YEAR END TAX PLANNING CONSIDERATIONS

As the year-end approaches it is a good time to evaluate your tax planning and address any time-sensitive decisions. We have prepared this newsletter to provide you with some year-end tax planning tips that may be of interest to you.

Owner Remuneration

As the corporate year-end approaches shareholders must consider the amount of shareholder draws from the company and the expected shareholder loan account balance at year-end. This is important because an overdraft in the shareholder loan account will need to be corrected and could result in personal taxes if the loans are not repaid within one year of the year-end.

As a business owner, you will have a choice whether to structure the repayment of the shareholder loan account as salary or as dividends.

Considerations for paying salary

- Employment income from salary or bonuses generates RRSP contribution room. If it is important to you to be able to make RRSP contributions, you should consider structuring some of your compensation as a salary or bonus. The contribution room generated will be 18% of earned income to a maximum of 26,010 in 2017. This means that salaries and bonuses up to 144,500 will allow you to generate maximum RRSP contribution room.

- Employment income will also be subject to payroll withholding. Non-arm's length employees, such as shareholders and their family members, will not have to pay EI premiums on employment earnings. However, both the employer and employee portion of CPP will still need to be paid on employment income. CPP contributions will increase your eventual CPP pension benefits, but you may wish to avoid paying into CPP by choosing to take dividends as compensation instead, as CPP contributions are not paid on dividends.

- Salaries and bonuses are deducted as expenses of the corporation thereby reducing the corporate taxable income. Bonuses can be used to reduce corporate income to the small business deduction limit of $500,000.

Bonuses deducted as an expense by the corporation will need to be paid out within 179 days of year end. For a December 31st, 2016 year-end, bonuses will need to be paid by June 28th, 2017. The bonus is deductible by the corporation in its 2016 year-end but the bonus is picked up as employment income in the 2017 calendar year resulting in a potential tax deferral.

250.220.7311
www.ddwca.com
202-4430 CHATTERTON WAY, VICTORIA BC V8X 5J2

Considerations for declaring dividends

- Dividends are not deductible as an expense; they are paid out of retained earnings. Dividends are subject to favorable personal tax treatment since the income has already been taxed at the corporate level. Dividend income will generate a dividend tax credit on your personal tax return. Dividend income, eligible dividends in particular, may trigger alternative minimum tax if most of your income comes from dividends.

- Depending on what type of income the company earns, there may be a choice between paying eligible and ineligible dividends. Eligible dividends are taxed at a lower personal tax rate than ineligible dividends. Eligible dividends are available if the corporation has a balance in its general rate income pool (GRIP). A GRIP balance arises when a corporation has taxable income that is taxed at the general rate and does not benefit from the small business deduction.

- If the company earns investment income (as opposed to active business income) or receives dividends from an investment portfolio it may have Refundable Dividend Tax on Hand (RDTOH). Eligible dividends should be paid in order to recover a dividend refund in the corporation of 38.3% of the dividends paid to shareholders. If eligible dividends are unavailable, there is potentially a higher combined taxes by the shareholder and the corporation if ineligible dividends are paid.

- Another factor to consider is whether your corporation can pay capital dividends. Capital dividends are tax free to the shareholders receiving them. The capital dividend account will generally consist of the one-half, non-taxable portion of any capital gains that the corporation has realized from selling capital property. Capital dividends paid from other corporations would also be included in the capital dividend account.

In order to provide tax planning and determine the most advantageous mix of salaries and dividends (both eligible and ineligible), an estimate of a shareholder's personal income levels, the corporation's income and the balances in the shareholder's loan accounts will be required.

Income Splitting Opportunities

Tax efficiency may be achieved by having additional income taxed by family members in a lower tax bracket. One way to achieve this is for salaries to be paid to family members. Any salary that is paid should be at the fair market value of the work performed. Dividends may also be used to split income, however, the impact of attribution rules must first be considered.

Contributing to Retirement Tax Plans

Registered Retirement Savings Plans (RRSP)

The deadline for making a 2016 RRSP contribution is March 1, 2017. Before making RRSP contributions, ensure that you have RRSP contribution room as 1% tax per month will be applied to RRSP contributions that exceed your deduction limit by more than $2,000. Your notice of assessment for the previous tax year will show your RRSP contribution room.

If you draw money from a corporation in the form of a salary and contribute it to an RRSP once you hold the money personally, the taxes paid overall will end up being very similar to leaving the money in the corporation or distributing it to a holding company, which can act as a "personal RRSP."

Tax Free Savings Account (TFSA)

For 2016 you can contribute up to $5,500 annually to a TFSA as long as you are 18 years or older and a resident of Canada. In subsequent years, the contribution limit will be indexed to inflation and rounded to the nearest $500.

TFSAs do not provide a tax deduction, however, the investment income earned inside of a TFSA is tax free and any unused amounts are carried forward.

Funds can be given to a spouse or common-law partner for them to invest in their TFSA and normal attribution rules would not apply.

