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2019 Year-End Tax Tips for Owner-Managers

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As an owner-manager of a company, it is important for you to consider year-end tax planning to make sure you are receiving distributions from your company in a tax-efficient manner. As the Liberal Party of Canada has been elected for a second term, albeit with only a mandate to form a minority government, it is likely that you and your business will continue to be affected by existing rules affecting small businesses, including the relatively recent tax on split income (TOSI) rules and the new passive investment income regime.

These new tax rules are complex and it will take you time to fully assess how they may affect you, your family and your private company. As a result, we recommend you meet with your KPMG Enterprise Tax Advisor as soon as possible—well before the end of the year—so that you can determine how these and other tax rules might affect you, your family and your private company.

Year-end planning checklist for 2019

To help you assess your 2019 tax situation, KPMG has prepared a checklist with tips that will help you evaluate your compensation plan, family tax considerations, business tax considerations, and estate plan, among other items. These tips assume your corporation has a December 31 year-end. However if it doesn't, you can still use these ideas to improve your overall tax position whenever your business' year-end comes up.

For tips on year-end tax savings for individuals, see our *TaxNewsFlash-Canada* No. 2019-47, "2019 Year-End Tax Tips for Your Personal Taxes".

For information about tax savings that are available to you when you make donations to charities, please see our upcoming *TaxNewsFlash-Canada*, "Charitable Planning – Helping

Your Donation Go Further". If your private corporation donates securities or other capital property, your corporation's capital dividend account will be increased by the non-taxable portion of the capital gains. This amount can be paid out to you and other shareholders tax-free.

Tax issues to consider before 2020

✓ **Your compensation**
- Do you have an effective dividend/salary mix?
- Have you considered accruing your salary or bonus?
- Do you have a stock option plan?

✓ **Family tax considerations**
- Should you employ and pay a salary to a member of your family?
- Have you considered whether distributions from your company are subject to TOSI?
- Have you considered income splitting loans with family members or family trusts?

✓ **Business tax considerations**
- Is your company affected by the new passive investment income regime?
- Should you pay dividends in 2019 or 2020?
- Should you pay an eligible dividend or non-eligible dividend?
- Do you pay inter-corporate dividends?
- Does your company receive dividends from a foreign affiliate?
- Have you maximized the small business deduction?
- Are you properly timing your purchase and sale of fixed assets?
- Do you have assets eligible for the new accelerated CCA rules?
- Did you purchase a zero-emission vehicle?
- Have you considered repaying shareholder loans?
- Have you applied for apprentice and co-op tax credits?
- Has your company made CPP and EI overpayments?
- Can you reduce the taxable benefit on your company car?
- Do you operate a professional business that has work in progress?

✓ **Your estate**
- Have you reviewed your will?

✓ **Other planning opportunities**

Your Compensation

☐ Do you have 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 in 2019, you should carefully analyze the best mix of dividends and salary for your particular situation. This will depend on many factors, including:

- Your current and future cash flow needs
- Your income level
- The corporation's income level
- Whether the TOSI rules affect you and your family
- Whether the new passive investment income regime including the new dividend refund rules affect your corporation
- 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 amount is 18% of the previous year's earned income, up to a limit of $26,500 for 2019, and $27,230 for 2020. You will need about $151,278 in salary in 2019 to make the maximum RRSP contribution for 2020.

Although the TOSI rules, which subject individuals to the top personal marginal tax rate, do not apply to salaries, remember that salaries paid to family members must be "reasonable" for your company to get a tax deduction (see below for additional considerations to keep in mind when paying salaries to family members).

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

See below for a discussion on paying dividends in 2019 versus 2020, as well as paying eligible or non-eligible dividends in a specific order to minimize the impact of the new dividend refund rules that are part of the new passive investment income regime.

☐ Have you considered accruing your salary or bonus?

