Debit Balances

December 17, 2021

© C/A Professional Seminars 2021

1

1

Donations in Corporation Public Company Stock

- Donations are deductible to corporation, and not as a tax credit
- Unused donations can be carried forward five years
- Donation deduction limited to 75% of net income
- Plus 25% of taxable capital gains on gifts of property
- No capital gain on donation of publically traded shares and gain is 100% CDA addition
- Donation of public flow-through shares, now capital gain on portion of deductions taken, even if donated

© C/A Professional Seminars 2021

Charitable donations made by a corporation result in a tax deduction rather than a tax credit. The value of the deduction is based on the corporate tax rate.

Donations of public company stock give rise to a nil capital gains inclusion rate. In a corporation, <u>100% of the capital gain is added to the CDA.</u>

The question which is posed is whether a donation of public company stock is more advantageous through a corporation than personally?

If done through a corporation, a tax deduction is given for the amount of the donation, and 100% of the capital gain is added to the capital dividend account. This can produce a larger benefit than if the donation was made personally.

Donation Alternatives

Public company shares (assume all value is gain)

Roll Shares into Corporation, Then Donate

Personal tax on shares rolled in and take back shares of corporation is nil.

Corporate Donation		**Low Rate ABI**	**High Rate ABI**	**Investment Income**
Donation Amount		100.00	100.00	100.00
Corporate Tax Saved	A	12.20	26.50	19.50
Funds Available for Distribution (Capital Dividend Account)		100.00	100.00	100.00
Personal Tax Saved on Dividend	B	47.74	39.34	47.74
Total Tax Saved	A+B	59.94	65.84	67.24
If personal		50.40	50.40	50.40

© C/A Professional Seminars 2021

These figures illustrate the tax savings from making a donation of public company shares in a Canadian corporation versus personally. The difference is significant.

If an individual has public company shares held personally which he or she wishes to donate, they can be transferred to a corporation on a rollover basis, and then donated.

For high rate income, the value of the strategy is approximately 65% of the amount donated. When the capital gain otherwise payable is taken into account, at approximately 25% to 26.5% (corporate or personal), this gives tax relief of approximately 90% to 92%. This means that the donation strategy will cost 8% to 10%. For persons wishing to make large donations, and who have funds “trapped” in their corporate structure that they would like to remove, there has never been a better time to carry out a donation strategy.

Share Donation in Corporation

- Maximum benefit of corporate donation when funds/retained earnings available to take out as CDA, and need or desire to do so
- Need to have sufficient income to fully utilize the donation (75% limitation)
- Donation in corporation erodes NERDTOH by reducing Part I tax
- Donate public company shares with highest gain to valve ratio. Gets maximum CDA addition.

© C/A Professional Seminars 2021

In carrying out this strategy, there are certain points which should be noted.

It is presumed that the corporation will not have a notionally negative balance in its capital dividend account (from previously incurred capital losses). Otherwise, the ability to pay out the non-taxable gain tax-free as a capital dividend will be limited.

Donations are subject to a limitation of 75% of net income. A large donation may not be able to be fully utilized in the year it is made. A five-year carryforward is available.

The best way for the donation to be taken is against high rate income subject to the 26.5% tax rate. If taken against income subject to NERDTOH, note that the donation deduction may erode the amount eligible for NERDTOH, because one of the limitations for accumulation of NERDTOH is tied to the amount of Part I tax paid.

In all, the strategy must be carefully evaluated because things can go wrong with the plan if not carefully considered.

15(2) General Rule

- Loan from corporation to shareholder
- Loan is outstanding more than one year from year-end of corporation in which loan is made
- Loan is then treated as income to the shareholder in the year the loan made
- Deduction available to shareholder when repaid

© C/A Professional Seminars 2021

In owner-manager tax practice, nothing is more troubling than loans between a corporation and a shareholder. These loans or indebtedness, often called a debit shareholder balance, result in an inclusion in income of the shareholder if not repaid within one year of the year-end of the corporation in which the loan is made. The income is fully taxable as regular income. In other words, it does not result in a dividend which would be taxed at a lower rate. It is included in the income of the shareholder in the year in which the loan is made.

