SUMMER 2017

THE Quarterly Dividend

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Your guide to income tax & financial planning

Should You Take a Salary and Pay into CPP?

Many owner/managers have been told conflicting "stories" by their advisors and their colleagues about how they should draw out funds from their companies on the most "tax efficient" basis. They know that since the corporate tax rate is 15% and personal tax rates start at a minimum of 20% that the decision to go "all dividends" looks appealing. They also know that while contributions to the Canada Pension Plan made today will not be accessed for many years to come, this is one expenditure that can wait as they need the money now to grow their business and provide for their family.

So it is a real dilemma. What to do and who to ask for advice.

The answer may lie in whether you consider CPP contributions to be a "tax" or a form of saving for the future. The old adage of "if it talks like a duck, and looks like a duck, then it probably is a duck" can apply to CPP contributions. If the government takes the money assigned to CPP contributions through the income tax system, then CPP contributions look like a tax.

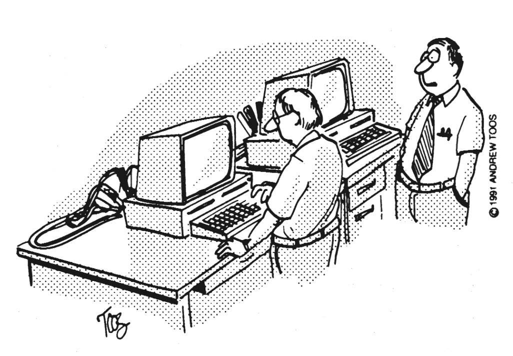
But if you look at CPP contributions as a form of "calculated" savings that will come in handy when it will be your turn to collect, then maybe contributing now for a "rainy day" does not look so bad.

Consider the analysis in the accompanying table. Our mythical entrepreneur has a business grossing $65354 per annum and expenses, not including salaries, of $10208. The decision to be made is how much remuneration should be drawn out of the company and in what form. Column (a) shows "all dividends", (b) shows maximum CPP contributions by the owner/manager and (c) and (d) show a mix between salaries and dividends.

Below each column is a breakdown of how much personal taxes, corporate taxes and CPP contributions that are required under the four scenarios. The final line shows the dollar amount differences that are reflected under the various options. The "all dividends" choice is the "cheapest" and the amounts due in excess of this value are shown when varying amounts of salary are taken.

It is important to note that if you do not subscribe to the notion that CPP contributions are a tax, the owner/manager is actually paying less personal and corporate tax by drawing a salary than if he did not. In other words, the extra amounts due in columns (b), (c) and (d) are significantly less than the amount than he is paying into CPP, and although he is giving the government more dollars today, the amount ear-marked for savings is greater than the additional amount he is required to pay.

It seems like a "no brainer" to at least take a mix of salary and dividends as an optimal form of remuneration. Even when the salary figure is really low, the extra $35 in payment to the government today will grow to something much larger down the road.



"If the jumper cables don't work, I'll pour in some more anti-freeze."

FAST TRACK

The CRA just doesn't give up

Real estate agents in Ontario are currently unable to arrange their business affairs so that they can earn their commissions through a corporation. This will likely be corrected in the near future and in anticipation of this change a few RE/MAX offices in the Toronto area gave their agents the option of "incorporating themselves" and having their commissions paid to a company controlled by the individual agents themselves.

This pilot program has worked out well from the agent's perspective as he/she can now

In this Issue:

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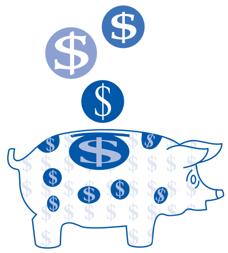


earn income that will be subject to the lower corporate tax rate of a Canadian Controlled Private Corporation versus the personal tax rate that was applicable before.

The only problem that arose was that the brokerage firm continued to issue T4A slips at the end of the year showing the agent's name and social insurance number rather than the name of the corporate entity that the agent had set up.

The Canada Revenue Agency seized upon this error and assessed individual agents as having earned their commissions as "self-employed" salespeople.

Some agents acquiesced to the wishes of the CRA and changed their tax returns from showing T4 employment income from their individual companies to the self-employed treatment dictated by the Agency.

Other agents chose to fight the CRA and argue that the T4A's had been issued in error and that the income was to be recognized through the corporation.

The only way to fight the CRA was for the agent to file his/her return showing the T4 from his corporation and have the CRA issue a Notice of Assessment denying the way the taxpayer had shown his earnings. The agency would then re-classify the income (without allowing any expenses) as self-employment income.