Once you decide on an appropriate salary or bonus for your company to pay you, consider accruing the salary or bonus in the business at year-end, but deferring your receipt of that amount until next year (i.e., up to 179 days after the company's year-end). Assuming your company has a December 31 year-end, it will get a deduction in 2019, and source deductions will not have to be remitted to the CRA until the salary or bonus is paid to you in 2020. However, as discussed above, you may want to actually pay yourself enough salary in 2019 to allow yourself to make the maximum possible contribution to an RRSP in 2020.

If your company's tax year ends after March 18, 2019, and it claims Scientific Research and Experimental Development (SR&ED) tax credits, you no longer need to pay yourself enough salary or a sufficient bonus to keep the company's taxable income at or below the federal small business deduction limit of $500,000 to help enhance the benefits of your company's SR&ED tax credits and refunds. This is because the 2019 federal budget announced the repeal of the use of taxable income as a factor in determining a Canadian Controlled Private Corporation's (CCPC) annual expenditure limit for the purpose of the enhanced refundable SR&ED credits. As a result, small CCPCs with taxable capital of up to $10 million will be able to access the enhanced refundable SRED tax credits, on an unreduced basis regardless of their taxable income.

Alberta's 2019 budget announced it will eliminate its SR&ED tax credits, starting in 2020. As a result, expenses incurred after December 31, 2019 will no longer be eligible for this credit. If your private company is a resident in Alberta, you should consider accelerating eligible SR&ED expenditures to maximize the tax benefit of this credit. See *TaxNewsFlash-Canada* No. 2019-44, "Highlights of the 2019 Alberta Budget" for more details.

☐ Do you have a stock option plan?

If your company has a compensation plan that involves stock options, consider whether you could be affected by Canada's proposed new stock option rules, which would cap the amount of certain employee stock options eligible for the stock option deduction at $200,000, after December 31, 2019. Be advised, these rules will not affect you if your stock options are granted by a CCPC or certain "highly innovative, fast-growing companies". See *TaxNewsFlash*-Canada No. 2019-29, "Finance Reveals More Details on Stock Option Deduction Cap" for more information.

Family Tax Considerations

☐ Should you employ and pay a salary to a member of your family?

If you have family members who provide services to your incorporated business, you may want to consider employing them and paying them an appropriate salary. Your company will get a tax deduction for the salary paid, so long it is reasonable in light of the services they perform for the business.

A salary is usually considered "reasonable" if the services are genuinely being provided and if the salary is similar to a comparable market rate. If you are paying a salary to a family member, consider creating an employment contract or retaining documents (e.g., time sheets) to support their contributions to the business, and thus the reasonableness of the salaries paid.

Note that the extra cost of any payroll taxes including Canada Pension Plan contributions should be weighed against potential tax savings. On the other hand, and as mentioned above, a salary may allow your family members (e.g., a spouse and/or children) to contribute to their RRSPs. Also, the TOSI rules do not apply to salaries paid to members of your family.

☐ Have you considered whether distributions from your company are subject to TOSI?

If you or a family member (e.g., spouse and/or children) receive an amount subject to TOSI from your company, you or your family member will be taxed at the top marginal tax rate on that amount—even if you or that family member are not otherwise in that top marginal tax bracket. You and your family members may be subject to the TOSI rules when receiving amounts, such as dividends or interest from your private company, or certain capital gains from the disposition of shares or debts of your private company, or of an interest in a partnership or trust.

The TOSI rules became effective January 1, 2018, and include several exemptions that can prevent amounts from being taxed at the top personal marginal tax rate. For instance, the “excluded shares” exception exempts individuals who are 25 or older and who own at least 10% of the votes and fair market value of the company. The company must earn less than 90% of its income from providing services and cannot be a professional corporation (e.g., it cannot be a company operated by an accountant, lawyer, doctor or dentist) and it cannot derive more than 10% of its income from another “related” business. Determining whether the “excluded shares” exception applies requires an assessment each time an amount is received by you or a family member.

