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Owner-Managers — Time to Do Your 2021 Year-End Review

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If you are the owner-manager of a company, the approaching new year marks a good time to take stock of your tax situation. As 2021 draws to a close, a careful review can help ensure that you are receiving distributions from your company in a tax-efficient manner, and that you are meeting your small business tax obligations. Depending on your situation, this may also include reporting financial assistance that your business received as part of the government's emergency COVID-19 measures.

This publication outlines important issues and tax tips to consider in order to assess your 2021 tax situation. While these tips assume your corporation has a December 31 year-end, you can still use most of these ideas to improve your overall tax position whenever your business' year-end comes up.

It's important to remember that the tax rules affecting small businesses are complex and can have far-reaching effects on 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—to review your tax situation.

Top tax issues you should consider before 2022

- Your compensation
- Family tax considerations
- Business tax considerations
- COVID-19 considerations
- Your estate
- Other planning opportunities

Your compensation

Determine 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 2021, you should carefully analyze the ideal mix of dividends and salary for your particular situation. This depends on many factors, some of which are discussed further in later sections, including:

- Your current and future cash flow needs
- Your desired income level
- The corporation's income level
- Whether the Tax on Split Income (TOSI) rules affect you and your family
- Payroll taxes on salary.

You may want to consider paying yourself enough salary to allow the maximum possible contribution to your 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 $27,830 for 2021 and $29,210 for 2022. You will need about $162,278 in salary in 2021 to make the maximum RRSP contribution for 2022.

There are some other important considerations too. The TOSI rules, which subject individuals to the top marginal personal income tax rate, do not apply to salaries. However, remember that salaries paid to family members must be "reasonable" for your company to receive a tax deduction. In addition, 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.

Consider 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 for the bonus in 2021, and the related source deductions do not have to be remitted to the CRA until the salary or bonus is paid to you in 2022.

Time your dividend payments

When deciding whether you should pay dividends in 2021 or 2022, you typically need to consider relevant yearly tax rate changes as well as the acceleration or deferral of taxes and to factor in the possible impact of the TOSI rules. See the attached Appendix for the combined top marginal personal income tax rates on dividends for these years.

Keep in mind that there will be no tax savings from paying dividends to recover refundable dividend tax on hand where the combined top marginal personal income tax rate on dividends is higher than the 38.33% dividend refund rate.

Family tax considerations

Consider employing and paying 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, as long as the amounts are “reasonable”. A salary is usually considered reasonable if the services are genuinely being provided, and 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 documentation (e.g., time reports) to support their contributions to the business, and the reasonableness of the salaries paid.

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

Consider whether distributions from your company are subject to TOSI

If you or a family member (e.g., spouse or children) receive an amount subject to TOSI from your company, that person will be taxed at the top marginal personal income tax rate on that amount—even if you or that family member are not otherwise in that top personal income tax bracket. In addition, the only credits allowed against income subject to TOSI are the disability tax credit, the dividend tax credit and the foreign tax credit. You and your family members may be subject to the TOSI rules when receiving amounts such as dividends or interest from your private company. The rules may also apply on certain capital gains from the disposition of shares or debts of your private company, or of an interest in a partnership or trust.

Determining whether TOSI applies to your particular situation requires a detailed analysis, as the rules are extremely complex and there are many potential exceptions. It’s a good idea to consider professional advice on this matter.

Consider income splitting loans to family members or family trusts

The CRA’s current low prescribed interest rate of 1% offers an opportunity for you to lock in an income splitting loan arrangement with family members or a family trust on or before December 31, 2021. See *TaxNewsFlash-Canada* 21-54, “Get a Head Start on Your 2021 Personal Tax Roundup” for details.

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 marginal personal income tax rate (which would generally negate any tax benefits available from the loan).

Revisit your business succession plan

If you are thinking about passing your business down to your children or grandchildren, you should contact your KPMG Enterprise Tax Advisor to discuss the new rules on intergenerational transfers. Specifically, the government recently passed new income tax relief intended to address the transfer of shares to corporations controlled by certain family members. As a result, you may qualify for a more favourable tax treatment when passing along your family business to the next generations. For more details, see *TaxNewsFlash-Canada* 21-41, "New Intergenerational Transfer Rules — More Changes Coming".

Note that the government says it intends to consult on further amendments to these new rules.

Business tax considerations

Calculate "safe income" before paying inter-corporate dividends

If you pay inter-corporate dividends, or redeem shares 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 or redeeming shares. This is because certain tax-free inter-corporate dividends could be recharacterized as taxable capital gains under specific anti-avoidance tax rules. 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.