A deduction is given when the loan is repaid.

Although there may be no income inclusion overall, because a deduction is given in a later year, there may still be a substantial tax cost when the tax on an overall basis is considered. A large income inclusion in one year may push the individual into higher tax brackets. The deduction may result in unused dividend tax credit, loss of the ability to claim personal exemptions, and so on.

15(2) Observations

- Loan or indebtedness
  - Includes all debt
  - Includes sale at FMV
  - Does not matter if interest-free or not
- Short year-end of corporation (in year loan made)
  - Advances repayment deadline
- Applies to shareholder or person connected
  - 10% test
  - Non-arm's length test
- Applies to all corporations, Canadian and foreign

© C/A PROFESSIONAL SEMINARS 2021

There are many misconceptions about shareholder loans, and how a debit balance is treated.

Firstly, the rule applies to all types of indebtedness. For example, if the indebtedness arose from the sale of a corporate asset at fair market value to the shareholder, this does not exempt the loan from this rule. In addition, it does not matter whether interest is charged or not on the loan.

The rule applies only to shareholders who hold more than 10% of the shares of the corporation, or persons who deal non-arm's length with such a shareholder. The rule is not limited to Canadian corporations, and applies to all corporations, Canadian and foreign.

If a corporation has a short taxation year, in the year the loan is made, then this can accelerate the time at which repayment must be made. For example, suppose that a corporation typically has a December 31st year-end, so that a debit balance must be repaid by December 31st of the following year. However, the corporation had a deemed year-end from an acquisition of control, say on May 31st of the first year. This means that the loan must be repaid by May 31st of the following year.

15(2) Exceptions

- Loan "qua employee" to buy stock of corporation from treasury, car for employment duties, a dwelling, or under normal business operations (e.g., bank) if reasonable repayment terms
- Imputed interest benefit (if it's a low-interest loan)
- Very risky for major shareholder and family

© C/A Professional Seminars 2021

There are exceptions that exclude from income certain shareholder loans. For these exceptions to apply, three conditions must be met which are:

1. The loan must be made by virtue of the person being an employee, and not because the person is a shareholder.
2. The loan must be made for a specific listed purpose being one of the following:
   - (i) To purchase treasury shares from the corporation to be held personally by the shareholder
   - (ii) To purchase a car for use in employment related duties
   - (iii) To purchase a home
   - (iv) A loan made in the normal course of business where the corporation is in the business of making loans
3. The loan must have a provision for bona fide repayment within a reasonable period of time and must be repaid according to these conditions.

In most owner-manager situations, it will be difficult to support that a loan is made by virtue of the person being an employee. Accordingly, we do not recommend that these types of loans be made to a significant shareholder, unless similar arrangements are made for other employees and even then it is open for CRA to argue that the loan is not made to the particular shareholder by virtue of employment. Accordingly, it is dangerous to rely on this exception and we do not recommend this strategy. If the loan does meet these expectations, or if the loan is repaid within one year, an imputed benefit can be calculated if the loan is at less than the prescribed rate of interest. The imputed interest benefit is deemed to be interest paid pursuant to a legal obligation, and if the proceeds of the loan are used by the shareholder for an income earning purpose (such as investment), then a deduction can be taken for the imputed interest benefit. The income inclusion is considered to be employment income, and the deduction is allowed as a carrying charge deductible from investment income.

In our experience, there are many situations where the imputed interest benefit is ignored and not reported on a T4. This is a common area where CRA will audit.

15(1) vs. 15(2)

- 15(1) – property of corporation appropriated to or for benefit of shareholder
- Income inclusion at the time, no repayment period, no deduction on repayment, no corporate deduction
- For indebtedness, 15(2) usually applies, not 15(1)
- Applies to cash taken, assets bought at below FMV, expenses not legitimate etc.

© C/A Professional Seminars 2021

Cadesky Tax
Experience. Excellence. Delivered.

A separate provision applies where property of a corporation is appropriated to or for the benefit of a shareholder. Under this provision (subsection 15(1)) the amount which appropriated is included in the income of the shareholder. No deduction can be taken when the amount is repaid, because the amount is not a loan.

