TaxNewsFlash Canada

Owner-Managers — Tax Planning Tips for 2016

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As an owner-manager, the end of the year is always a good opportunity for you to consider ways to improve your tax position. Before January 1st arrives, you can still act to manage taxes for yourself and your incorporated business for 2016. This year, there are several new things to keep in mind as you review your 2016 business tax situation. If your company is a Canadian controlled private corporation and you want to sell your business remember that due to the new eligible capital property rules, you may want to conclude the sale before December 31, 2016 in order to benefit for a tax deferral of approximately 12%.

Also, as a note of caution, if you need to pay inter-corporate dividends through a corporate group, you should carefully review the recent tax changes which expand the rules that re-characterize certain tax-free inter-corporate dividends as capital gains that are subject to tax.

To help you assess your 2016 tax situation, KPMG has prepared the following checklist, complete with tips. The checklist will help you review your compensation, investments, family tax considerations and business tax considerations, among other things.

These tips assume your corporation has a December 31 year-end. But even if it doesn't, you can still use these ideas to maximize personal tax savings in 2016 and whenever your business' year-end comes up. For more general tips on year-end tax savings for individuals, see our *TaxNewsFlash-Canada* 2016-49 "2016 Year End Tax Planning Tips".

Your Compensation

☐ Have you planned an effective dividend/salary mix?

As the owner of an incorporated business, you can choose to receive corporate income as salary or dividends. To determine what's best for you for 2016, you should carefully analyze the best mix of salary and dividends for you, which will depend on many factors including:

- Your current and future cash flow needs
- Your income level
- The corporation's income level
- Payroll taxes on salary.

You may want to pay yourself enough salary to allow the maximum possible contribution to an RRSP. The same goes for any family members you've employed. The maximum contribution is 18% of the previous year's earned income, up to a limit of $25,370 for 2016 and $26,010 for 2017. As such, you will need about $144,500 in salary in 2016 to make the maximum RRSP contribution for 2017.

If you are in a volatile business that you feel could suffer from an economic downturn, you should, however, consider whether paying out a large salary in a profitable year to reduce company income can take away your company's option to carry back a later year's business loss to recover corporate taxes paid, if such a loss materializes.

☐ Have you considered accruing your salary or bonus?

Once you decide on the appropriate salary or bonus for your company to pay you, consider accruing the salary or bonus in the business at year-end but deferring the payment to you until next year (up to 179 days after the company's year-end). Assuming a December 31 year-end, the company gets a deduction in 2016, source deductions do not have to be remitted until the salary or bonus is paid in 2017, and you don't have to include the amount in your income until you file your personal tax return for 2017, sometime in 2018.

If your company claims R&D tax credits, you may want to pay yourself enough salary or bonus to keep the company's taxable income at or below the federal small business deduction limit of $500,000. Doing so can help to enhance the benefits of your company's R&D tax credits and refunds.

Paying Inter-corporate Dividends

If you need to pay inter-corporate dividends by transferring cash or assets through your corporate group (for example, to provide cash flow for your company to pay dividends to you personally) you should carefully consider the recent changes to the tax rule which re-characterizes certain tax-free inter-corporate dividends as capital gains that are subject to tax.

The changes significantly broaden the circumstances in which the anti-avoidance rule can apply by introducing several new purpose tests and narrowing the scope of the related party exception. As a result, many standard corporate transactions that give rise to dividends may now be caught by this rule, which applies to dividends received after April 20, 2015 (see *TaxNewsFlash*-Canada 2016-28, "Paying Inter-Corporate Dividends? Proceed with Caution").

As a result of these changes, in most cases you should calculate "safe income" before paying an inter-corporate dividend, in order to determine whether it qualifies for the exception to the anti-avoidance rule for dividends paid out of a corporation's safe income.

Family Tax Considerations

☐ Family employment — Have you thought about paying a salary to your family?

It's worth considering having your company pay a salary to your spouse and/or children. Your company will get a tax deduction for the salary paid, if it is reasonable in light of the services they perform for the business (e.g., bookkeeping, administrative work, acting as a director). A salary is usually considered reasonable if the services are genuinely being provided and if it is similar to arms' length comparables. Note that the extra cost of any payroll taxes and Canada Pension Plan contributions should be weighed against potential tax savings. A salary will also enable your spouse and/or children to contribute to their RRSP.

Business Tax Considerations

☐ Selling Your Business

If you are thinking of selling your business, you may want to consider doing so before December 31, 2016. In particular, if you own a Canadian-controlled private corporation (CCPC) and eligible capital property (ECP), for example, goodwill, is its biggest asset, delaying a sale until after December 31, 2016 might mean that you could lose a tax deferral of approximately 12% (assuming you have no immediate personal need for the proceeds from the sale of your business).

If you cannot complete the sale of your business before December 31, 2016 an internal sale of your business, including your ECP, could be considered depending on the circumstances. ECP may include intangibles, such as goodwill, trademarks, customer lists, and certain licenses, including farm production quotas.

The new rules will generally tax a sale of ECP as capital gains, effective January 1, 2017, subject to certain transitional rules. Currently, gains from the sale of ECP are taxed at 50% of the active business income tax rate, which is lower than the capital gains tax rate. (See *TaxNewsFlash-Canada* 2016-45, "Selling Your Business — Preserve Lower Tax Rates Now", for more.)

