In this issue

Year-end remuneration planning

An "advantage" received in the first year from TFSA swap transactions continued to produce an advantage in subsequent years

Publications and articles

Canada – TaxMatters@EY

December 2019

Asking better year-end tax planning questions[1]

Alan Roth, Toronto

Have you ever found yourself looking for tax savings while completing your tax return in April? If so, you've probably realized that at that point, there's not much you can do to reduce your balance owing or increase your refund balance. By the time you prepare your tax return, you're looking back and simply reporting on the year that has ended.

But don't worry. As we approach the end of the year, there's still some time left for forward-looking planning. You can approach year-end planning by asking yourself questions, going through a checklist, considering a framework or using all three methods.

Taking time out of your busy December to think about these questions can help you find better answers that may save you money on your 2019 tax bill and beyond:

[1] For more detail on topics such as personal tax for investors and for estate planning, see the latest version of *Managing Your Personal Taxes: A Canadian Perspective*.

TaxMatters@EY is a monthly Canadian bulletin that summarizes recent tax news, case developments, publications and more. For more information, please contact your EY advisor.

Are there any income-splitting techniques available to you?

You may be able to reduce your family's overall tax burden by taking advantage of differences in your family members' marginal income tax brackets using one or a combination of the following:

- **Income-splitting loans** – You can loan funds to a family member at the prescribed interest rate of 2% (for loans created in 2019). The family member can invest the money and the investment income will not be attributed to you (i.e., treated as your income for tax purposes), as long as the interest for each calendar year is paid no later than January 30 of the following year.
- **Reasonable salaries to family members** – If you have a business, consider employing your spouse or partner and/or your children to take advantage of income-splitting opportunities. Their salaries must be reasonable for the work they perform.[2] This planning may be more important than in the past, because other income splitting opportunities involving your business may be limited for 2018 and later years (see below re: income-splitting private corporation business earnings).
- **Spousal RRSPs** – In addition to splitting income in retirement years, spousal RRSPs may be used to split income before retirement. The higher-income spouse or partner can get the benefit of making contributions to a spousal plan at a high tax rate and, after a three-year non-contribution period, the lower- or no-income spouse can withdraw funds and pay little or no tax.

Have you paid your 2019 tax-deductible or tax-creditable expenses yet?

- **Tax-deductible expenses** – A variety of expenses, including interest and child-care costs, can only be claimed as deductions in a tax return if the amounts are paid by the end of the calendar year.
- **Expenditures that give rise to tax credits** – Charitable donations, political contributions, medical expenses and tuition fees must be paid in the year (or, in the case of medical expenses, in any 12-month period ending in the year) in order to be creditable.
- **Unused education or textbook tax credits from prior years** – These federal credits were eliminated effective January 1, 2017. However, any unused education and textbook tax credit amounts carried forward from years prior to 2017 remain available to be claimed in 2017 and subsequent years. Note that some provinces and territories still provide these credits.
- **Consider whether deductions or credits may be worth more to you this year or next year** – If you can control the timing of deductions or credits, consider any expected changes in your income level and tax bracket or marginal tax rate.

Have you considered the impact of any recent changes to personal tax rules[3]?

- **Employee stock options grants** – Proposed amendments will limit the availability of the 50% employee stock option deduction[4] to an annual maximum of $200,000 of stock options that vest in a calendar year, based on the fair market value of the underlying shares on the date of grant. The proposed rules will apply to stock options granted on or after January 1, 2020 by corporations that are not Canadian-controlled private corporations. However, these amendments will not apply to options granted to employees of "startup, emerging, or scale-up companies." The government is expected to provide definitions in the near future on what these terms mean in this context.

  The following example illustrates the impact of these proposed measures. Your employer, a long-established public company, grants you 10,000 options (which vest immediately) to purchase shares of the company for $100 per share at a time when the fair market value of the shares is also $100 per share. Therefore, the value of the shares represented by the options at the time of grant is $1,000,000. If you exercise the 10,000 options in a particular year, the stock option deduction will only apply to 2,000 ($200,000/$100) of the options granted.

  To the extent that you have control over the timing of the granting of options, consider having the options granted prior to 2020 to ensure that the existing rules still apply to them. For further details, see EY Tax Alert 2019 Issues No. 26, Proposed changes to employee stock option rules (June 2019 update) and No. 14, *Federal budget 2019-20: proposed changes to the stock option deduction*.

[2] For example, salaries comparable to what arm's-length employees would be paid in a similar capacity.

[3] There are other changes taking effect that could impact personal taxes that are not listed here, as they are of limited application. Consult with your tax advisor for details.

[4] If you acquire shares under an employee security option plan, the excess of the value of the shares on the date you acquire them over the price you paid for them is included in your income from employment as a security option benefit. When the corporation is not a Canadian-controlled private corporation, the benefit is generally included in your income in the year you acquire the shares. Half of the option benefit included in income generally qualifies as a deduction, provided the price you paid for the securities was not less than the value of the securities on the date you were granted the options (minus any amount you paid to acquire the option), and the securities have the general characteristics of common shares (or units of a widely held class of units of a mutual fund trust).

- **Holding passive investments in your private corporation** – Recent amendments effective for taxation years beginning after 2018 may limit a Canadian-controlled private corporation's (CCPC's) access to the small business deduction and, accordingly, the small business tax rate[5] in a taxation year to the extent that it holds passive investments that generate more than $50,000 of income[6] in the preceding year. Consult your tax advisor for possible strategies to mitigate the adverse impact of these rules. For example, if you are considering realizing accrued gains in the company's investment portfolio before its 2019 taxation year end and the company is likely to cross the $50,000 income threshold by doing so, consider deferring the gains to the following year so that the 2020 taxation year is not impacted. You may also consider the pros and cons of holding a portion or all of the portfolio personally instead of within the company. The impact of these rules on CCPCs subject to taxation in Ontario or New Brunswick is not as harsh because both provinces have confirmed that they are not adopting them for purposes of their respective provincial small business deductions.

  For more information, see TaxMatters@EY, May 2018, "Federal budget simplifies passive investment income proposals."

- **Non-eligible dividend income** – Dividends received from private corporations and paid out of income taxed at the small business tax rate are generally non-eligible dividends. The tax rate applicable to non-eligible dividend income increased for dividends received on or after January 1, 2019.