If you are 65 or older and your spouse is a shareholder of your company, you may be able to pay dividends to your spouse without TOSI applying. If your spouse is in a lower tax bracket than you, paying him/her dividends may yield overall tax savings. This rule (i.e. the “pension income splitting” exception) was introduced to provide private company owners with a similar tax benefit available to individuals who are eligible to split their pension income with their spouse.

In addition to the “excluded shares” exception and “pension income splitting” exception, there are other exceptions based on the age group of the individuals receiving amounts from private companies, such as the “excluded business” exception, “reasonable return” exception, and “not from a related business” exception, to name a few. Whether any of these exceptions apply to your particular situation requires a detailed analysis because the rules are quite complex.

You and your KPMG Enterprise Tax Advisor may want to review your tax situation to assess any TOSI implications. You might also need to think about your private company’s organizational structure in light of the TOSI rules. You may need to make changes concerning share ownership and distributions, to ensure you and your family are not adversely affected by the TOSI rules.

☐ Have you considered income splitting loans with family members or family trusts?

The CRA’s low prescribed interest rate offers an opportunity for you to enter into income splitting loan arrangements with family members or a family trust. It may be a good idea for you to lock into such a loan at the 2% rate on or before December 31, 2019, and have a family member or family trust invest the borrowed funds at a higher rate of return. This way, you can transfer future investment income earned on the funds to your spouse or another family member who has little or no other income and thus pays little or no tax. If properly implemented, you can effectively arrange for all investment income earned over 2% to be taxed at the lower-income-earning family member's tax rate while the loan is outstanding.

However, you should note that interest earned on income splitting loans between an individual (e.g., you or a family member) and your private company may be subject to the TOSI rules. Consider whether it makes sense to unwind such a loan, since the income earned from the loan may be taxed at the top personal marginal tax rate (which would generally negate any tax benefits available from the loan).

Business Tax Considerations

☐ Is your company affected by the new passive investment income regime?

If your corporation has a December year-end, operates an active business, and earns passive investment income then 2019 is the first taxation year that the new passive investment income regime may apply to your company. This regime introduces two major changes: limiting access to the small business deduction and limiting access to dividend refunds.

Limiting access to the small business deduction

The new rules can reduce or eliminate the small business deduction for a private company that holds passive investments and also carries on an active business. Under the new rules, the small business deduction is generally reduced on a straight-line basis for affected companies that have between $50,000 and $150,000 of passive investment income. In particular, a company that earns more than $50,000 in passive investment income will lose access to the small business deduction at a rate of $5 for every $1 over $50,000. The small business deduction is therefore completely eliminated where the corporation earns passive investment income of $150,000 or more. Because these new rules apply to associated corporations and certain related corporations, isolating passive investments in a single corporation may not prevent a reduction to the corporate group's small business deduction.

These changes were first introduced at the federal level. Since then, Ontario and New Brunswick have indicated that they will not follow the federal rules to limit the access to the small business deduction. As a result, the negative impact of a reduction to a company's small business deduction will be relatively less for a corporation resident in these two provinces.

Limiting access to dividend refunds

Under the new passive investment income rules, a private company will need to pay non-eligible dividends to obtain dividend refunds on certain taxes that previously could have been refunded when an eligible dividend was paid.

You won't be affected by these rules if your company earns active business income or passive investment income, but not both. However, if your company earns active business income as well as passive investment income, you should contact your KPMG Enterprise Tax Advisor to determine if any planning opportunities should be considered before the end of the year, to mitigate the impact of the new passive investment income regime. For example, distributing some of your passive investments out of your corporation and instead owning them personally, or changing your investment portfolio to invest in equities that pay eligible dividends, so that your corporation can obtain a dividend refund upon the payment of eligible dividends to you.

☐ Should you pay dividends in 2019 or 2020?