At this point the real estate agent would then file a Notice

		(a)	(b)	(c)	(d)
		$	$	$	$
Revenue		**65354**	**65354**	**65354**	**65354**
Expenses					
Operating costs		**10208**	**10208**	**10208**	**10208**
Mgmt salaries			**54900**	**25000**	**12500**
CPP Exp			**2544**	**1064**	**446**
		10208	**67652**	**36272**	**23154**
Inc/loss from operations		**55146**	**-2298**	**29082**	**42200**
Other inc (from HST)		**2298**	**2298**	**2298**	**2298**
Income for year bef inc taxes		**57444**	**NIL**	**31380**	**44498**
Provision for inc taxes		**8617**	**NIL**	**4706**	**6674**
Net income for year		**48827**	**NIL**	**26674**	**37824**
Dividends paid		**48827**		**26674**	**37824**
R/E beg and end of year		**NIL**	**NIL**	**NIL**	**NIL**
HST Quick Method					
collected	**8496**				
remitted	**6198**				
other inc	**2298**				
Personal inc tax		**2659**	**9774**	**5837**	**4191**
CPP contrib			**2544**	**1064**	**446**
Corp taxes		**8617**		**4706**	**6674**
		11276	**12318**	**11607**	**11311**
Difference		**-1042**	**n/a**	**-331**	**-35**

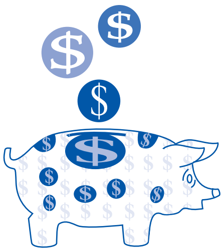
Commentary on The 2017 Federal Budget

The Trudeau government presented their second budget earlier this year, and while there is really very little of interest to the "average taxpayer" there are a couple of issues that readers of this newsletter may want to consider. They are:

(a) Review of Tax Planning Strategies

The government in the upcoming months will conduct a "review of tax planning strategies" involving the use of private corporations, specifically: (i) the time honoured tradition of allowing income to be earned through a corporation and then paid out to employees of these companies in any way that the directors of the corporation see fit. This has typically been the "hiring" of spouses and children above the age of eighteen and the payment of salaries to them so that family members earn incomes that take advantage of annual tax brackets and maximum Canada Pension Plan contribution limits; (ii) the holding of "passive" investments within an "active" company. When set up in this manner, investment income is taxed at the lowest corporate rate due to the taking of the "small business deduction" which is intended to be only available to companies engaged in activities such as consulting, manufacturing, etc; and (iii) converting a company's "regular" earnings that the company earns on an ongoing basis to "capital gains" to take advantage of their income inclusion at the preferential rate of 50%.

Each of these "planning strategies" has been around so long and subject to scrutiny over such an extended period of time that they are truly "non-issues" in 2017. Each of the points have always been subject to a "reasonableness test" that has been in the back of tax planners' minds since the beginning of time. The spreading of corporate earnings amongst family members, the manner in which corporate income is classified and the conversion of income to capital gains that is really only available when the owners decide to sell their shares, have all been addressed before and need not be specifically targeted by the government. The fact that they see the need to



of Objection pointing out the error and hopefully have his case reviewed by a sympathetic Appeals officer.

In some instances, the dollars involved were significant. One particular agent had originally filed her income tax return showing taxes payable of $16500. The CRA went after $185000.

When the time came for the appeal to be considered, the real estate agent explained the circumstances behind the "problem" and was rewarded with the CRA's view of the world being completely overturned.

But having lost at this stage, the CRA was not finished.

The way the CRA works, as soon as the Notice of Assessment asking the agent to come up with $185000 had been issued, the clock on interest on the unpaid balance began to start ticking. The longer the taxpayer refused to "budge" the more interest the CRA was going to realize until the agent eventually abandoned her position and paid the amount they wanted so that no more interest would be demanded.

Since the agent did not relent the interest on the $185000 tax bill kept growing and much to the surprise of the agent herself was never rescinded even after the CRA's position had been overturned and the taxpayer exonerated.

In fact, the CRA continues to add interest charges on a fictitious tax balance even until today.

look at them again only shows their complete inability to understand how small businesses work and are taxed.

(b) Associated Companies

A few months back the government lost an important case in court concerning the ability of corporations with the same sets of owners being able to access the "small business deduction". In the past it was assumed that as long as the directors of one corporation had legal control over the operations of a second company, the two entities were "associated" with each other and had to share the deduction. The Canada Revenue Agency extended the definition on its own accord and applied a second test where they took it upon themselves to decide if two companies were associated by considering whether the directors of one company had "factual" or "operational" control of the other. If so, the companies involved would have to share the deduction. When challenged in court the Agency was instructed that it could no longer apply the second test.

The government has reacted by changing the Act to allow it to continue to apply the law in the way it sees fit. They would rather re-write the legislation rather than comply with court rulings they do not like. If this philosophy continues, the ability of taxpayers to seek relief in court will be reduced substantially. What is the point of going to court, if even if successful, the government will only re-write the law to enact the same provisions you have correctly pointed out to be unfair and retroactively to boot!!

Taxable Benefits vs Input Tax Credits

From time to time the question arises whether the owner-manager of a business should (a) have the company purchase the automobile required for business purposes and "allow" him to drive the company car or (b) have the owner-manager own the vehicle out right and "charge" the company for the amount of kilometers he drives on their behalf.

The decision requires looking at several factors, particularly the amount of usage the owner-manager will be needing the car. For income tax purposes, the "cut-off" point is whether he needs the vehicle fifty percent or more of the time for business purposes or alternatively, drives the automobile fifty percent or more of the number of kilometers put on the car during the year.