- **Digital news subscriptions** – Recent amendments introduced a new temporary 15% non-refundable tax credit on amounts paid by individuals for eligible digital news subscriptions, for a maximum annual amount of $500 annually (a maximum annual tax credit of $75) beginning in 2020. Certain conditions apply. For example, the subscription must entitle you to access content provided in digital form by a qualified Canadian journalism organization (QCJO)[7] that is primarily engaged in the production of original written news content, and not engaged in a broadcasting undertaking[8]. In addition, the credit will be limited to the cost of a standalone digital subscription where the subscription is a combined digital and newsprint subscription. If there is no such comparable subscription, you will be limited to claiming one half of the amount actually paid. The credit will apply to eligible amounts paid after 2019 and before 2025.

- **Tuition fees associated with training** – Recent amendments have introduced a new refundable tax credit, the Canada training credit. Effective for 2020 and later taxation years, the credit will assist eligible individuals who have either employment or business income to cover the cost of up to one-half of eligible tuition and fees associated with training. Beginning in 2019, eligible individuals will accumulate $250 each year in a notional account which can be used to cover the training costs. A number of conditions must be met to be eligible[9]. The amount of the refundable credit that can be claimed in a taxation year will be equal to the lesser of one-half of the eligible tuition and fees paid in respect of the year and the individual's notional account balance. The portion of eligible tuition fees refunded through the Canada training credit will reduce the amount that would otherwise qualify as an eligible expense for the tuition tax credit. The first credit can be claimed for the 2020 taxation year.

Do you income-split private corporation business earnings with adult family members?

Recent amendments may limit income splitting opportunities with certain adult family members[10] through the use of private corporations in 2018 and later years. For example, a business is operated through a private corporation, and an adult family member in a low income tax bracket subscribes for shares in the corporation. A portion of the business's earnings is distributed to the family member by paying dividends. These rules apply the highest marginal personal income tax rate (the tax on split income) to the dividend income received unless the family member meets one of the legislated exceptions to the application of this tax. For example, if the adult family member is actively engaged in the business on a regular basis by working an average of at least 20 hours per week during the year (or in any five previous but not necessarily consecutive years), the tax on split income may not apply.

Consult with your tax advisor to learn more.

For more information about these rules, see EY Tax Alert 2017 Issue No. 52, *Finance releases revised income splitting measures*, and TaxMatters@EY, February 2018, *Revised draft legislation narrows application of income sprinkling*.

[5] The small business deduction applies to the first $500,000 of active business income earned by a CCPC in the taxation year. This limit must be shared with a CCPC's associated companies. The provinces and territories also have their own small business tax rates, with most jurisdictions also applying a $500,000 active business income limit. The federal small business rate is 9% in 2019. The federal general corporate rate is 15%.

[6] Examples include dividend income on a stock portfolio, interest income on the holding of debt instruments and taxable capital gains realized on the disposition of assets that are not used by the corporation to earn active business income in Canada.

[7] There are conditions under the definition in subsection 125.6(1) of the *Income Tax Act* (the Act) for an organization to be a QCJO. For example, if it is a corporation with share capital, it must meet certain ownership tests.

[8] Effective January 1, 2020, certain Canadian journalism organizations will become qualified donees. This means that if you make either a cash donation or a donation in kind (e.g., donating publicly listed securities) to them, they will be required to issue a tax receipt to you for the amount donated (or for the fair market value of a donation in kind) which you may then claim as a charitable donation tax credit on your income tax return. For further details, see EY Tax Alert 2019 Issue, No. 9, *Federal budget 2019-20: Investing in the middle class*.

[9] To accumulate the $250 each year, you must be a Canadian resident who is between 25 and 64 years of age at the end of the year, file a tax return, have employment or business income in the preceding taxation year in excess of $10,000 and have net income in the preceding taxation year that does not exceed the top of the third tax bracket ($147,667 for 2019). The maximum accumulation over a lifetime will be $5,000, which will expire at the end of the year in which you turn 65.

[10] There were already rules in place that limited income splitting opportunities with children under the age of 18 prior to 2018.

Have you maximized your tax-sheltered investments by contributing to a TFSA or an RRSP?

- **Tax-free savings account (TFSA)** – Make your contribution for 2019 and catch up on prior non-contributory years. You won't get a deduction for the contribution, but you will benefit from tax-free earnings on invested funds. Also, to maximize tax-free earnings, consider making your 2020 contribution in January.
- **TFSA withdrawals and re-contributions** – TFSA withdrawals are tax free and any funds withdrawn in the year are added to your contribution room in the following year. But if you have made the maximum amount of TFSA contributions each year[11] and withdraw an amount in the year, re-contributions made in the same year may result in an overcontribution, which would be subject to a penalty tax. If you have no available contribution room and are planning to withdraw an amount from your TFSA, consider doing so before the end of 2019, so that it's possible to re-contribute in 2020 without affecting your 2020 contribution limit.
- **Registered retirement savings plan (RRSP)** – The earlier you contribute, the more time your investments have to grow. So consider making your 2020 contribution in January 2020 to maximize the tax-deferred growth. If your income is low in 2019, but you expect to be in a higher bracket in 2020 or beyond, consider contributing to your RRSP as early as possible, but holding off on taking the deduction until a future year when you will be in a higher tax bracket.

Are you considering making an RRSP withdrawal under the Home Buyers' Plan?

- If you're a first-time home buyer,[12] the Home Buyers' Plan (HBP) allows you to withdraw up to $35,000[13] from your RRSP to finance the purchase of a home. No tax is withheld on RRSP withdrawals made under this plan. If you withdraw funds from your RRSP under the HBP, you must acquire a home by October 1 of the year following the year of withdrawal, and you must repay the withdrawn funds to your RRSP over a period of up to 15 years, starting in the second calendar year after withdrawal. Therefore, if possible, consider waiting until after the end of the year before making a withdrawal under the HBP to extend both the home purchase and repayment deadlines by one year.

Have you maximized your education savings by contributing to an RESP for your child or grandchild?[14]

- **Contributions** – Make registered education savings plan (RESP) contributions for your child or grandchild before the end of the year. With a contribution of $2,500 per child under age 18, the federal government will contribute a grant (CESG) of $500 annually (maximum $7,200 per beneficiary).
- **Non-contributory years** – If you have prior non-contributory years, the annual grant can be as much as $1,000 (in respect of a $5,000 contribution).