Watch out for rules that limit access to the small business deduction

There are complex rules that limit access to the small business deduction, so remember to review your corporate group's structure before claiming this deduction on your company's fiscal 2021 corporate tax return. For example, if your company (or an associated company) operates an active business and your company (or an associated company) earns passive investment income, then you should consider whether you may be affected by the passive investment income rules which limit access to the small business deduction. Under these rules, the small business deduction is generally reduced on a straight-line basis for companies within an associated group when the associated group earns between $50,000 and $150,000 of passive investment income. The small business deduction is completely eliminated where the associated group of companies earns passive investment income of $150,000 or more. However, note that Ontario and New Brunswick have not harmonized with this federal measure. Your company's access to the small business deduction may also be restricted because its income is generated by providing property or services to another non-arm's length corporation.

Properly time your purchase and sale of fixed assets

If you are thinking about selling a depreciable asset owned by your company that will be subject to recaptured depreciation, you may want to defer the sale until after your 2021 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 2022.

On the other hand, if you're considering buying any depreciable assets, try to acquire them before your 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 2021 at half of the CCA rate otherwise allowable due to the "half-year" rule, or even an accelerated CCA rate in certain circumstances.

Furthermore, you should consider how acquisitions may be affected by the proposed rules on immediate expensing of eligible property for Canadian-controlled private corporations (CCPCs). For example, you may want to take a closer look at the timing of acquiring eligible property, and consider to which assets the new rules should apply in cases where you have a choice, among other considerations.

Although draft legislation is still pending for this measure, the 2021 federal budget provides immediate expensing of certain properties acquired by a CCPC, up to a maximum of $1.5 million per taxation year. Eligible property includes any capital property subject to the CCA rules, except for property that would be included in Classes 1 to 6, 14.1, 17, 47, 49 and 51. Immediate expensing applies to eligible property acquired on or after April 19, 2021 and available for use before 2024. For more details, see *TaxNewsFlash-Canada* 21-21, "2021 Federal Budget Highlights" and *TaxNewsNow*, "Immediate expensing of capital property — Tax planning".

Repay 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 with a December 31 year-end loaned you funds on October 1, 2020, you must repay the loan by December 31, 2021. Otherwise, the loan will generally be considered income that is taxable in your 2020 personal tax return (i.e., the year the funds were loaned to you).

Apply for apprentice and co-op tax credits

If you claim federal or provincial tax credits for apprentices and co-op students you employ, you should review these credits to determine whether there have been any recent changes or enhancements. These credits, which can help boost your business' cash flow, vary by province, and can change from year to year. If you don't claim such credits, it's worth the time to check whether you qualify.

Don't forget to 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 obtain them after apprentices have left your employ. For assistance with these credits, contact the KPMG Tax Incentives group.

Check whether your company made CPP and EI overpayments

As an employer, your company has until December 31, 2021 to file a refund application for CPP contributions overpaid in 2017, or for EI premiums overpaid in 2018 (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).

Reduce the taxable benefit for your company car

If you drive an automobile that is owned or leased by your company, you might be able to reduce the taxable benefit for your use of the car in 2021. See *TaxNewsFlash-Canada* 21-54, "Get a Head Start on Your 2021 Personal Tax Roundup" for details.

Determine whether the professional business you operate has work in progress

Designated professionals (i.e., accountants, dentists, lawyers, doctors, veterinarians, or chiropractors) must include certain "in progress" amounts in their year-end business income. This amount is 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 for tax years beginning after March 21, 2017.

It is important to understand the five-year transitional relief mechanism, and accurately calculate the cost of a professional's work in progress, as it can be challenging.

Sell investments with capital losses/gains

If your company owns investments with unrealized capital losses, consider selling them before your company's year-end (but only after your company's capital dividend account has been paid out). This way, your company can realize the loss and apply it against any net capital gains your company realized during the taxation year, or in the past three taxation years. When selling these investments, remember that it's important to comply with special tax rules designed to stop the artificial creation of tax losses (e.g., the suspended loss rules). If you intend to do any last-minute 2021 trades, consider completing all trades on or before December 20, 2021 (assuming a calendar year-end for the company), and confirm the settlement date with your broker.

Many owner-managers realized capital losses as a result of the economic impact of the COVID-19 outbreak. If your company has unused capital losses, you may want to meet with your KPMG Enterprise Tax Advisor to find ways to use these losses to improve your cash flows.

If your company has investments with unrealized capital gains but no capital losses to offset the capital gains, consider whether it may be beneficial for your company to sell those investments after your corporate year-end, so that your company will be taxed on the gains in a later taxation year instead of this year.

On the other hand, consider whether it may be beneficial for your company to sell investments with unrealized capital gains now. Although an increase to the capital gains inclusion rate was not part of the Liberal Party's 2021 federal election campaign platform, there has been media speculation of a possible increase in the capital gains inclusion rate. It is important to note that selling now may not make sense if you are not already thinking of selling those investments in the near future because your company will be paying taxes earlier than it otherwise would.

In each case, tax considerations should not override your investment decisions.