This provision is normally applied where a transaction is not in the nature of a loan of indebtedness. For example, cash taken out of the business which is not reported would be considered an appropriation. CRA frequently uses this provision to tax the shareholder on personal expenses put through a corporation. If an asset of a corporation is purchased for less than fair market value, this provision can be applied to tax the difference between what was paid and fair market value.

Where income is assessed under subsection 15(1), it is common for CRA to apply a 50% gross negligence penalty as well.

Where there is an appropriation of property to or for the benefit of a shareholder, double taxation arises because the amount will not be deductible to the corporation, and yet will be included in income of the shareholder. The amount is not considered a dividend, and is fully taxable as ordinary income.

Issues of Repayment

- “Repaid within one year of year-end of corporation” and not part of a series of loans and repayments
- Otherwise, loan is included in personal income in the year the loan is made
- If loan repaid where 15(2) benefit is assessed, deduction is available in the year repaid
- Various issues arise, some unanswered

© C/A Professional Seminars 2021

A loan to a shareholder must be repaid within one year of the end of the year of the corporation, and not be part of a series of loans and repayments. Sometimes an individual will inject money into the corporation to repay an outstanding loan shortly before year end and then borrow the money again after the year end, so that the amount does not show up at year end. This is the most blatant example of a series of loans and repayments. Basically the repayment is ignored in this circumstance.

CRA also takes the position that if a debit balance is cleared in a bona fide way at year end, and in the next year the shareholder draws an amount from the corporation, this will not be a series of loans and repayments. So for example assume that a shareholder draws $20,000 from the corporation monthly and at the end of the year owes the corporation $240,000. A dividend of $240,000 is declared and paid (possibly by journal entry) to offset the debit balance at year end. In this circumstance CRA will not normally apply subsection 15(2).

Various issues arise with respect to loans and repayments which are outlined in the slides that follow. There are some uncertainties in the application of these rules which are noted.

1. Repayment by Journal Entry

- CRA accepts journal entry if not backdated (effective dated?)
- *Prévost* case supports this

© C/A Professional Seminars 2021

CRA accepts an offset of a shareholder loan by way of journal entry. This is supported by Case Law, and also CRA's published assessing position. However, the journal entry must be effective as of the end of the year, and not at some future date. If the offset is by way of a dividend paid to the shareholder, the dividend must be paid (not payable) as at year end. Accordingly, the directors' resolution authorizing the dividend must be "effective" as of that date.

In practice, CRA allows a certain degree of latitude in owner-manager remuneration planning, and normally does not question the date on which a directors' meeting was held, or the date of which a dividend payment was supposedly made by journal entry and offset. That said, the transaction giving rise to the offset of the debit balance should be legally effective and properly documented and consummated by the end of the year, and not at some subsequent date.

Many people regard the ultimate deadline as being the date when T5 slips must be prepared and even then, some people will prepare amended or late filed T5 slips and use the amount shown as a dividend to offset the shareholder debit balance. We do not support this approach. Accordingly, owner-manager remuneration should be planned and the strategy put in place before the end of the year of the corporation, and not at some future date when the books and records are being written up, financial statements are being prepared and the corporate tax return is being drafted. There are, however, practical difficulties which are noted.

2. Repayment by Bonus Accrual

- No offset until payment
- Bonus accrued at year-end, paid later (180 days after year-end), is not paid at year-end
- No offset of accrued bonus by journal entry at year end. Can offset bonus, net of source deductions, when paid.
- Per CRA, evidence of payment of bonus timely remittance of source deductions.

© C/A Professional Seminars 2021

Cadesky Tax
Experience. Excellence. Delivered.

There is a widespread belief that a bonus which is accrued at year end can be used to offset a shareholder loan debit balance. This is not correct. If a bonus is accrued at year end, to be paid later, say up to 180 days after year end, so that it is taxed in the hands of the individual perhaps in the following calendar year, it is a payable at the end of the year, and not a payment. As a payable, it cannot be used to offset a shareholder loan receivable.

If a shareholder loan debit balance is to be offset by a bonus, then the bonus must be paid by year end. The best support for the timing of the payment is the remittance of source deductions in the following month by the due date.