Is there a way for you to reduce or eliminate your non-deductible interest?

- Interest on funds borrowed for personal purposes is not deductible. Where possible, consider using available cash to repay personal debt before repaying loans for investment or business purposes on which interest may be deductible.

Have you reviewed your investment portfolio?

- **Accrued losses to use against realized gains** – While taxes should not drive your investment decisions, it may make sense to sell loss securities to reduce capital gains realized earlier in the year. If the losses realized exceed gains realized earlier in the year, they can be carried back and claimed against net gains in the preceding three years and you should receive the related tax refund. Note that the last stock trading date for settlement of a securities trade in 2019 is Friday, December 27, 2019 for securities listed on both Canadian and US stock exchanges. Just remember to be careful of the superficial loss rules, which may deny losses on certain related-party transactions. For more on the superficial loss rules, refer to TaxMatters@EY, October 2015, "Making the most of investment losses."

[11] The maximum contribution limit was $6,000 in 2019, $5,500 in each of 2016, 2017 and 2018, $10,000 in 2015, $5,500 in each of 2013 and 2014, and $5,000 for each of 2009 to 2013.

[12] You are considered a first-time home buyer if neither you nor your spouse or partner owned a home and lived in it as your principal residence in any of the five calendar years beginning before the time of withdrawal.

[13] The withdrawal limit was increased from $25,000 to $35,000 for 2019 and later years in respect of amounts withdrawn after March 19, 2019. The amendments will also permit an individual to re-qualify, in certain circumstances and subject to certain conditions, for the HBP following the breakdown of a marriage or common-law partnership even if they would not otherwise qualify as a first-time homebuyer. These amendments will be effective with respect to withdrawals made after 2019.

[14] See the November 2019 issue of TaxMatters@EY.

- **Realized losses carried forward** – If you have capital loss carryforwards from prior years, you might consider cashing in on some of the winners in your portfolio. As noted above, be aware of the December 27, 2019 deadline for selling securities listed on a Canadian or US stock exchange to ensure that the trade is settled in 2019. Or consider transferring qualified securities with accrued gains to your TFSA or RRSP (up to your contribution limit). The resulting capital gain will be sheltered by available capital losses, and you will benefit from tax-free (TFSA) or tax-deferred (RRSP) future earnings on these securities. Alternatively, you could also consider donating publicly traded securities (e.g., stocks, bonds, Canadian mutual fund units or shares) with accrued gains to a charitable organization or foundation. If you do, the resulting capital gain will not be subject to tax and you will also receive a donation receipt equal to the fair market value of the donated securities.

Can you improve the cash flow impact of your income taxes?

- **Request reduced source deductions** – If you regularly receive tax refunds because of deductible RRSP contributions, child-care costs or spousal support payments, consider requesting CRA authorization to allow your employer to reduce the tax withheld from your salary (Form T1213). Although it won't help for your 2019 taxes, in 2020 you'll receive the tax benefit of those deductions all year instead of waiting until after your 2020 tax return is filed.
- **Determine requirement to make a December 15 instalment payment** – If you expect your 2019 final tax liability to be significantly lower than your 2018 liability (for example, due to lower income from a particular source, losses realized in 2019 or additional deductions available in 2019) you may have already paid enough in instalments. You are not required to follow the CRA's suggested schedule and are entitled to base your instalments on your expected 2019 liability. However, if you underestimate your 2019 balance and your instalments end up being insufficient or the first two payments were low, you will be faced with interest and possibly a penalty.

Have you thought about estate planning?

- **Review your will** – You should review and update your will periodically to ensure that it reflects changes in your family status and financial situation, as well as changes in the law.
- **Consider your life insurance needs** – Life insurance is an important tool to provide for the payment of various debts (including taxes) that may be payable as a result of your death, as well as to provide your dependants with money to replace your earnings. Review your coverage to ensure that it remains appropriate for your financial situation.
- **Consider an estate freeze to minimize tax on death and/or probate fees** – An estate freeze is the primary tool used to reduce tax on death and involves the transfer of the future growth of a business, investments or other assets to family members. Consider the impact of the revised rules for the taxation of testamentary trusts and charitable planned giving, and the impact of the revised tax on split income rules (see above – *Do you income-split private corporation business earnings with adult family members?*) on income-splitting strategies using estate freezes. For example, an estate freeze is set up where parents transfer the future growth in value of a business to the next generation. Dividends paid in 2018 or later years to an adult child may be subject to the highest marginal personal income tax rate under these rules unless the individual meets one of the legislated exceptions to the application of this tax. For details, see EY Tax Alert 2017 Issue No. 52, *Finance releases revised income splitting measures*.
- **Consider a succession plan for your business** – A succession plan involves devising a strategy to ensure that the benefit of your business assets passes to the right people at the right time.

These questions may seem familiar, but as tax rules become more complex, it becomes more important to think of the bigger tax picture continuously throughout the year, as well as from year to year as your personal circumstances change. Start a conversation with your tax advisor to find better answers.

Year-end tax to-do list

Before December 31 2019:

- Make 2019 TFSA contribution.
- Make 2019 RESP contribution.
- Final RRSP contribution deadline for taxpayers who are 71 years old.
- Pay tax-deductible or tax-creditable expenses.
- Advise employer in writing if eligible for reduced automobile benefit.
- Request CRA authorization to decrease tax withheld from salary in 2020.
- Review your investment portfolio for potential dispositions to realize gains or losses in 2019 (note the last day for settlement of a trade in 2019 is December 27 on both Canadian and US stock exchanges).
- Make capital acquisitions for business.
- Evaluate owner-manager remuneration strategy.
- Consider allowable income-splitting strategies.

Early 2020:

- Interest on income splitting loans must be paid by January 30.
- Make 2019 RRSP contribution (if not already made) by February 29.
- Make 2020 RRSP contribution.
- Make 2020 TFSA contribution.
- Make 2020 RESP contribution.

A framework for year-end tax planning

There are two benefits to doing year-end tax planning while there is enough time left in the year to do it well.

First, you're more likely to avoid surprises next April that can be both financially and emotionally stressful. Second, if done from the wide-angle perspective of comprehensive financial and estate planning, year-end tax planning can help you understand whether you're doing the right things in the right way, not just to minimize income taxes, but also to make it that much easier to achieve your longer-term financial goals.