Consider upcoming tax rate reduction for zero-emission technology manufacturers

If your company is a zero-emission technology manufacturer, you should be aware that the 2021 federal budget proposed to temporarily reduce the small business tax rate to 4.5% (from 9%) and the general corporate tax rate to 7.5% (from 15%) on eligible zero-emission technology manufacturing and processing income. Although draft legislation is still pending for this measure, the reduced tax rates are proposed to apply to taxation years beginning after 2021. The reduced rates are gradually phased out starting in taxation years that begin in 2029, and are fully phased out for taxation years that begin after 2031.

COVID-19 considerations

Report government assistance

If you claimed the Canada Emergency Wage Subsidy (CEWS), the Canada Emergency Rent Subsidy (CERS), the Lockdown Support Subsidy or the Canada Recovery Hiring Program (CRHP) this year, you should ensure that you correctly report these amounts on your 2021 tax return and remit any required taxes as these subsidies are considered taxable income. For the latest details on these subsidies, see *TaxNewsFlash-Canada* 21-49, "COVID-19 — Changes Ahead for Business Support Programs".

If you received a loan through the Canada Emergency Business Account (CEBA) this year, you should ensure that you report the forgivable portion of this loan as income on your 2021 tax return and remit any required taxes. However, as CEBA funds are to be used to pay for non-deferrable operating expenses of your business, you can instead elect to reduce the amount of an outlay or expense as opposed to reporting the amount as an income inclusion. If the amount is repaid, you can claim a deduction at the time of repayment.

Consider an estate freeze or refreeze to pass on future growth to family members

An estate freeze can help ensure that the future growth in the fair market value of your company will accrue to family members who are participating common shareholders (either directly or via a family trust). An estate freeze may also cap your fair market value in the company, and thus limit your income tax liability from a future disposition of your shares. However, the impact of the TOSI rules on this planning should also be considered.

If you previously did an estate freeze, you may want to consider “refreezing” if the fair market value of your company has recently declined in value as a result of the economic impact of COVID-19.

Complete and sign Form T2200 or Form T2200S so employees can claim home office expenses

If you asked your employees to work from home this year during the ongoing COVID-19 pandemic, they may be able to claim home office expenses for work spaces and home office supplies, as long as you do not directly reimburse these expenses. Although the CRA has not yet updated its guidance on home office expenses for 2021, last year you had to complete and sign a Form T2200, "Declaration of Conditions of Employment" or Form T2200S, “Declaration of Conditions of Employment for Working at Home Due to COVID-19” for each employee who used the detailed method to claim home office expenses. For more details, see *TaxNewsFlash-Canada* 21-54, “Get a Head Start on Your 2021 Personal Tax Roundup”.

Your estate

Review your will

You may want to review your will this year if your family situation has changed (e.g., 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 taxed at the top marginal personal income tax rate rather than the lower graduated income tax rates.

You may 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

Make a charitable donation

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. For more about tax savings that are available to you when you donate to charities, see *TaxNewsFlash-Canada* 21-52, "Make Your 2021 Charitable Gifts Go Further".

Consider more opportunities

As an owner-manager you may also want to take stock of other opportunities to:

- Use realized non-capital losses to improve your cash flows
- Determine whether a family trust in your corporate structure could facilitate estate planning and achieve other tax and non-tax objectives
- Ensure your company is maintaining its status as a "qualified small business corporation", especially in light of the TOSI and new intergenerational transfer of family business 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)
- Determine whether to segregate investment assets from your operating company for asset protection purposes.

We can help

Most businesses find year-round tax planning to be crucial for making the most of their financial resources. Recent tax rule changes 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 Personal Income Tax Rates						
	Non-Eligible Dividends			Eligible Dividends		
	2022	**2021**	**Increase / Decrease**	**2022**	**2021**	**Increase**
British Columbia	48.9%	48.9%	-	36.5%	36.5%	-
Alberta	42.3%	42.3%	-	34.3%	34.3%	-
Saskatchewan	41.8%	42.3%	-0.5%	29.6%	29.6%	-
Manitoba	46.7%	46.7%	-	37.8%	37.8%	-
Ontario	47.7%	47.7%	-	39.3%	39.3%	-
Quebec	48.7%	48.0%	0.7%	40.1%	40.1%	-
New Brunswick	47.8%	47.8%	-	33.5%	33.5%	-
Nova Scotia	48.3%	48.3%	-	41.6%	41.6%	-
Prince Edward Island	47.0%	46.2%	0.8%	34.2%	34.2%	-
Newfoundland and Labrador	49.0%	44.6%	4.4%	46.2%	42.6%	3.6%
Yukon	44.0%	44.0%	-	28.9%	28.9%	-
Northwest Territories	36.8%	36.8%	-	28.3%	28.3%	-
Nunavut	37.8%	37.8%	-	33.1%	33.1%	-