Suppose that a corporation has a July year end. At the year end, the shareholder owes an amount to the corporation. A bonus is accrued at July 31, and paid in January of the following year. This will not clear the debit balance at year end.

3. Repayment by Offset of Debt

- Shareholder A has debit balance
- Shareholder B has credit balance
- Can you offset?
- Yes, provided documented evidence that shareholders have offset the amounts

© C/A Professional Seminars 2021

Cadesky Tax
Experience. Excellence. Delivered.

Sometimes one shareholder may have a debit balance and another shareholder has a credit balance. The question is whether they can be netted or offset.

There is no authority to offset debit balances and credit balances for different shareholders. Even if the persons are closely related (for example spouses) specific steps must be taken for an offset. The normal way would be for the shareholder with a credit balance to transfer this amount (possibly by way of gift) to the shareholder with a debit balance, and then for an offset to be effected, possibly through a journal entry. There should be some evidence of the gift by the one shareholder to the other, such as a deed of gift or failing that at least a note of some sort.

Having a notation in the accountant's working papers without any external support, or simply a journal entry, may be insufficient for CRA.

4. Repayment by Offset of Debt

- Shareholder, has loan receivable and loan payable, do they net?
- Probably <u>not</u>, unless evidence of action to net
- Adverse position supported by case law

© C/A Professional Seminars 2021

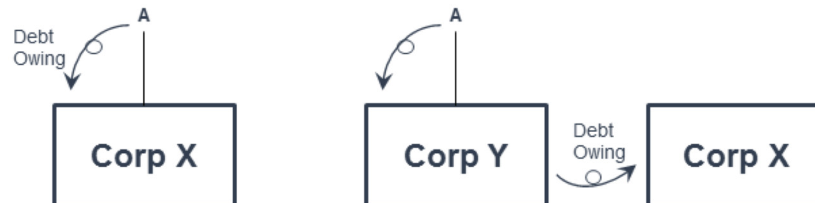
Suppose a shareholder has 2 loan accounts, and one is in a debit balance and the other is in a credit balance. The question is do they offset.

Case law suggests that there is not an automatic offset. In one situation, the amount receivable from the shareholder was shown as an asset on the financial statements and the amount payable to the shareholder was shown as a liability. Accordingly the financial statements did not show that the amounts were netted. CRA took the position that there was no repayment, and the court agreed.

© C/A Professional Seminars 2021

5. Debt Assumed by Another Corporation

- Shareholder A has debt from Corporation X
- Shareholder arranges debt to be assumed by Corporation Y



- Is this a new loan, new time period, now one year from year-end of Corporation Y?
- Answer – no, probably not

© C/A Professional Seminars 2021

CADESKY TAX
EXPERIENCE. EXCELLENCE. DELIVERED.

Some people will try to extend the deadline for repayment of a shareholder loan debit balance by assigning the loan to another corporation. In this example, shareholder A owes money to corporation X. in order to get more time to repay the loan corporation Y assumes the loan to corporation X so that the shareholder A now owes the loan to corporation Y. The idea is that this is a new loan, subject to a new period for repayment.

The problem with this approach is the loan to corporation X remains outstanding, even though it is owed to corporation X by someone other than shareholder A. We do not recommend this strategy.

© C/A Professional Seminars 2021

5. Debt Assumed by Another Corporation

- Debt not repaid to Corporation X as it is still outstanding
- Debt is assigned to different person
- Case law says 15(2) applies
- Unclear as to which time frame governs (Y/E of Corporation X, Y/E of Corporation Y, or period starts over)
- Most conservative position is Y/E of Corporation X

© C/A Professional Seminars 2021

Continuing on from this example, the question becomes whether the time for repayment is the year end of corporation X or the year end of corporation Y, if that happens to be later. In our view, it is the year end of corporation X which governs and not the year end of corporation Y.

This is a dangerous strategy to carry out and we do not recommend it.