Registered Education Savings Plan (RESP)

A Registered Education Savings Plan is a tax-efficient approach to save for your child or grandchild's post-secondary education. Through the Canada Education Savings Grant (CESG), the government will match 20% of contributions made, up to $500 annually, for each year the beneficiary is 17 or younger. This annual CESG maximum is increased to $1,000 if you have unused grant room carried forward from a prior year. The maximum lifetime CESG grant that you may receive is $7,200.

The maximum lifetime contributions that you may make to an RESP are $50,000 for each beneficiary. An additional benefit of an RESP is that contributions made and grants received grow tax-free until they are withdrawn by a beneficiary to help cover the costs of their post-secondary education. Education Assistance Payment withdrawals from a RESP are taxed on the student's tax return and generally result in minimal tax, provided they have limited other income while they are going to school.

Registered Disability Savings Plan (RDSP)

A Registered Disability Savings Plan is an investment option that can be used to provide financial security for an individual who is eligible to claim the Disability Tax Credit. An individual's parents of other eligible contributors can contribute up to $200,000 to an RDSP before the designated beneficiary turns 59.

If the contributions are made before the individual is 49, federal assistance may be available to match up to $3,500 of contributions annually under the Canada Disability Savings Grant (CDSG) and $1,000 of contributions annually through the Canada Disability Savings Bond (CDSB). The specific assistance available is dependence on the net income of the beneficiary's family and may be carried forward for up to ten years if not used.

Investment income earned in the RDSP will grow tax-free and are not taxed by the beneficiary until they withdraw the investment income or the federal assistance from the RSDP.

Charitable Donations

In order to claim charitable donations on your 2016 personal tax return, the donation must be made by December 31st. The combined federal and BC provincial donation tax credits available are equal to 26% of the first $200 of charitable donations made and 44% for donations greater than $200, up to 75% of your net income.

In addition, if you and your spouse have not claimed a charitable donation tax credit since 2008, you may be eligible to claim the First-Time Donor's Super Credit (FDSC) equal to 25% of the first $1,000 in donations claimed.

Gifting publically-traded securities directly to a registered charity is another tax-efficient option as you will receive a donation tax credit based on the current fair market value of the securities and you do not pay tax on any accrued or unrealized capital gains.

Triggering Tax Losses

If you own investments with unrealized losses, you may consider selling them prior to December 31, 206 in order to offset against current year capital gains or to carry back to the previous three taxation years.

There are rules in place for creating an artificial loss that need to be considered. Specifically that you do not buy similar property 30 days subsequent to the sale of the property.

Corporate Tax Considerations

Corporations that are Canadian-controlled private corporations (CCPCs) are eligible for the small business deduction for income up to $500,000. Income beyond $500,000 is subject to higher corporate tax rates.

For 2016, combined BC and Federal income that is eligible for the small business deduction is taxed at 13%. For income above the $500,000 threshold, the general rate is 26%. Investment income earned in a CCPC is taxed at 49.7%.

As part of your year-end tax planning, you may want to consider reducing your corporate income to the small business deduction by paying out bonuses in order to benefit from the lower tax rate for the corporation. As well, there may be opportunities to utilize losses in other related companies.

If funds are to be reinvested in the corporation, a taxpayer may wish to pay corporate income tax at the general rate and defer payment of dividends and the personal income taxes that would be incurred on a bonus.

Another factor to consider as your year-end approaches is the purchase of capital assets. For tax purposes, the business can claim a tax depreciation in the year of acquisition at one-half of the normal rate. If you purchase and place assets into use close to your year-end, you will effectively be accelerating the rate at which you can claim CCA since you will be able to claim CCA for one-half of the year.

Changes to Eligible Capital Property

The 2016 Federal budget introduced changes to the eligible capital property (ECP) rules that will take effect January 1, 2017. ECP includes intangible assets that have been purchased including goodwill, customer lists, licenses, and trademarks.

Currently, when ECP is purchased, 75% of the cost is added to the company's cumulative eligible capital (CEC) balance and 7% may be amortized annually. When ECP is sold for proceeds greater than the original cost, including the sale of internally generated goodwill, any previously claimed amortization must be included in income. In addition, half of any gain is taxed as active business income and the remaining half is added to the company's capital dividend account (CDA) and may be paid out tax-free to shareholders.

Effective January 1, 2017, a company's cumulative eligible capital account will be removed and the balance will be transferred to a new class of depreciable capital property, Class 14.1. Similar to other capital cost allowance classes, any intangible assets added to Class 14.1 may be amortized annually at a rate of 5%. Under the new rules, when intangible property is sold for greater than its cost, half of the gain will now be reported as a taxable capital gain and treated as investment income. The non-taxable half of the gain is still added to the company's CDA account and may be paid out to shareholders tax-free.

Tax Planning Point:

If you are currently in the process of selling your business with high internally-generated goodwill, completing the sale before December 31, 2016 will result in a large tax deferral as half of the gain on the goodwill will be included as active business income instead of investment income, which is taxed at a significantly higher tax rate.

If the sale is not anticipated to complete before the calendar year-end, a corporate reorganization could also be considered to realize the gain on the sale of the goodwill to a separate company.

This discussion is intended only as an introduction to the matter and is not exhaustive. Should you have any questions relating to how these rules may affect you or your family please contact us.

Dickson Dusanj & Wirk
250.220.7311
www.ddwca.com