Consider how you can approach current year-end planning with an eye to the future. By assessing any major step taken today for its effect on the tax, financial and estate planning in the next stage(s) of your life, you may preclude choices that will reduce planning flexibility and could increase taxable income in the future.

A good place to start is a quick check of some fundamentals that may need some attention while there's still time this year to fix any problems. For example, do a projection for 2019 taxes to determine whether you had enough tax withheld and/or paid sufficient instalments to avoid an underpayment issue. The projection might suggest that some adjustments are in order (or that you can relax a little).

You should also determine if there will be any significant change in the amount and/or composition of your income next year. Among other things, changes in your personal life (such as changes in your marital or parental status) need to be considered. This information could prove to be important when selecting and designing particular tax planning steps.

Planning with income

You should understand the composition of your employment, business or professional income (salary, bonus, options, self-employment income, etc.), how each component is taxed in the current or future years and the extent to which you can control the timing and amount of each type of income.

Taxes are only one of the factors to be considered in deciding whether to do some loss planning in your portfolio. But there may be capital losses that can be triggered and/or used to offset gains or to avoid year-end distributions. You should also understand the composition of your investment income (i.e., interest, dividends and capital gains) and the extent to which you can control the timing, amount and character of each item.

Another tax planning issue associated with investing is "asset location," meaning selecting the right investments to hold in taxable versus tax-deferred accounts, respectively. Even some minor tweaking here could create significant benefits down the road.

Planning with deductions and credits

On the other side of the ledger from income are deductions. Here again, you should understand what deductions you are entitled to and the extent to which you can control the timing of those deductions. If you can benefit from a deduction or credit this year, make sure you pay the amount before year end (or in the case of RRSP contributions, no later than February 29, 2020). Or, if you expect to be in a higher tax bracket next year, consider deferring deductions until next year, when they will be worth more.

Consider reviewing and re-assessing the tax and financial implications of your major deductions and credits. For example, can you plan to minimize non-deductible interest expense or replace it with deductible interest expense? Or can you plan your usual charitable contributions to maximize their tax benefit? If you will incur significant medical expenses in 2020, will you be able to use all the credits? (If not, consider other options such as choosing a different 12-month period ending in the year for computing medical expenses, or having your spouse claim the credit).

Also, if you're thinking about making a gift to an adult child, it pays to do your homework. In Canada, gifts to adult children are generally received tax free, but there may be tax implications for the parent. See "It's better to give than to receive: tax-free gifts to adult children" in the November 2017 issue of TaxMatters@EY.

Estate planning

Your estate plan should start as soon as you begin to accumulate your estate. It should protect your assets and provide tax-efficient income before and after your retirement, as well as a tax-efficient transfer of your wealth to the next generation.

Your will is a key part of your estate plan. You and your spouse or partner should each have a will and keep it current to reflect changes in your family status and financial situation as well as changes in the law.

Remember that the revised tax on split income rules may limit income-splitting strategies using estate freezes. It's generally a good idea to review your estate planning goals and wills on a regular basis, but now is an especially good time to do that review in light of these rules.

These suggestions for year-end tax planning should help you set the agenda for a comprehensive discussion with your tax advisor this year and in years to come.

Year-end remuneration planning

Wes Unger, Saskatoon, and Iain Glass, Toronto

Corporate business owners have great flexibility in making decisions about their remuneration from a private company. This flexibility is available to all types of businesses, including incorporated professionals and business consultants. However, the planning process is not a simple one as there are many tax issues that must be addressed. It's important that decisions about remuneration be considered before year end, as well as during the business's financial statement and tax return finalization processes.

The federal government's proposals on income sprinkling were enacted in 2018 and are applicable to 2018 and later years (See **Rules limit income splitting after 2017** below). These rules impacted some of the traditional planning that was previously available to corporate business owners.

In addition, the 2018 budget introduced legislation impacting the taxation of private corporations in 2019. Further discussion of these rules continues below.

Rules limiting income splitting after 2017

The Tax on split income (TOSI) rules introduced in 2017 broadened the base of individuals affected and increased the types of income subject to the existing rules, (formerly known as "the kiddie tax") aimed at preventing income splitting. In essence, the TOSI rules limit income splitting opportunities with most adult family members through the use of private corporations after 2017.

Beginning in 2018, any income received by an individual that is derived directly or indirectly from a related private company (with the exception of salary) could be subject to the TOSI legislation. Any income subject to TOSI will be taxed at the highest marginal tax rate, which eliminates any tax advantage. To avoid application of the TOSI, the type of income needs to meet one of the exceptions or the individual receiving the income must fall into one of the exclusions. The application of the rules will also depend on the age of the individual receiving the income.

Exclusions are provided to recipients who are actively engaged in the business, payments that represent a reasonable return (based on a number of factors) and payments received by certain shareholders. Certain other exclusions are also provided. For more information, refer to EY Tax Alert 2017 No.52, *Finance releases revised income splitting measures*, and the February and May 2018 issues of TaxMatters@EY.

