

The Tax Break

MUST I PAY CRA INSTALMENTS?

Many individuals received **unusually high incomes** in 2015 as a result of triggering capital gains or taking extra dividends and/or salary from their corporation to avoid being subject to the higher tax rates taking effect in 2016. When tax returns for 2015 were filed, many of these individuals would have been required to make a substantial tax payment in April of 2016 since their 2015 withholdings and instalment payments were not sufficient to cover the additional income. In general, if that April payment upon filing was greater than **\$3,000**, CRA will **request** those individuals to make **instalment payments** during the 2016 year.

Instalment reminders are usually sent out by CRA in August and may ask for **large amounts** to be paid in September and December of 2016. Those amounts are based on the **income from the 2015 year**. The first few instalment requests in 2017 may also be based on 2015 income levels. If the taxpayer's income in 2016 is, or will be lower than 2015, the instalments per the notices may significantly **exceed** the taxpayer's **expected 2016 liability**. It is important to note that there are **alternatives** to paying the

recommended instalment amount included on the notice.

One such possibility is to pay instalments **based** on the **expected tax liability** for the 2016 year. If there has been a **significant decrease** in **income**, this method may free up large amounts of cash that may otherwise have been tied up in instalment payments and only returned upon CRA processing of the 2016 personal tax return.

Where estimates are made, interest may be assessed if instalments are short.

LOSING THE SMALL BUSINESS DEDUCTION (SBD)

INTERCOMPANY PAYMENTS

The 2016 Federal Budget proposed a number of measures to **prevent the ability to multiply access** to the \$500,000 SBD limit. Broad restrictions in eligibility for the SBD on **payments between private corporations** in general have been introduced. The restrictions as proposed are so broad that they will affect many corporations



and structures where multiplication of the SBD was not a goal or even a consideration.

The measures will apply to **taxation years that begin on or after March 22, 2016**. For example, a corporation with a December 31 fiscal year-end will first be subject to these restrictions in the year ending December 31, 2017.

A corporation with a March 31 fiscal year-end will first be affected in the year ending March 31, 2017.

In general, these new **Specified Corporate Income (SCI)** rules will restrict access to the SBD on any **active business income (ABI) earned** from providing services or property to another **private corporation (PayerCo)** where there is **common ownership**. Such income will not be eligible for the SBD.

Consider the situation where ServiceCo provides services to PayerCo, and PayerCo pays a fee back to ServiceCo. *continued...*

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BEWARE OF ONGOING CRA SCAMS!

Did a call/email/text from Canada Revenue Agency seem suspicious? It may be a scam! CRA will never use aggressive language, threaten you with arrest, ask for prepaid cards or send e-transfers.

If you are receiving this newsletter by mail and would like to receive it by email instead (or vice versa), or if you no longer wish to receive our newsletter, please contact Julie at julie@accountantsplus.ca or 604.299.9274.

Payments will be restricted by the SCI rules where **an interest in PayerCo is held by any of:**

- **ServiceCo** (the corporation providing the service and receiving the fees);
- **any shareholder** of ServiceCo; or,
- **any person** who does **not** deal at **arm's length** with any shareholder of ServiceCo.

There is **no de minimis ownership interest** threshold – based on the draft legislative proposals of July 29, 2016, even one share of thousands will cause these restrictions to apply. In addition, even **indirect interest** can trigger the SCI rules. For **example**, if you own 10% of ServiceCo, and your **brother-in-law** owns one share of thousands issued by PayerCo, these rules could apply.

An exception: if **all or substantially all** of **ServiceCo's active business income** (which CRA generally considers to be 90% or more) is earned from providing **services to arm's length persons** other than PayerCo, ServiceCo will not be subject to the SCI rules.

Examples of Corporations Potentially Affected

Consider a corporation, **OpCo**, held by **four unrelated shareholders** which pays **management fees** (or some other type of active income) to **four HoldCos** each **owned** by one of the **four shareholders** (whether in whole or in part).

Under the **proposals**, the management **fees** earned by the four HoldCos would **not generally be eligible for the SBD**, unless OpCo allocated a portion of its own \$500,000 limit amongst the HoldCos. In other words, OpCo and the four HoldCos must now **share access to a single business limit**, assuming the HoldCos

do not have ABI from other sources. Historically, each of the five corporations (OpCo and the four HoldCos) may each have had full access to the \$500,000 SBD depending on their ownership and business structure.

The proposals are quite **broad** and there are many **existing corporate structures** which are, or could be, **exposed to these provisions**. While the proposals may change during the process of becoming law, it is clear that many existing structures will be affected.

Review your current corporate structures to determine if the small business rates will remain applicable, and whether any change in historical planning is appropriate.



SELLING YOUR BUSINESS

DO IT BEFORE 2017?

Some of the most valuable business assets that can be sold are the **intangibles** such as **goodwill** and customer lists. These types of assets are presently classified as **"Cumulative Eligible Capital"** (CEC). When sold, there is often a **large gain** on these assets. The corporate tax **rates applicable** to this type of gain for **2017 onwards** will **change significantly**.

Half of the **gain** is currently **tax-free**, and can be distributed to the corporation's shareholders, still tax-free, as a **capital dividend**. This will

not change. The tax changes relate to the **taxable half of the gain**.

For sales occurring **before 2017**, the taxable half of the gain on CEC sales would be considered **"business income"**. It may be eligible for the small business deduction which equates to a **corporate tax rate** around **15%**. Even where the small business deduction is not available, the rate would only be approximately 27%. Specific rates vary by province/territory.

In 2017, these **assets will be converted** from this special CEC class to a regular asset class thereby creating **"capital gains"** rather than **"business income"** upon sale. The initial corporate **tax rate** on the taxable half of the gain for these assets is **approximately 50%**, but again, ranges by province/territory. The cash left in the corporation after taxes will be significantly less if the sale occurs in 2017 or later.

All is not lost, however, since a large portion of the 50% in corporate taxes will be refunded when the **cash is paid out** to the individual shareholder as a **taxable dividend**. Once all of the sale proceeds have been distributed to the individual shareholder, the after-tax cash remaining will be **roughly the same** whether the asset sale occurred in 2017 or prior.

In other words, realizing the gain **prior to 2017** will leave **more cash available** to the corporation. This deferral of taxes will be particularly **beneficial** where the shareholder does **not require all of the sale proceeds immediately** for personal use. The funds left in the corporation can often be invested for many years.

If you would like to retain the proceeds of a sale in the corporation for the long term, consider whether a close before the end of 2016 is preferential.

We recommend that you obtain professional advice before acting on information contained in this newsletter.

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