6. Debt in Foreign Currency

- Shareholder draws funds in U.S. dollars
- Loan calls for repayment in U.S. dollars
- How to calculate loan amount and repayment for SS15(2)?
- If fully repaid in U.S. dollars, no issue
- If partially repaid, look at balance outstanding at original exchange rate
- Borrow US$100, repay US$90, outstanding is US$10. Income is US$10 at exchange rate when loan taken out

© C/A Professional Seminars 2021

It is quite common for a shareholder to draw money from the corporation in foreign currency, for example U.S. dollars. Suppose that the foreign exchange rate fluctuates, the question becomes what is the amount that needs to be repaid.

Clearly if the loan is denominated in U.S. dollars and the full amount is repaid in U.S. dollars, then no amount remains outstanding, and therefore the loan can be said to be repaid in full. Otherwise, if the loan is denominated in U.S. dollars, and it is repaid in Canadian dollars, it is our view that the amount of repayment must be the U.S. equivalent at the time the loan was taken out. If not, then a balance of the loan will remain outstanding.

Borrowing and repaying funds in a foreign currency can give rise to capital gains and capital losses to the shareholder and to the corporation (generally in offsetting amounts). In order to avoid this, if a shareholder does borrow funds in a foreign currency, the loan repayable to the corporation should be stated in Canadian currency using the exchange rate at the time the funds are taken, in order to prevent foreign exchange gains and losses from arising.

7. Statute-Barred

- Per CRA, 15(2) income inclusion, may not be statute-barred as failure to report is “misrepresentation attributable to carelessness, neglect or willful default”
- Generally cases support CRA
- Penalties often applied

© C/A Professional Seminars 2021

It is not uncommon in practice to see shareholder loans outstanding for a long period of time, say several years. The taxation year of the individual in which the loan was taken may be beyond the three year assessment period. Accordingly, sometimes an argument is advanced to CRA that the taxation year is statute barred and although the amount perhaps should have been reported as income with the shareholder, it is too late for CRA to reassess.

CRA takes the position that a debit balance to be included in the income of the shareholder is generally not statute barred because the inaccuracy in the personal tax return of the shareholder is due to a misrepresentation which is attributable to carelessness, neglect or willful default. As a result, the three year statute of limitations dos not apply. CRA will often assess a gross negligence penalty as well, in order to further reinforce their view that the taxation year is not statute barred. Although the threshold for the 50% penalty (being gross negligence) is much higher than carelessness or neglect it is normally CRA practice to assess the penalty and it will be up to the taxpayer to appeal this and try to get reversed.

8. Re-characterize Income

- Can you argue 15(2) loan inclusion is dividend (taxed at lower rates) or bonus (deductible to company)?
- Answer – No

© C/A Professional Seminars 2021

If one can argue that the income inclusion is actually a dividend, and not regular income, then the personal tax would obviously be reduced. We are aware that various creative arguments have been advanced to CRA and it is clear that CRA will not accept a simple re-characterization of the shareholder loan debit balance as a dividend. They will also not accept a re-characterization as a bonus, management fee, or reduction of paid up capital.

9. Death of Shareholder

- Income inclusion eliminated if repaid by one year from year-end of lender
- Does not matter if borrower deceased (repaid by estate) or by someone else, per CRA admin position

© C/A Professional Seminars 2021

If the shareholder dies with a shareholder debit balance (which is not uncommon), the question arises as to who and how to make the repayment.

On a strict reading of the provisions, the shareholder would never have repaid the loan, even if his or her estate actually makes the repayment. However, CRA takes the position that if the estate makes the repayment within the required time, this will be accepted as repayment by the original shareholder.

© C/A Professional Seminars 2021

10. Timing of Income Inclusion

- Income to shareholder in year loan is made
- May need to amend past filings
- No place to put on T-4 / T-5 / T-4A
- Repayment gives deduction in year repaid

© C/A Professional Seminars 2021

Where a loan is not repaid within one year of the year end of the corporation in which the loan is made, it is included in the income of the shareholder for the calendar year in which the loan is taken.

For example, suppose that a corporation has a July 31st year end. A debit balance is outstanding. The deadline for repayment is 12 months after the July 31st year end, regardless of whether the corporation has a short taxation year or not. In other words, it is by July 31st of the following year. Put another way, it must be repaid within a 12 month period, and not within one taxation year.