When deciding whether you should pay dividends in 2019 or 2020, you typically need to consider relevant yearly tax rate changes as well as the acceleration or deferral of taxes. (Please see the Appendix for the combined top marginal tax rate on dividends in 2019 and 2020.) You also need to factor in the possible impact of the TOSI and passive investment income regime, as discussed above.

As illustrated in the Appendix, the combined top marginal tax rates on dividends are not changing in 2020 from 2019, other than in Quebec and Ontario. Therefore, in provinces excluding Quebec and Ontario, it might not make a difference whether you choose to pay a dividend in 2019 versus in 2020, from a tax rate perspective (assuming that the federal or provincial governments do not introduce changes to the dividend tax rates in their 2020 budgets).

In Quebec, the combined top marginal tax rate on eligible dividends will increase slightly by 0.1% from 40.0% in 2019 to 40.1% in 2020 and the combined top marginal tax rate on non-eligible dividends will increase by 0.8% from 46.3% in 2019 to 47.1% in 2020. Therefore, in Quebec, there might be potential tax savings to pay out dividends in 2019, instead of postponing the payment to 2020.

In Ontario, the combined top marginal tax rate on non-eligible dividends will increase by 0.3% in 2020 (to 47.7% from 47.4% in 2019) and thus potential tax savings may be available if you choose to pay dividends in 2019 rather than in 2020.

☐ Should you pay an eligible dividend or non-eligible dividend?

If a decision has been made to pay a taxable dividend, you may consider paying eligible or/and non-eligible dividends in a specific order, since the new passive investment income regime may limit a dividend refund claim. For example, you may want to pay eligible dividends first to exhaust ERDTOH (i.e., eligible refundable dividend on hand) account balance before paying any non-eligible dividends. This is because although the ERDTOH account balance could also be refunded by the payment of non-eligible dividends, triggering a refund from the ERDTOH account by the payment of non-eligible dividends is not tax efficient since non-eligible dividends are taxed at a higher personal rate than eligible dividends.

Also, since the combined top marginal rate in all provinces on non-eligible dividends is higher than the 38.33% dividend refund rate in both 2019 and 2020, there is no advantage to paying non-eligible dividends to recover refundable dividend tax on hand in either year.

Please contact your KPMG Enterprise Tax Advisor to determine how taxable dividends should be paid in order to minimize the effect of the new passive investment income rules that limit dividend refunds. Remember that the TOSI rules also need to be assessed before paying dividends.

☐ Do you pay inter-corporate dividends?

If you pay inter-corporate dividends by distributing cash or assets through your corporate group (e.g., to provide cash flow for your holding company to pay you dividends), you should calculate “safe income” before paying such an inter-corporate dividend. This is because certain anti-avoidance tax rules could apply to re-characterize what would otherwise be tax-free inter-corporate dividends as taxable capital gains. By calculating “safe income” you can determine if that dividend qualifies for the exception to the anti-avoidance rules for dividends paid out of a corporation’s safe income.

☐ Does your company receive dividends from a foreign affiliate?

If your company receives dividends from a foreign affiliate, you should ensure that you have prepared detailed surplus account computations. The CRA recently indicated that it will deny dividend deductions to companies that rely on surplus pools if they are not able to provide documents supporting the pool balances.

☐ Have you maximized the small business deduction?

Are you able to claim a small business deduction? The federal small business tax rate decreased to 9% in 2019 (from 10% in 2018), and is currently expected to stay at 9% in 2020. As a result, at the federal level, the small business deduction provides the same tax savings to your company in 2019 compared to 2020. At the provincial level, Quebec, Prince Edward Island and Ontario will reduce their small business tax rate to 5% in 2020 (from 6% in 2019), to 3% in 2020 (from 3.5% in 2019) and to 3.2% in 2020 (from 3.5% in 2019), respectively. Thus, in these provinces a small business deduction is worth more to a company in 2019 compared to 2020, all else being equal (and assuming no other tax rate changes are forthcoming in 2020 federal or provincial budgets).