Basic considerations

- In general, if a corporate owner-manager does not need personal funds for spending, earnings should be left in the corporation to generate additional income and defer personal tax until a later date when personal funds are needed. For 2019, this tax deferral benefit resulting from the difference between corporate tax rates and personal tax rates can range, for individuals taxed at the highest marginal tax rate, from as little as 20.4% in Prince Edward Island when applying the general corporate tax rate to as high as 42.0% when applying the small business corporate tax rate in Nova Scotia. Deferring personal tax allows you to reinvest the corporate earnings and earn a rate of return on the personal tax you would have otherwise paid if you had extracted the funds from the business.
- For fiscal years starting in 2019, the amount of income eligible for the federal small business deduction is generally reduced if the corporation (together with all associated corporations) has passive investment income greater than $50,000 in the previous year, and is eliminated entirely if the amount of passive investment income exceeds $150,000, similar to the reduction that is applied to a corporation whose taxable capital exceeds $10m in the prior year. See the May 2018 issue of TaxMatters@EY. A corporation with too much passive investment income in the prior year will be taxable at the general corporate rate[15] on its active business income. Paying tax at the higher general corporate tax rate will decrease the amount of the tax deferral benefit, but will allow the corporation to pay out eligible dividends in the future. At this time only two provinces have decided not to follow this federal provision.[16]
- Even if funds are not required for personal consumption, business owners may want enough salary to create sufficient earned income to maximize their RRSP contribution and use tax savings associated with graduated income tax rates. Whether or not this is an appropriate strategy depends on an overall review of the owner-manager's financial plan for the near future, as well as the long term. To contribute the maximum RRSP amount of $27,230 for 2020, business owners will need 2019 earned income of at least $151,278. One method to generate earned income is to receive a salary in the year. Note that salary must be earned and received in the calendar year. Receipt of a salary would also allow the business owner to maximize CPP pensionable earnings for the year (based on maximum pensionable earnings of $57,400 for 2019).
- If funds are needed for personal consumption, the CRA has a longstanding policy of not challenging the reasonableness of remuneration where the recipient is active in the business and is a direct or indirect shareholder. This criterion of reasonableness is relevant when considering if the remuneration is deductible to the paying corporation. It is generally more advantageous to distribute corporate profits as a salary or bonus to an active owner-manager based on current provincial corporate and personal tax rates. However, this may not be applicable for all provinces, and certain provinces levy additional payroll taxes, such as Ontario's employer health tax, which may impact an analysis of the optimal compensation strategy.
- In many provinces there is an overall "tax cost" to distributing business profits in the form of a dividend, meaning the total corporate and personal tax paid on fully distributed business earnings exceeds the amount of personal tax that would be paid in that province if the individual earned the same amount of income directly. However, business owners may still wish to earn money through a corporation and defer the tax, if future cash needs can be satisfied by salaries or bonuses from future profits. Earnings subject to a large deferral of tax can remain reinvested in the business or corporate environment for many years, sometimes indefinitely. However, this strategy has to be used carefully, because accumulating excessive business earnings could impact the corporation's ability to claim the small business deduction on its active business income in the future. See the previous discussion on passive investment income changes. It could also affect a shareholder's ability to claim the lifetime capital gains exemption (see comments on QSBC status below).

[15] The federal general corporate rate is 15%. The small business rate is, 9% for 2019.
[16] Ontario and New Brunswick have both tabled legislation confirming previous announcements that they would not parallel the federal measure.

Advanced considerations

- Shareholder loans made to the corporation can be repaid tax free and represent an important component of remuneration planning. Advance tax planning may permit the creation of tax-free shareholder loans.
- Complex tax rules associated with otherwise tax-free intercorporate dividends could result in the dividends being recharacterized as capital gains. However, advance tax planning may be available to mitigate this issue, and it also may be possible to benefit from corporate distributions taxed at reduced tax rates associated with capital gains.
- A business owner who holds personal investments such as marketable securities can sell them to a private corporation in exchange for a tax-paid note or shareholder loan. While capital gains may arise on the transfer, the personal tax rate on capital gains is generally lower than the personal tax rate on eligible or non-eligible dividends. Advance tax planning may also allow recognition of the capital gain to be deferred; however, tax losses may not be realized on a transfer to an affiliated corporation.
- Corporate-level merger and acquisition transactions, such as the divestiture of a business or real estate, may also generate favourable tax attributes such as tax-free capital dividend account (CDA) balances or refundable taxes. These attributes form an important component of remuneration planning.
- A business can claim a capital cost allowance (CCA) deduction for the purchase of depreciable assets that are available for business use on or before the business's fiscal year end. A business that is contemplating a future asset purchase and has discretion in the timing of acquisition may choose to make the purchase sooner rather than later and then bring the asset into use to allow CCA to be claimed.

  This strategy should be carefully considered in light of the opportunities for an enhanced CCA deduction currently available. Refer to EY Tax Alerts 2019-15 and 2018–40.
- Retaining earnings in a corporation may affect a Canadian-controlled private corporation's (CCPC's) entitlement to refundable scientific research and experimental development (SR&ED) investment tax credits. A business should compare the investment return from deferring tax on corporate earnings against the forgone benefit of high-rate refundable SR&ED investment tax credits.
- Leaving earnings in the corporation may also impact the status of the corporation's shares as qualified small business corporation (QSBC) shares for the purpose of the lifetime capital gains exemption (currently $866,912). Advance tax planning may be available to mitigate this issue and permit continued accumulation of corporate profits at low rates without impacting the QSBC status of the shares.
- Paying dividends may occasionally be a tax-efficient way of getting funds out of a company. Capital dividends are completely tax free, and eligible dividends are subject to a preferential tax rate. For fiscal years that begin after 2018, eligible dividends are only eligible to generate a dividend refund out of the eligible refundable dividend tax on hand (ERDTOH) account. For more information, see the June 2018 issue of TaxMatters@EY. Non-eligible dividends can generate a dividend refund out of the ERDTOH and the non-eligible refundable dividend tax on hand (NERDTOH) account. A review of the company's tax attributes will identify whether these advantageous dividends can be paid.[17]

[17] ERDTOH generally consists of refundable taxes paid under Part IV of the *Income Tax Act* (the Act) on eligible portfolio dividends received from non-connected corporations and Part IV tax paid on eligible or non-eligible intercorporate dividends received from connected corporations to the extent such dividends result in the paying corporation receiving a dividend refund from its own ERDTOH account. NERDTOH generally consists of refundable taxes paid under Part I of the Act on investment income, as well as Part IV tax paid for the year less Part IV tax added to the private corporation's ERDTOH account. See EY Tax Alert 2018 No. 7, *Federal budget 2018-19* and June 2018 Tax Matters@EY.

- Dividends and other forms of investment income from private corporations do not represent earned income, and so do not create RRSP contribution room for the recipient. An individual also requires earned income to be able to claim other personal tax deductions, such as child care and moving expenses. Business owners should consider how much earned income they need in light of the RRSP contributions they wish to make or personal tax deductions they wish to claim.