Where a shareholder load is taxable, it should be reported on the tax return as other income, there is no place on a T4 or a T5 to put the amount. Where the tax return has already been filed, and it is later determined that the amount must be included in income, a T1 adjustment should be sent in to amend the tax return.

11. Errors in Records

- Records show debit balance but not correct or records show credit balance that is too large
- CRA position
  - Debit balance is right unless proven wrong, so taxable
  - Credit balance too large in error (shareholder could have taken funds without tax), so taxable
- CRA likely correct on debit balance, case law supports taxpayer on credit balance (see Chopp [95] DTC 527 and Lee [99] DTC 636 cases) if inadvertent and funds not taken

© C/A Professional Seminars 2021

It is not uncommon for there to be errors in the calculation of a shareholder loan account. A body of case law has developed as to whether such errors give rise to an inclusion to the income of the shareholder. For example, suppose that a shareholder loan is believed to be in a credit balance. The credit balance is too large. Suppose that CRA audits the corporation and determines that the shareholder loan account is say $300,000 too high, but still a credit balance.

CRA's position is often that the amount should be included in income because if it was not discovered the shareholder would be able to simply take this amount and not pay tax on it. However, the case law generally says otherwise, because an overstated shareholder loan credit balance does not actually result in funds taken out by the shareholder. The case law is not complexly clear, and CRA may resist these arguments.

Where the shareholder loan account is wrong, and ultimately determined to be in a debit balance, CRA will proceed with assessing the amount of the debit balance as income to the shareholder.

12. How to Get Rid of Debit Balance

- Repayment within one year of year-end of corporation
- Transfer assets to corporation
- Repatriate arm's length ACB (pipeline)
- Creative offsets net debits/credits (look at group overall)
- Capital dividend account (on hand or create)

© C/A Professional Seminars 2021

Much of owner-manager remuneration is devoted to getting rid of a shareholder debit balance by some form of offset or repayment. Here are some further comments on ways to create an offset.

Aside from remuneration (dividends, bonuses, etc. with an effective date of payment at or before the corporation's year end being within one year of the corporation in which the loan is made), there are certain other ways to effect payment. Four of these ways are:

1. Transfer assets to the corporation
2. Use the adjusted cost base of the shares to create a sequence of transactions which result in a note payable which can then be offset
3. Offset debits and credits within a corporate group where there is a debit shareholder loan and credit balance in some other entity
4. Pay a capital dividend if there is a capital dividend account on hand or create a transaction that gives rise to a capital dividend account and then pay a capital dividend.

12. How to Get Rid of Debit Balance

- Reduce personal cash needs (pay permissible amounts with corporate funds, e.g. move personal life insurance to corporation)
- PUC reduction resulting in capital gain (high PUC, low ACB) or tax-free (high PUC, high ACB)
- Taxable dividend paid (especially if generates dividend refund)
- Bonus net of source deductions

© C/A Professional Seminars 2021

23

Other alternatives include finding ways to reduce personal cash needs, a reduction of paid up capital or the traditional ways of paying a taxable dividend or a bonus net of source deductions.

It may be possible for a corporation to assume certain expenditures of the shareholder. For example, a life insurance policy could be transferred to the corporation with the corporation being the owner and beneficiary of the policy. Then the life insurance premiums can be paid by the corporation. Although these premiums will not necessarily be deductible to the corporation, it does reduce the amount which the shareholder needs to take from the corporation.

Where shares have a high paid up capital, it may be possible to reduce the paid up capital and create a credit balance which can then be offset. If the shares have high PUC and a low ACB, a capital gain will arise. If the shares have high PUC and a high ACB, the payment may be tax-free.

Effectiveness of Payment

• Salary	47%
• Dividend	52% - 61%
• Capital Gain	73%
• CDA	100%

© C/A Professional Seminars 2021

It is interesting to consider the effectiveness of various strategies in offsetting a shareholder loan debit balance.

At the top tax bracket, a salary will yield approximately 47% as an offset. Personal tax of 53% will be paid, and deducted as source deductions.