Remember that you must review your corporate group's structure before claiming a small business deduction on your company's fiscal 2019 corporate tax return. Changes introduced in the 2016 federal budget limit the multiplication of the small business deduction through the use of certain corporations and partnerships. If your company's claim to the small business deduction is restricted because, for example, its income is generated from providing property or services to another non-arm's length corporation, then consider whether any changes should be made to your corporate structure. These changes are effective for a corporation's tax year that begins after March 21, 2016. Although these changes have been effective for a few years, the rules are complicated and thus a company may be unknowingly negatively impacted.

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

If your company has a depreciable asset you are thinking about selling, and if it will be subject to recaptured depreciation, consider deferring the sale until after your 2019 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 any recapture arising from the sale until 2020.

On the other hand, if you're considering buying any depreciable assets, try to acquire them before the end of 2019 (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 2019 at half of the CCA rate otherwise allowable due to the "half-year" rule, or even an accelerated CCA rate in certain circumstances (see following paragraph for details).

☐ Do you have assets eligible for the new accelerated CCA rules?

If you acquired a capital property in 2019, you might be able to claim a CCA of up to three times the amount of tax depreciation that would otherwise apply in the first year that the asset is available for use. You might also be able to immediately expense the cost of certain investments in qualifying machinery and equipment, as well as specified clean energy equipment.

Please contact your KPMG Enterprise Tax Advisor to find out whether you have assets eligible for these accelerated CCA rules and how much tax you can expect to save.

☐ Did you purchase a zero-emission vehicle?

If you purchased a zero-emission vehicle for your company on or after March 19, 2019, you might be eligible for a 100% CCA write-off. This 100% write-off applies to zero-emission vehicles purchased and available for use before January 1, 2024 and is subject to a limit of $55,000 plus applicable sales tax.

If you are renewing your fleet of vehicles, consider vehicles that would qualify as zero-emission vehicles to access this enhanced write-off.

Please talk to your KPMG Enterprise Tax Advisor to verify whether a specific vehicle you purchased or are considering purchasing would qualify as a zero-emission vehicle.

☐ 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 2% 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, 2018, you must repay the loan by December 31, 2019. Otherwise, the loan will generally be considered income that is taxable in your 2018 personal tax return (i.e., the year the funds were loaned to you).

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

Federal or provincial tax credits for apprentices and co-op students you employ can provide a valuable cash flow boost to your business. It's important to determine whether there have been any changes or enhancements to these credits if you already claim them. If you don't claim such credits, it's worth the time to check whether you qualify.

It's key that you gather proper documentation 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.

Since these credits vary by province and can change from year to year, please consult the KPMG Tax Incentives Group for more information.

☐ Has your company made CPP and EI overpayments?

As an employer, you must file a refund application by December 31, 2019, to claim certain overpaid contributions of Canada Pension Plan (CPP) or Employer Insurance (EI). Some of these overpaid contributions may be related to remittances on amounts that do not require withholding CPP contributions or EI premiums.

If your company made such remittances, or has made payments on amounts exceeding the maximum insurable earnings or pensionable earnings, you may be eligible to claim a refund if you file your refund application within specific time limits (i.e., no later than four years from the end of the year in which the CPP overpayment was made, and no later than three years from the end of the year in which the EI overpayment was made). In particular, you must make a refund application by December 31, 2019 for CPP contributions overpaid in 2015, or for EI premiums overpaid in 2016.

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

If you drive an automobile provided by your company, you may be able to reduce your taxable benefit for the use of the car for 2019. 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 also be reduced by any reimbursement you make in 2019 for use of the car other than the portion relating to the operating cost.

The taxable benefit for operating costs is 28¢ per kilometre of personal use for 2019. If your 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 28¢ rate applies (less any partial reimbursement that you pay by that date).

