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This publication is a high-level summary of the most recent tax developments applicable to business owners, investors, and high net worth individuals. Enjoy!

TAX TICKLERS… some quick points to consider…

- CRA has opined that **U.S. Economic Impact payments** received by residents of Canada are **not taxable** in Canada.
- 1,252,830 **Canada Emergency Wage Subsidy** (CEWS) applications have been approved for a total value of **$41.12 billion** (as of October 4, 2020).
- On October 9, 2020, the Government announced that the CEWS program will be **extended to June 2021**. Further, the **maximum subsidy for period 8** (calculated using October's revenues) of 65% would be **maintained for the next two periods** even though it was scheduled to decline.
- 767,336 businesses have been approved for the **Canada Emergency Business Account** (CEBA) for a total disbursal of **$30.62 Billion** (as of October 8, 2020).

CPP: When to Apply?

While the **normal age** to begin receiving regular CPP is **65**, individuals can apply to start receiving **earlier** at a cost, **or later** for a greater benefit:

- If the individual starts **before age 65**, payments will **decrease by 0.6% each month** (or by 7.2% per year), up to a maximum reduction of 36% if started at age 60.
- If the individual starts **after age 65**, payments will **increase by 0.7% each month** (or by 8.4% per year), up to a maximum increase of 42% if started at age 70.

The **decision** as to when to commence CPP payments **can be very complex**, with **extensive variables** to consider, primarily related to personal factors and economic scenarios. While **95% of Canadians** have consistently **taken CPP** payments **at normal retirement age** (age 65) or earlier since the CPP introduced flexible retirement in the 1980s, a July 27, 2020 report (**The CPP Take-Up Decision**) by the Canadian Institute of Actuaries and the Society of Actuaries examined whether that is always the best option.

Tax Tips & Traps

The report **compared** receiving CPP **commencing at age 65** against pulling funds from RRSP/RRIF savings to replace the CPP payments and then **commencing CPP at age 70**. The two primary factors which influence the decision are **life expectancy** and **rate of return**. In particular, the report noted the following:

- A major advantage of increasing CPP payments via postponement is that the increased CPP provides **additional secure lifetime income** that increases each year alongside the price of consumer goods, thus **protecting against inflation**, financial **market risk**, and the risk of **outliving retirement savings**.
- Given today's **low-interest-rate** environment and general population longevity expectations, the report noted that **delaying CPP payments** is often a **financially advantageous** strategy.
  - In the risk-free investment comparison, **75-80% of Canadians** within this framework **receive more income** by **delaying** their CPP payments.
  - Even in an **extreme case** that favours not deferring CPP payments (low longevity expectations and very high expected investment returns), a person faces a **50% probability** of receiving **more income by delaying** CPP payments, along with the risk-reduction benefits of a delay mentioned above.
- **Higher-income Canadians** have **longer life expectancies** than lower-income Canadians, and **females generally live longer** than males; therefore, it would more often be in their best interest to delay CPP payments.

ACTION ITEM: Consider whether starting CPP before, after, or at age 65, would be the most advantageous.

REASONABLE MEAL ALLOWANCES: Moving, Medical and More!

On September 3, 2020, CRA announced that, **effective January 1, 2020**, the rates allowable under the simplified method related to travel for **medical** expenses, **moving** expenses, and the **northern residents deduction**, as well as meal claims for transport employees, increased to $23 from $17 per meal, for a total of $69/day. This is also the amount that CRA has stated is reasonable for a meal and therefore the non-taxable portion of an **overtime meal or allowance**, or certain **other travel allowances** provided to employees.

CRA has previously noted that **reasonable allowances** paid by employers for **meal costs** incurred while **travelling** is a **question of fact**. Reasonable allowances are generally not taxable. Although they would **generally accept $23 per meal** (including taxes), **higher amounts** could be reasonable, provided they are **supported** by relevant facts, including:

- **cost of ordinary meals** in the travel area;
- **availability of meals** in proximity to the location of work or lodgings while away;
- whether some **meals** will likely be **provided** to the employee **at no cost**; and
- **exchange rates** where travel is outside of Canada.

