2nd QUARTER 2018

The PEL Tax Break

CORPORATE PASSIVE INVESTMENT INCOME

PROPOSED CHANGES

A **new passive investment tax regime** for **Canadian Controlled Private Corporations** (CCPCs) is proposed to **apply** to taxation **years commencing after 2018**. Passive income may include **interest**, **rental**, **royalties**, **dividends** from **portfolio investments** and **taxable capital gains**.

Two significant changes are proposed. First, a **limit** to the **small business deduction** for CCPCs generating significant income from passive assets, and second, a new regime to **stream** the **recovery of refundable tax** to the payment of specific types of dividends (eligible versus non-eligible).

Access to the Small Business Deduction (SBD)

The first prong of the proposals will **reduce access** to the **SBD** for **CCPCs** having **more** than **$50,000 of passive income**. CCPCs with passive income in excess of the threshold will incrementally lose access to their SBD, until $150,000 of passive income is reached, at which point the entire SBD will be lost. The prior year's passive income will determine the current year's SBD limit.

For purposes of these new rules, **capital gains** on **certain types of property** will be **excluded** from being considered passive income. These are as follows:

- **Capital gains** realized on the disposition of **property used principally in an active business** carried on in Canada. The active business could be carried on by the owner of the asset, or by a related party. Examples include gains on the sale of the goodwill of an active business, and gains on the real estate from which the active business operates.

- **Capital gains** realized on **shares** of another **CCPC all or substantially all** of whose **assets** are used in an **active business** carried on in Canada, provided the seller has a significant interest (generally over 10%) in that corporation.

- Similarly, **capital gains** realized on an **interest in a partnership all or substantially all** of whose **assets** are used in an **active business** carried on in Canada will generally be

excluded where the seller has a significant interest (generally over 10%) in the partnership.

Capital losses realized in a different taxation year that are applied to offset capital gains realized in the current year will not reduce passive income for these new rules.

Consistent with the existing SBD rules, the sum of passive income of **all associated corporations** will determine the reduced business limit available to the associated group.

The **total advantage** or **disadvantage** of earning passive investment income in a corporation, after considering personal and corporate tax costs, will **depend** on a **number of factors** such as the **individual's marginal tax rate**, **rate of return** on the investment and the **province or territory** of residence.

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POST-TAX SEASON'S GREETINGS!

Congratulations to **Tony W.**, this year's winner of our **Early Bird Draw** for bringing in his tax information **before March 31**. It pays to get in early!

On an unrelated note, we wish to announce our most recent addition to the PEL team. Kindly join us in welcoming **Travis Taylor, CPA, CA**, who joined our firm earlier this year as our new senior manager!

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.*

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Recovering Refundable Taxes

Passive income is subject to a **high corporate tax rate**. However, a portion of these taxes are **refunded** when the **CCPC pays taxable dividends**.

The second prong of the passive income proposals will add a **new restriction**. **Recovering refundable taxes** will **generally require** the CCPC to pay out **non-eligible dividends**. These carry a higher personal tax cost than eligible dividends. The **exception** will be where **refundable taxes** arise from the CCPC's receipt of **eligible dividends**. Dividends received from most Canadian public corporations are eligible. This portion of the refundable tax can then be recovered when the CCPC pays out eligible dividends.

If your corporation has passive earnings in excess of $50,000 and is also earning active business income, prepare for a potentially higher corporate tax bill in the coming years.

CONSTRUCTION ACTIVITIES

REPORTING OBLIGATIONS FOR SUBCONTRACTORS

A July 17, 2017 **Technical Interpretation** examined the **conditions** which would **require** the filing of a T5018, Statement of Contract Payments.

Where a person or partnership **primarily** derives their **business income** from **construction** activities for a reporting period, **a** T5018 should be **filed** for any subcontractor payment or credit made relating to goods or **services** received in the **course of construction activities**. The reporting period may be a **calendar** or **fiscal year** but cannot be changed once selected (unless authorized by CRA).

The term **"construction activities"** is broadly defined. It includes, for example, the erection, excavation, installation, alteration, modification, repair, improvement, demolition, destruction, dismantling or removal of all or any part of a building, structure, surface or sub-surface construction, or any similar property. Such activities are considered to be those normally associated with the on-site fabrication and erection of buildings, roads, bridges, parking lots, driveways, etc. which are intended to be permanently affixed to the land on which they are built.

It is a **question of fact** as to whether a particular activity is a **construction activity**, and whether the business income for the reporting period is derived **primarily** from such activity. If a T5018 is not required, consideration should be given to the requirement of a **T4A, Statement of Pension, Retirement, Annuity, and Other Income.**

CRA has also noted that there are **businesses** that have a **significant amount of construction** done for them or by them, **but** the activity is **not their principal business**. For example, a natural gas company may do a large amount of construction to install pipelines, however, its principal business is gas transmission, not constructing pipelines. It would not be required to file T5018s.

Penalties are levied on the payer when T5018s are not timely filed. Penalties range from $100 to $7,500, depending on the number of T5018s and the number of days they are late.

If you are in the construction industry, ensure you are filing T5018s appropriately.

FAMILY MEMBERS

CAN YOU PAY THEM A SALARY?

For a small business, whether operated as a corporation, proprietorship or partnership, it is quite possible that **relatives** of the owners or partners may be **engaged** as **employees**. Due to the closer familial relationship between employer and employee, CRA pays particular attention to ensure that the salary is **truly an eligible deduction to the business**.

According to CRA, salaries to children and spouses are deductible as long as all of these conditions are met:

- the salary is actually **paid**;
- the work the family member does is **necessary** for earning business or professional income; and
- the salary is **reasonable** when considering the family member's age and the amount one would pay someone else.

CRA also states that T4s are required for all employees, including family members, and subject to payroll deductions, as appropriate. Payment in the form of **room and board** is **not accepted by CRA**.

CRA suggests that the **average salary for an arm's length person** providing similar services under similar conditions would provide **guidance as to reasonableness**.

Consider whether family members can perform services for one's business, and what level of income is reasonable.

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