☐ Do you operate a professional business that has work in progress?

For tax years beginning after March 21, 2017, designated professionals (i.e., accountants, dentists, lawyers, doctors, veterinarians, or chiropractors) must include in their year-end business income the lesser of either the cost of their work in progress or the fair market value of their to-be-completed work, subject to a five year transitional relief period. Determining the cost of a professional's work in progress can be challenging because uncertainty may exist as to how the cost should be determined.

If you need assistance understanding the five year transitional relief mechanism, or determining the cost of work in progress, please contact your KPMG Enterprise Tax Advisor.

Your Estate

☐ Have you reviewed your will?

You may want to review your will this year if your family situation has changed (for example, if there has been a marriage, divorce, birth, or disability) or if your estate plan includes a plan to create a trust to pass on your family business to family members. You should make sure that your will planning is still tax effective, since trusts are now taxed at the top marginal personal tax rate rather than the lower graduated tax rates.

You will also want to review your will to determine whether the private company shares you leave to children (or other persons) will cause them to be caught under the TOSI rules.

Lastly, you may want to review your will or, if you have one, your secondary will, to make sure that they achieve your intended probate fee objectives.

Other Planning Opportunities

☐ Have you considered other tax planning opportunities?

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

- Consider a succession plan to ensure your business is transferred to your children, key employees or a third party in a tax efficient manner
- Consider the use of a family trust in your corporate structure to facilitate estate planning and achieve other tax and non-tax objectives
- Take steps to maintain your company's status as a "qualified small business corporation", especially in light of the new TOSI rules
- Use your lifetime capital gains exemption
- Maximize capital dividend payments—keeping your capital dividend account balance up to date is a good practice
- Make a tax-free repayment of capital (this repayment must be carefully structured to ensure it will be tax-free)
- Consider segregating investment assets from your operating company for asset protection purposes (however, if you use a holding company to segregate assets you need to ensure that you don't inadvertently cause the TOSI rules to apply to income that is received by you or family members from the holding company)
- Determine whether you should make a relieving election in situations where you sold eligible capital property (ECP) before March 22, 2016, and a portion of the proceeds of disposition became receivable after 2016. In this situation, you could elect to have 50% of the portion of proceeds receivable after 2016 taxable as business income (i.e., tax treatment that applied to ECP under the old tax regime), rather than as capital gains subject to refundable tax under the current ECP regime. The election must be

filed by the filing due date for the taxpayer's first taxation year that ends after September 30, 2019. For details, please contact your KPMG Enterprise Tax Advisor.

We can help

Most businesses find year-round tax planning to be absolutely crucial for getting the most out of their financial resources. Various relatively recent tax rules affecting private companies make planning this year even more important. Your KPMG Enterprise Tax Advisor can help you review your personal and business tax situation and determine which steps you and your business can take before the end of the year.

For details, contact your KPMG Enterprise Tax Advisor.

Appendix

Combined Top Marginal Tax Rates							
	Non-Eligible Dividends				Eligible Dividends		
	2020	2019	Increase		2020	2019	Increase
British Columbia	44.6%	44.6%	-		31.4%	31.4%	-
Alberta	42.3%	42.3%	-		31.7%	31.7%	-
Saskatchewan	40.4%	40.4%	-		29.6%	29.6%	-
Manitoba	46.7%	46.7%	-		37.8%	37.8%	-
Ontario	47.7%	47.4%	0.3%		39.3%	39.3%	-
Quebec	47.1%	46.3%	0.8%		40.1%	40.0%	0.1%
New Brunswick	47.8%	47.8%	-		33.5%	33.5%	-
Nova Scotia	48.3%	48.3%	-		41.6%	41.6%	-
Prince Edward Island	45.2%	45.2%	-		34.2%	34.2%	-
Newfoundland and Labrador	44.6%	44.6%	-		42.6%	42.6%	-

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