CRA has also indicated previously that they consider the **meal allowances** based on the **National Joint Council rates** (which well exceed $69/day but are currently less than $23 for breakfast or lunch) to be **reasonable** for the meal portion of these travel allowances. However, these Council rates are not accepted for the other purposes mentioned above.

ACTION ITEM: Keep a list of all medical and moving travel. Retain associated receipts so that the actual costs can be compared against claims available under the simplified method rates.

COMMINGLING OF PERSONAL EXPENSES IN THE BUSINESS: The Cost Could Be Very High

In a July 23, 2020 **Tax Court of Canada** case, at issue were a number of **expenses** claimed by the taxpayers (a **corporation** and its **sole individual shareholder**) in respect of the business of selling financial products and providing financial planning advice. CRA denied various expenses spanning 2007 and 2008 and assessed many of them as shareholder benefits. That is, the amounts were taxable to the individual shareholder and not deductible to the corporation.

CRA also **assessed beyond the normal reassessment period** on the basis that the taxpayers made a misrepresentation attributable to neglect, carelessness, wilful default or fraud. They also assessed **gross negligence penalties** which is computed as the greater of 50% of the understated tax or overstated credits related to the false statement or omission, and $100.

The following expenses were reviewed:

- **bonuses** paid **to** family members who were not employees of the taxpayer;
- **payments** to family members under an **Employee Profit Sharing Plan** (EPSP) where there was no evidence that the payments referred to profits;
- **salaries** paid to **family members** (including the shareholder's daughter who received a salary of $5,000 in 2007 and $400 in 2008);
- **salaries** paid **to** the taxpayer's **children's care providers**;

- **salaries** to the taxpayer's **former spouse**, which the taxpayer argued was the same as personally paying spousal support;
- travel costs for the taxpayer and his **family** to go on a **cruise** on which the taxpayer made **business**-related **presentations** (CRA conceded the taxpayer's travel costs);
- significant **interest expense** with very **little support**; and
- many other costs such as **clothing**, **toys**, **jewelry**, **personal items**, **lawncare**, **maid service**, and **pet care** for the **shareholder** and **family members**.

While the taxpayer originally claimed the travel expenses for the taxpayer's family to travel to Hawaii for a shareholders' meeting, the taxpayer conceded these amounts.

The taxpayer argued that any benefits taxable to him personally were conferred by virtue of his employment, not his shareholdings, and, therefore, should be deductible to the corporation.

Taxpayer loses
In dismissing the taxpayer's argument, the Court found that the vast **majority of expenses** reviewed were **personal** in nature and denied the deduction. The Court also found the vast majority of **denied expenses** to be a **shareholder benefit**. These expenses were **not**, by and large, expenses a **reasonable employer** would otherwise **pay** for the **benefit** of an **arm's length employee**. The taxpayer, through his unfettered control, chose not to pay salaries or bonuses but rather to deduct the disallowed expenses from the corporate receipts and never report or ascribe any amount of benefit or employment income to himself.

The Court **upheld** CRA's **assessment beyond the normal limitation period** as well as **gross negligence penalties**, noting:

- the sole shareholder's **education** and **training** regarding complex tax integration, small business deduction strategies, and corporate/personal lifestyle structuring;
- the individual unilaterally directed which expenses the corporation should deduct, even though some were clearly personal; and
- the **degree** and **scope** of the upheld **assessments** were **very large** – in excess of $700,000 for the corporation and in excess of $1,100,000 for the individual, both spanning a two-year period.

The Court stated that the **gross negligence penalties** exist for these such situations: **sophisticated taxpayers must appreciate** that **using corporate** structures to **mask inappropriate deductions** and shield personal income from tax should **not be done**.