A dividend can yield a 100% offset, because there are no source deductions or withholdings on a dividend payment. However, the shareholder will have a tax liability for the personal tax on the dividend. This can result in a timing difference, because the tax on the dividend will not be due until the personal tax return is filed (although it may affect instalment requirements). However, whenever this tax is taken into account, the after tax amount will be 52% to 61% of the amount of the dividend (ineligible or eligible).

If the offset is effected by way of a capital gain, then approximately 27% tax should be reserved. This means that the capital gain produces an offset at the rate of approximately 73%.

Because a capital dividend is not taxable, it can produce an offset of 100% of the amount.

Transfer in Illiquid Assets

- John can take back a note payable up to the cost base of the real estate (assumed capital property)
- The note payable can be used to offset a debit balance
- Land transfer tax payable (probably in Ontario)
- At what value would you transfer the real estate?
- Do you create capital gain?

© C/A Professional Seminars 2021

In this example, John, the shareholder, has a debit balance owing to Opco. He does not have the funds to repay this debit balance, and instead transfers real estate to the corporation creating a note payable.

If John does not wish to have a capital gain personally, then the real estate will be transferred on a rollover basis electing at $100,000. However, John could consider transferring the real estate at a value of $200,000, creating a capital gain of $100,000. He could then remove $200,000 from the corporation, or use $200,000 to offset a debit balance.

Note that land transfer tax may be payable in a transaction such as this. Also note that personal use property (a home, cottage, Florida condominium, etc.) should not be used for this purpose.

© C/A Professional Seminars 2021

Repatriate ACB

John purchased 40% of Opco at arm's length for $120,000. There are 100 common shares outstanding and the PUC is $100.

What can John do?

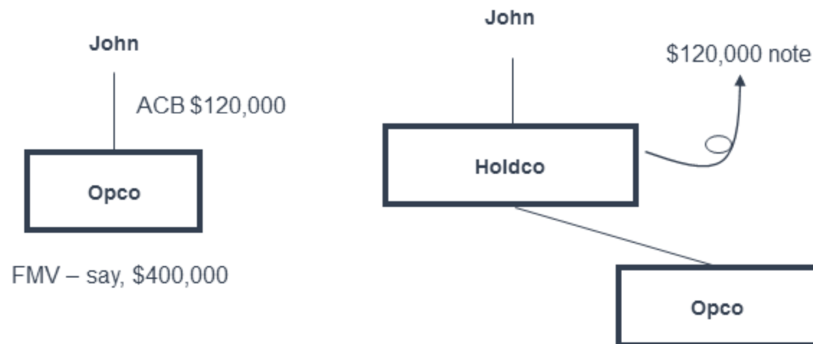
© C/A Professional Seminars 2021

26

In the next example John purchased 40% of Opco from an arm's length person for $120,000. Because John has a high adjusted cost base on the shares, he may be able to use this adjusted cost base to create a shareholder credit balance which can then be offset. This can be seen in the next slide.

© C/A Professional Seminars 2021

Repatriate ACB



- Roll to Holdco for note of $120,000 and shares
- Dividend to Holdco
- Repay note payable to John tax-free

© C/A Professional Seminars 2021

In this example, John transfers his Opco shares to Holdco and takes back a promissory note for the adjusted cost base of $120,0000. Opco then pays a dividend to Holdco, and the promissory note is repaid. Alternatively, the promissory could simply offset a debt balance.

In these types of transactions, care must be taken because a provision can deem the note payable to be a dividend, assessed personally to John, which defeats the purpose.

Specialized advice should be taken in carrying out these types of "pipeline" transactions.

House / Cottage in Corporation

- Becoming more common strategy
- Pay FMV next to corporation or taxable benefit
- Lose principal residence exemption
- CRA may view as aggressive
- Last resort strategy?

© C/A Professional Seminars 2021

CADESKY TAX
EXPERIENCE. EXCELLENCE. DELIVERED.

High personal tax rates (especially on dividends) and now the inability to income split has led to buying personal use real estate in a corporation and renting. People are doing this with cottages and even their main residence.

If FMV rent is paid, it is likely that CRA cannot assess a taxable benefit. But don't expect CRA to like this. Also note loss of principal residence exemption.