Income splitting considerations (subject to TOSI)

- Consider paying a reasonable salary to a spouse or adult child who provides services (e.g., bookkeeping, administrative, marketing) to the business in order to split income.
- If a spouse or adult child (older than 24 years of age) is not active in the business and has no other sources of income, consider an income-splitting corporate reorganization whereby the family members become direct shareholders in the business, owning 10% or more of the votes and value of the corporation. This planning is still available even with the TOSI rules in effect, as long as the corporation is not a professional corporation and has less than 90% of its gross business income from the provision of services and at least 90% of the company's income is not derived directly or indirectly from one or more related businesses. For non-active family members, there generally must be a direct shareholding as described above.[18] Non-active family members are no longer able to be indirect shareholders and avoid the TOSI legislation. Active family members are able to be indirect shareholders and avoid the TOSI legislation as long as they fit into one of the exclusions under the TOSI rules. Depending on the province of residence, an individual who has no other source of income can receive anywhere between approximately $10,000 (eligible) and $52,000 (non-eligible) dividends tax free. These amounts increase where the recipient has access to tax credits such as the tuition tax credit in the case of adult-children students. Commercial and family law considerations, in conjunction with the tax benefits, will determine whether it is worthwhile pursuing such a strategy. In select cases, a low-interest family loan can be advantageous for permissible income splitting. Given the low 2% "prescribed rate," it may be worthwhile exploring this planning option, especially if the return on investment exceeds the prescribed rate.

Managing tax cash flow

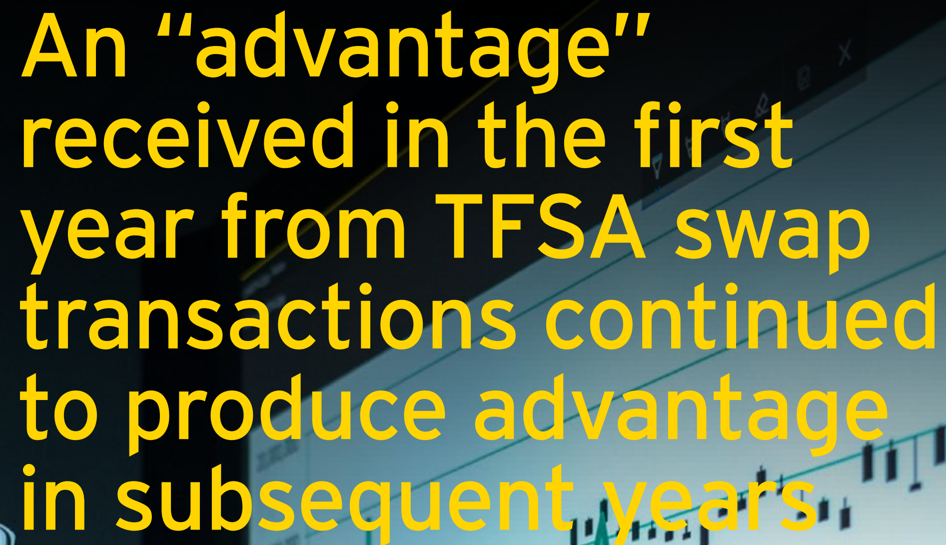
- If there's a plan to pay salary, remember that bonuses can be accrued and deducted by the business in 2019, but not included in the business owner's personal income until paid in 2020. To be deductible to a corporation, the accrued bonus must be paid within 180 days after the company's year end, permitting a deferral of tax on salaries of up to six months.[19]
- If earnings left in the corporation exceeded the available small business deduction limit for the preceding tax year, corporate taxes for the current year will be due two months, rather than three months, after the year end. The current rate for late payment arrears interest is 6% and is not deductible for income tax purposes.
- Monthly and quarterly tax instalments (for corporate and personal income, respectively) must be managed to avoid arrears interest and penalty interest. A single midyear payment strategy can be used to simplify the obligation of making recurring payments, and generally reduce or eliminate interest and penalties.
- Use of a shareholder "debit" loan account (where the corporation has a receivable from the individual shareholder) may simplify the need to project exact owner-manager remuneration requirements. Shareholder debit loans must be repaid within one year after the end of the year in which the loan was made, or else the loan will be included in the business owner's income in the year funds were withdrawn. The repayment of a shareholder loan cannot constitute a series of loans or other transactions and repayments if the one-year repayment is to be considered valid.
- Borrowing from the company within the permissible time limits will cause a nominal income inclusion at the prescribed rate, which is currently only 2%. The cost of financing from the corporation using shareholder loans can therefore currently be achieved at tax-effected rates of 0.95% to 1.08% at the highest marginal tax rates, depending on your province of residence.

For more information on remuneration planning and other tax-planning and tax-saving ideas, contact your EY advisor.

[18] See the definition of "excluded shares" in subsection 120.4(1) of the *Income Tax Act* (the Act). Family members who are active in the business may be able to meet one of the tests under "excluded business." Active in the business means generally working an average of at least 20 hour per week. The exception may apply if the individual is active in the current year or in any five (not necessarily consecutive) prior years.

[19] The expense will not be deductible in the current year if it is unpaid on the 180th day after the year end. See subsection 78(4) of the Act.

An "advantage" received in the first year from TFSA swap transactions continued to produce advantage in subsequent years



Louie v Canada, 2019 FCA 255

Winnie Szeto, Toronto

This Federal Court of Appeal (FCA) case involved whether the taxpayer received an "advantage" in relation to her tax-free savings account (TFSA) in the 2009, 2010 and 2012 taxation years within the meaning of subparagraph (b) of the definition of "advantage" in subsection 207.01(1) of the *Income Tax Act* (the Act).

It was the first time the FCA considered these rules. The taxpayer was previously successful at the Tax Court of Canada (TCC) for 2010 and 2012, but not for the 2009 taxation year. For details, see the February 2019 issue of TaxMatters@EY.

Summary of facts

The taxpayer was a sophisticated investor who, from May 15 to October 17, 2009, made 71 swaps between her TFSA and her Canadian direct trading account (CDTA) and self-directed registered retirement savings plan (RRSP). She selected the highest trading price of the day for shares swapped out of her TFSA, and the lowest trading price for shares swapped into her TFSA. Using this method, she increased the total fair market value (FMV) of her TFSA from $5,000 at the beginning of 2009 to more than $205,000 by the end of 2009, which represented an increase of more than 4,000%.

Effective October 17, 2009, such swap transactions were no longer allowed and, as a result, the taxpayer decided to leave the shares in her TFSA. However, due to market forces, the FMV of the TFSA continued to increase in 2010 and 2012, but decreased in 2011.

The Minister of National Revenue assessed the taxpayer on the basis that the FMV of her TFSA had increased in 2009, which tainted the subsequent FMV increases in 2010 and 2012, and as a result she was extended an "advantage" as defined in subsection 207.01(1) of the Act, and therefore, was liable to pay the special advantage tax that applies under section 207.05. The taxpayer appealed to the TCC.