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Small Business Deduction Changes

Have you determined whether you are affected by the 2016 federal budget's changes to limit access to the small business deduction? While the small business deduction rate is staying at 10.5% (and not decreasing to 9% by 2019, as previously scheduled) there have been several changes that reduce the number of instances where the small business deduction can be claimed. These changes affect corporations' tax years that begin after March 21, 2016. You should review your corporate structure to ensure that your small business corporation that was previously eligible to claim the small business deduction is still able to claim the deduction in the future.

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Update for HST Changes

Businesses should ensure that they have completed any adjustments that need to be made to their systems and processes to accommodate the new HST changes in New Brunswick, Newfoundland and Labrador, Ontario and Prince Edward Island, if they have activities in those provinces (see *TaxNewsFlash-Canada* 2016-27 "Upcoming HST Changes — Get Systems and Processes Ready).

☐ Are you properly timing your purchase and sale of fixed assets?

If your company has a depreciable asset you're thinking about selling that will be subject to recaptured depreciation, consider holding off on closing the sale until after your 2016 corporate year-end, as long as it makes sense for your business. That way, you'll be able to claim capital cost allowance (CCA) on the asset for one more year. You'll also defer the recapture arising from the sale until 2017.

On the other hand, if you're considering buying any depreciable assets, try to acquire them by December 31, 2016 (assuming your company has a December 31 year-end). As long as you can actually put the asset to use in your business this year, acquiring the asset just before the company's year-end will accelerate the timing of your tax deduction — you'll be able to claim CCA on the asset for 2016 at half of the CCA rate otherwise allowable (due to the "half-year" rule). You'll also be able to claim CCA at the full rate for all of 2017.

☐ Have you considered repaying shareholder loans?

If you borrow money from your corporation at low or no interest, you are generally considered to have received a taxable benefit from the corporation equal to the CRA's current 1% prescribed interest rate, minus any interest you actually pay during the year or within 30 days after the end of the year.

Unless the loan is for a limited number of qualified purposes, it will be included in your income for tax purposes in the year it was advanced, unless you repay it within one year after the end of the company's taxation year in which the loan was made. For example, if your company has a December 31 year-end and it loaned you funds on October 1, 2015, you must repay the loan by December 31, 2016 to avoid paying tax on the amount of the loan as income in your 2015 personal tax return.

☐ Have you applied for apprentice and co-op tax credits?

If your company claims federal or provincial tax credits for apprentices and co-op students you employ, you already know these tax credits can provide a valuable cash flow boost to your business. If you don't claim these credits, it's worth the time to check on whether you qualify. It's important to gather the proper documents to support your claim for these credits, such as apprenticeship training agreements, as soon as possible because it can be difficult to get these documents after apprentices have left your employ. If your apprentices or co-op students are leaving your company at the end of the year, now is a good time to make sure you have all the paperwork you need from them.

☐ Can you reduce the taxable benefit for your company car?

If you drive an automobile provided by your company, your taxable benefit for your use of the car may be reduced for 2016. The taxable benefit consists of two elements: the standby charge and the operating cost benefit. If certain conditions are met, you can reduce your standby charge by a percentage equal to your personal-use kilometres driven divided by 20,000 (assuming the car was available to you for the full 12 months). The standby charge may be reduced by any reimbursement you make in 2016 for use of the car other than the portion relating to the operating cost.

The taxable benefit for operating costs is 26¢ per kilometre of personal use for 2016. If the company pays any operating costs during the year for your personal use of the company car and you don’t fully reimburse the company by the following February 14, the 26¢ rate applies (less any partial reimbursement that you pay by this date). (For more planning ideas regarding the business use of a vehicle, see section 12.2 of KPMG's *Tax Planning for You and Your Family 2017.*)

☐ Have you considered other planning opportunities?

Other opportunities may be available to you and your business. For example, you could:

- Take steps to keep the corporation a small business corporation at all times
- Consider the ability to use your lifetime capital gains exemption
- Maximize capital dividend payments
- Consider a tax-free repayment of capital (this repayment must be carefully structured to ensure it will be tax-free)
- Consider transferring non-personal assets (e.g., an investment) to the corporation to establish a shareholder loan from which you may be able to later withdraw corporate funds on a tax-free basis. However, the transfer may result in an immediate tax cost, and other tax and non-tax issues must be considered before an actual transfer is made.

For more details on these opportunities, as well as other ideas you can use to manage your taxes, see chapter 14, "If you have your own corporation" of KPMG's latest book *Tax Planning for You and Your Family 2017.*

Your Retirement

☐ Estate planning — Have you reviewed your will?

If your estate plan includes creating a trust to pass on your business to family members, you should review your will in light of new legislation that taxes testamentary trusts at the top marginal tax rate rather than the lower graduated tax rates, effective January 1, 2016.

Also, if you plan to make gifts to charity through your will or estate, you may be able to benefit from new flexibility in the use of your estate's donation tax credits. (See KPMG's *TaxNewsFlash-Canada* 2016-48, "Making the Most of Your Charitable Gifts for 2016.)

We can help

Tax planning throughout the year should be an important part of your efforts to get the most out of your business' financial resources. Your KPMG Enterprise adviser can help you review your personal and business tax situation to determine what steps you can take in the remaining two months of 2016 to manage the taxes you and your business pay. For details, contact your KPMG Enterprise adviser.

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