- **TOSI:** Excluded shares blocked by Holdco, so trigger an amalgamation to form Amalco, freeze Opco and issue new shares to shareholders to meet TOSI exemption.
- **Trust Sandwich:** Switch remuneration from salary to dividend and pay out excess funds to a corporation which is beneficiary of a family trust (Part IV tax not applicable if common control) and now Opco shares continue to qualify for CGE.

Income Splitting

➢ **Spouse / Common-Law Partner**

- Income and capital gains attribute
- N/A if transferor is deceased or non-resident or spouse separated
- Attribution avoided by prescribed rate loan, FMV transfer, or freeze

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Income Splitting

➢ **Non-Arm's Length Children**

- Income attribution back to the contributor (no attribution on capital gains)
- Ceases when transferee turns 18
- Attribution avoided by prescribed rate loan
- Parents, grandparents, siblings, cousins no attribution

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Income Splitting

➢ Trust If Reversionary

- The income will attribute income to the person to whom the income will revert to transferor – Section 75(2)
- No tax-free rollover to beneficiaries
- Contribution is beneficiary of a trust, or contributor is trustee of a trust (sole or 1 of 2)
- Have 3 trustees, contributor not a beneficiary, FMV sale to the trust or contribution by prescribed rate loan

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Income Splitting *(Continued)*

➢ Corporate Attribution

- Imputation of income to preferred shareholder (if children under 18 or spouse are beneficiaries of the trust)
- Applies if the corporation is not an SBC
- Exceptions apply (clause in trust deed for children under 18, spouse not to benefit)

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Income Splitting *(Continued)*

- **Interest Free Loan**
  - Interest free loan, income from the loan proceeds attributes to non-arm's length lender
  - Applies to non-residents as well
  - Income earned on the proceeds of the loan attributes (Does not apply to capital gains)

TOSI

- Applies to all sources of income from private companies unless salary or excluded
- Husband pays interest on loan spouse and earns business income (proprietor). Interest income not be subject to TOSI
- TOSI rules – ages at various levels, related business definition, excluded business, excluded share

TOSI *(Continued)*

- Real Estate Co-tenancy – Partnership will be related business, but a co-tenancy for real estate is exempt. Co-tenancy income, gains not listed as TOSI.
- Partnerships – Related business for related partners and no minimum % rule (problem)
- Excluded business and excluded shares definitions

TOSI *(Continued)*

- Investco that earns property income that constitutes a business qualifies for excluded shares (probably)
- Excluded shares definition targets professionals and services businesses. Holding via trusts won't qualify for excluded shares exception from TOSI as it requires direct shareholdings of 10% or more of voting and FMV

TOSI *(Continued)*

- Holding companies are problematic for TOSI
- No donation tax credit against TOSI
- No capital losses or net capital loss carryover do not offset capital gains that are considered to be TOSI
- Expenses allowed in determining net rental and business income for TOSI, otherwise no deductions
- No TOSI on income retained in a trust

TOSI Planning

Examples

Real estate corporation with rental (Three individuals who are related)	Not subject to TOSI even if not actively involved, excluded shares
Partnership	Tax-free dissolution and make it a real estate co-tenancy (but be careful not still a partnership)
Service Opco	Need >10% from non-service business revenue for excluded shares
Opco and Holdco	Drop down structure freeze (Freeze and new common shares to family members) for excluded shares
Two share classes	A is active, but B is not. Issue 2 class shares and only pay dividends to active family member

TOSI Planning *(Continued)*

Examples

Become active	Work at least 20 years a week, keep time sheets
Non-resident	Ownership exempt of TOSI
Management company widely held	No shareholder has 10%, no TOSI
Timing of planning	Offside in 2021, not excluded share for 2022. Meaning planning for 2021 to qualify for 2023
Use of Trust	Set up a spousal trust / transfers shares to the trust. Then the sale happens and capital gains taxed in the trust. No TOSI
Sale of shares to Pubco	TOSI exempt if rolled into Pubco for shares under Section 85
Inheritance	Under 25 rule, age 25 rule (golden share)
Preferred beneficiary election	Income allocated to PB not subject to TOSI if not designated as dividend.

Summary
Strategies to Minimize TOSI Impact

- Pay out CDA by triggering capital gains at corporate level (Trust Sandwich Structure). No TOSI on CDA
- Reasonable amount for person not substantially active. Biggest income splitting benefit is for small amounts
- Personal capital gains on SBC shares
- Use non-TOSI income to split

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Summary
Strategies to Minimize TOSI Impact
(Continued)

- Sell shareholder loan for prescribed rate loan (1%) and pay interest @ 7% (the spread is 6%)
- Switch to salary (reasonable)
- Two classes of shares – taxable dividend to active member and capital dividends to non-active

Summary
Strategies to Minimize TOSI Impact
(Continued)

- Age 18 and under prescribed rate loans and investment assets (need to avoid normal attribution rules also)
- Age 18 to 24 no related business plan
- Age 25 (excluded shares)
- Age 65 and active or excluded shares, other spouse no TOSI