The TCC dismissed the taxpayer's appeal for the 2009 taxation year, but allowed the appeals for the 2010 and 2012 taxation years. The TCC had concluded that the taxpayer received an "advantage" in relation to her TFSA in 2009, but that such "advantage" did not continue into her 2010 and 2012 taxation years.

The taxpayer appealed the TCC's decision in respect of the 2009 taxation year and the Crown cross-appealed in respect of the 2010 and 2012 taxation years.

The taxpayer's appeal

With respect to the taxpayer's appeal of the 2009 taxation year, the FCA considered whether the TCC erred in finding that:

- The swap transactions were part of a series of transactions.
- The parties to the series of transactions were not dealing at arm's length.
- One of the main purposes of the series of transactions was so that the taxpayer could benefit from the TFSA's tax exemption.

Series of transactions

The FCA agreed with the TCC that the swap transactions were part of a series of transactions. In its decision, the TCC concluded that "[a]ll that was necessary was that the Appellant have [sic] planned on doing swap transactions with the purpose of achieving the objective of the series." Furthermore, the TCC concluded that "[w]hile the series of transactions never had a predetermined end point, all the transactions were completed in contemplation of the series." Therefore, the FCA concluded that intervention with the TCC's conclusion was not justified, because the taxpayer did not demonstrate any extricable error of law or any palpable and overriding error of fact.

Dealing at arm's length

The FCA agreed with the TCC that the parties to the swap transactions were not dealing at arm's length. After considering the three factors in the majority decision of Canada v McLarty, 2008 SCC 26, the TCC found that the taxpayer was the single mind that directed all of the swap transactions and that the parties in control of the RRSP and CDTA acted in concert without separate interests. Again, the FCA concluded that intervention with the TCC's conclusion was not justified because the taxpayer did not demonstrate any extricable error of law or any palpable and overriding error of fact.

One of the main purposes

The FCA agreed with the TCC that one of the main purposes of the series of transactions was so that the taxpayer could benefit from the TFSA's tax exemption. The FCA noted that determining the main purposes of a non-commercial transaction is a factual inquiry. The court noted that the relevant facts in the present case included:

- The taxpayer was aware of the TFSA's tax-exempt status.
- The taxpayer executed a method using non-market transactions to move significant amounts of value into her TFSA.
- The taxpayer's selection of share price artificially increased the number of shares moved into the TFSA with each swap (by using the lowest value of the shares swapped in) and artificially increased the gains in the TFSA when the shares were swapped out (by using the highest value of the shares on that day).

The FCA noted that even though none of the shares were sold, and taxable income was not transferred between accounts, the result of the taxpayer's strategy was to inflate the value of the TFSA so as to benefit from a tax-free distribution from her TFSA (as opposed to a taxable withdrawal from her RRSP or a taxable gain within her CDTA). As a result, the FCA concluded that intervention with the TCC's conclusion was not justified because it made no error of fact.

The Crown's cross appeal

With respect to the cross appeal by the Crown, the FCA considered whether the TCC erred in interpreting the phrase "directly or indirectly" in subparagraph (b) of the definition of "advantage" in subsection 207.01(1) of the Act.

An "advantage" means "a benefit that is an increase in the total fair market value of the property held in connection with the [TFSA] if it is reasonable to consider, having regard to all the circumstances, that the increase is attributable, directly or indirectly, to… a transaction or event or a series of transactions or events that…" meet certain criteria.

The Crown argued that the TCC construed too narrowly the phrase "if it is reasonable to consider, having regard to all the circumstances, that the increase is attributable, directly or indirectly, to…". The Crown further argued that but for the swap transactions, the taxpayer would not have had, after October 16, 2009, the amount of capital that she had to engage in the share transactions to the extent that she did, which generated the FMV increases in the TFSA in 2010 and 2012.

The FCA then considered the definition of "advantage" using a textual, contextual and purposive approach and concluded that:

- The broad, textual meaning of the phrase "directly or indirectly" is not constrained by the requirement to base a determination about the source of an increase in the value of a TFSA on what "it is reasonable to consider, having regard to all the circumstances."
- The statutory context does not require or favour a narrow, restrictive definition of "advantage."
- A broad interpretation of "advantage" is supported by the anti-avoidance purpose of sections 207.01 and 207.05.

Based on the above, the FCA concluded that but for the swap transactions that increased the TFSA's value in 2009, the increase in value in 2010 and 2012 would not have been as significant as it was. In other words, the FCA was of the view that while the increase in value in 2010 and 2012 was directly attributable to the performance of the shares held in the TFSA in those years, it was indirectly attributable to the 2009 swap transactions which increased the number of shares held in the TFSA and their value.

In conclusion, the FCA found that the TCC erred in

- Its interpretation of the definition of "advantage" in subsection 207.01(1) of the Act
- Not finding that the increase in the TFSA's FMV in 2010 and 2012 was indirectly attributable to the 2009 swap transactions

The FCA conclusion

Based on the above, the taxpayer's appeal with respect to the 2009 taxation year was dismissed and the Crown's cross appeal with respect to the 2010 and 2012 taxation years was allowed.

Lessons learned

In applying a restrictive interpretation of "advantage," the TCC was concerned about "when or how far into the future an advantage… will be considered as attributable to" abusive transactions. This would appear to be a valid concern. However, it is interesting to note that the FCA's response to this was that such concerns are to be addressed by other provisions in the Act, such as the Minister's ability to waive or cancel advantage taxes (subsection 207.06(2)) or to determine the unused TFSA contribution room (subsection 207.01(1)). According to the FCA, such are the mechanisms intended to address the future impact of abusive transactions.

Publications and articles

Tax Alerts – Canada

Tax Alert 2019 No. 40 MLI comes into force

On August 29, 2019, Canada deposited its instrument of ratification for the *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS* (the MLI).

The MLI will enter into force vis-à-vis Canada on December 1, 2019. Accordingly, it will enter into effect for any particular covered tax treaty in accordance with the provisions set forth in its "entry into effect" articles and will apply to some of Canada's tax treaties with effect as early as January 1, 2020.

Tax Alert 2019 No. 41 Alberta budget

Publications and articles

Publications and articles

EY's Global Capital Confidence Barometer

The 20th edition of EY's *Global Capital Confidence Barometer* describes how 76% of Canadian respondents expect to pursue M&A in the next 12 months, the second-highest ever (behind April 2018) and the fifth consecutive year above the historical average of 50%.