Here is an example where the owner-manager uses the vehicle less than fifty percent of the time for business purposes (mostly because almost all owner-managers will tell you that is what happens in their business, as they downplay the amount of personal usage they really put on the car).

Scenario:

(a) Rebecca owns 100% of a corporation

(b) the car costs $33900; purchase price $30000 plus $3900 HST

(c) the car is expected to be owned for four years

(d) it will be driven 20000 km annually, 15000 km business, 5000 km personal

(e) the car costs $200/month in operating costs

Questions:

What is Rebecca's income tax position if (i) the company buys the car or (ii) she buys the car personally and has the company re-imburse her for expenditures incurred on behalf of the company

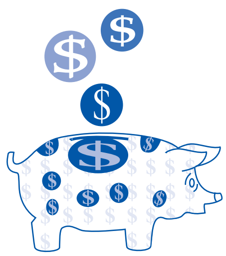
Rebecca Drives Company Car - Implications for Rebecca - Option (a)

The Numbers:

(i) Rebecca must pay income tax on the "taxable benefit" provided to her every year that the company owns the vehicle. It is calculated as (A) and (B) below:

(A) "reasonable standby charge" calculated as 2%/month x cost of car $33900 or $8136. However, this figure is reduced when the taxpayer drives the car less than 20000 km annually for "personal usage". Since Rebecca only puts on 5000 personal km, her calculation is 5000/20000 x $9492 or $2034, and

(B) "operating expense benefit" calculated as the lesser of $0.26/per personal km driven ($1300) or 50% of (A) above if Rebecca used the car more than half of the time for business purposes. Here, $2034 @ 50% or $1017 is appropriate.



When the Notice of Re-Assessment was issued by the Agency, it clearly showed the taxpayer's previous $16500 balance had been restored and recognized that it had long ago been paid. It also clearly showed that the interest that the CRA was still seeking now totalled more than $10000.

It has now fallen on the taxpayer to file a second Notice of Objection pointing out that interest cannot be charged on a tax balance that was $NIL. And even if a certain amount of interest had accrued while the Appeals process eventually allowed the agent to plead her case, now that she had won, all interest charges from day one should be reversed and the CRA could not go after her.

The Appeals case has been filed, and the Agency continues to ask for interest on an amount that has been thrown out. We will have to see what happens next and find out if the CRA having lost one case can successfully go after the taxpayer to try and make up for their loss.

Thanks for Your Referrals

We very much appreciate your referrals. If you know of someone who can benefit from the services we provide or who would like to receive our publication, please let us know. We will send them a copy with your compliments.

Under this scenario Rebecca's personal income taxes will increase $3402 on a present value basis over the four years of ownership (using a 3% interest rate).

		$
The PV of the reasonable standby charge is	**$2034 x 3.7171**	**7561**
The PV of the operating expense benefit is	**$1017 x 3.7171**	**3780**
		11341
Rebecca's marginal income tax rate		**0.30**
PV of Rebecca's additional income taxes over four years		**3402**

Rebecca Drives Her Own Car - Implications for The Company - Option (b)

The company paid $3900 in HST when it purchased the car, but cannot claim a full input tax credit as it is being driven only 75% of the time for business purposes. The amount that can be claimed each year is tied into the amount of capital cost allowance (CCA) that would have been available for an auto with at least 90% business usage multiplied by the actual business usage.

The accompanying chart shows the calculations for years one and two and the amounts for the following two years.

The total amount of input tax credits for the four years is $2294 (average $574/year) The total amount of capital cost allowance available for the four years is $17646 (average $4712/year).

The PV of input tax credits is $574 x 3.7171 or $2134. Company however had paid $3900 in HST. Net "loss" $1766.

The PV of the capital cost allowance is $17646/4 = 4412 x 3.7171 = $16400. The corporate tax rate is 15% so CCA tax savings over four years is $2460.

Scorecard:

(i) Rebecca's extra personal income taxes if she drives the company car are $3402. (ii) The company pays $3900 in HST but "gets back" ITC's of $2134. It also reduces its corporate income taxes by $2460. Total cost $694.

Option (b) is more tax effective by $2708.

	Year One	**$**		**Year Two**	**$**
Year of	**Purchase price**	**33900**	**Following**	**Purch price**	**33900**
acquisition:	**1/2 disallowed**	**-16950**	**year:**	**Input tax cred above**	**-496**
		16950			**33404**
	CCA rate	**30%**		**Prev year notional**	
	Notional CCA	**5085**		**CCA**	**-5085**
	Business usage	**75%**			**28319**
	CCA allowed	**3814**		**CCA rate**	**30%**
	HST rate	**0.13**		**Notional CCA**	**8496**
		496		**Business usage**	**75%**
				CCA allowed	**6372**
Year 3:	**CCA allowed**	**4273**		**HST Rate**	**0.13**
	Input tax cred	**556**		**HST**	**828**
Year 4:	**CCA allowed**	**3187**			
	Input tax cred	**414**			