EY's Worldwide Personal Tax and Immigration Guide 2018-19

This guide summarizes personal tax systems and immigration rules in more than 160 jurisdictions, including Australia, Brazil, Canada, France, Germany, Mexico, the Netherlands, the Russian Federation, the UK and the US.

EY's Worldwide Capital and Fixed Assets Guide 2019

This guide summarizes the complex rules relating to tax relief on capital expenditures in 31 jurisdictions and territories.

EY's Worldwide Estate and Inheritance Tax Guide 2019

This guide summarizes the gift, estate and inheritance tax systems and describes wealth transfer planning considerations in 39 countries.

Worldwide Corporate Tax Guide 2019

Governments worldwide continue to reform their tax codes at a historically rapid rate. Chapter by chapter, from Afghanistan to Zimbabwe, this EY guide summarizes corporate tax systems in 166 jurisdictions.

Worldwide VAT, GST and Sales Tax Guide 2019

This guide summarizes the value-added tax (VAT), goods and services tax (GST) and sales tax systems in 124 jurisdictions, including the European Union.

Worldwide R&D Incentives Reference Guide 2019

The pace at which countries are reforming their R&D incentives regimes is unprecedented. This EY guide summarizes key R&D incentives in 46 countries and provides an overview of the European Union's Horizon 2020 program.

2018-19 Worldwide Transfer Pricing Reference Guide

Transfer pricing rules and regulations around the world continue to grow in number and complexity. Practitioners need to have current knowledge of a complex web of country tax laws, regulations, rulings, methods and requirements. This guide summarizes the transfer pricing rules and regulations adopted by 124 countries and territories.

Board Matters Quarterly

The September 2019 edition of Board Matters Quarterly looks at various issues including digital audit, BOTs, tax transformations, the board's role in navigating geopolitics and the role of disruption in portfolio strategy.

EY Trade Watch

EY Trade Watch Autumn 2019 edition outlines key legislative and administrative developments for customs and trade around the world. This issue comes in a new, interactive and easy to share format, links to EY resources, interactive graphics and maps. Highlights include:

Global

- Focusing on fundamentals – a global trade leading practices briefing

Americas

- Spotlight on latest developments in Canadian trade
- Latest developments on the US-China trade dispute

Asia-Pacific and Japan

- Is the customs audit environment in Asia-Pacific changing?

Europe, Middle East, India and Africa

- African Union launches operational phase of the Africa Continental Free Trade Area (AfCFTA)
- Brexit update

Publications and articles

Websites

EY Law LLP

Our national team of highly qualified lawyers and professionals offers comprehensive tax law services, business immigration services and business law services. Serving you across borders, our sector-focused, multidisciplinary approach means we offer integrated and comprehensive advice you can trust. Visit **eylaw.ca**.

Focus on private business

Because we believe in the power of private mid-market companies, we invest in people, knowledge and services to help you address the unique challenges and opportunities you face in the private mid-market space. See our comprehensive private client services **webcast series**.

Online tax calculators and rates

Frequently referred to by financial planning columnists, our mobile-friendly calculators on ey.com/ca let you compare the combined federal and provincial 2018 and 2019 personal tax bills in each province and territory. The site also includes an RRSP savings calculator and personal tax rates and credits for all income levels. Our corporate tax-planning tools include federal and provincial tax rates for small business rate income, manufacturing and processing rate income, general rate income and investment income.

Tax Insights for business leaders

Tax Insights provides deep insights on the most pressing tax and business issues. You can read it online and find additional content, multimedia features, tax publications and other EY tax news from around the world.

The Worldwide Indirect Tax Developments Map

Updated monthly, our interactive map highlights where and when changes in VAT, global trade and excise duties are happening around the world. The map can be filtered by tax type, country and topic (e.g., VAT rate changes, compliance obligations and digital tax).

CPA Canada Store

EY's Complete Guide to GST/HST, 2019 (27th) Edition

Editors: Jean-Hugues Chabot, Sania Ilahi, David Douglas Robertson

Canada's leading guide on GST/HST, including GST/HST commentary and legislation, as well as a GST-QST comparison. Written in plain language by a team of EY indirect tax professionals, the guide is consolidated to 15 July 2019 and updated to reflect the latest changes to legislation and CRA policy. This edition has new commentary regarding duties on cannabis products under the *Excise Act*, 2001.

EY's Federal Income Tax Act, 2019 Edition

Editors: Albert Anelli, Warren Pashkowich and Murray Pearson

Complete coverage of Canada's *Income Tax Act* and Regulations. Included with this edition: interactive online features and purpose notes for selected provisions. Purchase of a print book includes access to an online updated and searchable copy of the federal *Income Tax Act* as well as the PDF eBook. This edition contains amendments and proposals from the 19 March 2019 federal budget, the 15 January 2019 proposed amendments to the *Income Tax Act* (salary overpayments) and 2018 legislation as passed and proposed.

EY's Guide to Preparing 2019 Personal Tax Returns

Editors: Lucie Champagne, Maureen De Lisser, Gael Melville, Yves Plante, Alan Roth

This is the line-by-line guide busy tax professionals rely on throughout the tax season. The guide includes a summary of what's new for the 2019 taxation year as well as tips, suggestions and reminders to consider when preparing 2019 personal tax returns. Available as an easy-to-use and searchable internet collection (includes access to four years of previous internet editions).

To subscribe to *TaxMatters@EY* and other email alerts, visit ey.com/ca/EmailAlerts.

For more information on EY's tax services, visit us at ey.com/ca/Tax.

Learn about EY's Electronic Publishing Services.

For questions or comments about this newsletter, email Tax.Matters@ca.ey.com.

And follow us on Twitter @EYCanada.

EY | Assurance | Tax | Transactions | Advisory

About EY
EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit ey.com.

© 2019 Ernst & Young LLP. All Rights Reserved.
A member firm of Ernst & Young Global Limited.

3318322
ED None

This publication contains information in summary form, current as of the date of publication, and is intended for general guidance only. It should not be regarded as comprehensive or a substitute for professional advice. Before taking any particular course of action, contact EY or another professional advisor to discuss these matters in the context of your particular circumstances. We accept no responsibility for any loss or damage occasioned by your reliance on information contained in this publication.

ey.com/ca