The result of these inappropriate deductions was **effectively triple taxation** – corporate tax on disallowed deductions, personal tax on shareholder benefits, and a 50% gross negligence penalty on both the corporate and personal taxes. It would have been much cheaper had the taxpayer taken additional salaries or dividends, and paid the additional taxes up front, rather than running personal expenses through the corporation.

In the case where personal expenses are paid by the corporation, the accounts should generally be corrected by adjusting the shareholder loan account or having the individual pay the corporation back. This was not done in this case.

ACTION ITEM: As best as possible, keep business and personal expenses separate. Deducting personal expenses in a corporation can lead to a very costly bill, well in excess of the tax should the amounts have been reported correctly.

UNREPORTED INCOME: Statute-Barred Periods

In a June 10, 2020 French Court of Quebec case, the taxpayer had been assessed with **unreported income** of $68,162, $66,192 and $31,540 for 2004, 2005 and 2006, respectively, all **beyond the normal reassessment period** (generally 3 years). The amounts were computed using the **cash flow analysis method**, meaning that cash received was considered taxable income unless it could be shown that it was from a non-taxable source, such as a gift or a loan.

Originally, the **taxpayer's son was under audit**. After it was noted that several **transactions had occurred between the taxpayer and his son**, the taxpayer came under audit.

The taxpayer argued that several **items were not taxable**. They included:

- **tax refunds gifted** from the son to the taxpayer;
- **insurance and car payments** by the son;
- **repayment of a loan** following a condo purchase that did not go through; and
- various **cash deposits**.

The taxpayer argued that he **had safety deposit boxes with large sums of money** which was deposited over time to **prevent his first wife**, who had struggled with mental health issues and addictions, **from stealing the money** and supporting her drug habit. He also noted that he continued to collect money in the boxes following the divorce of the first wife and on into the relationship with his second wife. It was **implied** that the **cash deposits** above **came from** these **safety deposit boxes**.

In order to assess **outside of the normal reassessment** period for Quebec purposes, similar to federal law, the taxpayer must have **misrepresented** the facts through **carelessness** or **wilful omission**, or have committed **fraud** in filing the statement or in providing information.

Taxpayer wins
The Court noted the following which indicated that the **criteria** for reassessment outside of the normal reassessment period were **not met**:

- the taxpayer's file was **not identified as being a risk file**, and was only a secondary file to that of his son;
- the taxpayer provided **good cooperation** and provided the documents requested of him (over 700 pages were provided); and
- the taxpayer's **testimony**, along with those of his sons, were **credible** and never seriously shaken.

As Revenu Québec did not demonstrate that the requisite level of misrepresentation was present, their **reassessments were overturned**. Further, the Court noted that, even if the test had been met, using the cash flow method in such a case, where many of the receipts were reasonably explained, would not have been justified.

ACTION ITEM: An audit of one person can trigger audits of others around them. Ensure to maintain proper documentation and comply with auditor requests as best as possible (with professional assistance) to conclude and contain the audit efficiently.

UNREMITTED GST/HST OR SOURCE DEDUCTIONS: Directors can be Personally Liable

Directors can be **personally liable** for employee **source deductions** (both the employer and employee's portion of CPP and EI, and income tax withheld) and **GST/HST** unless they exercise **due diligence** to **prevent failure** of the corporation **to remit** these amounts on a timely basis. As many businesses are struggling with cashflow, it may be attractive to direct these amounts held in trust for the government to satisfy other creditors, such as suppliers. However, in doing so, directors may unknowingly expose themselves to personal liability if the entity is not able to remit the required source deductions and GST/HST.

Director liability can extend beyond directors of a corporation to other directors, such as those of a non-profit organization.

The following recent **court cases** highlight some of the issues related to this liability exposure:

- In a July 20, 2020 Tax Court of Canada case, the use of **trust funds** (employee withholdings and GST/HST collected on revenues) to **pay other creditors** resulted in the directors being **personally liable** for the unremitted amounts. Their significant **contributions** of **personal assets** to pay other creditors and **efforts to remedy** the failure after it has occurred **could not offset** the lack of steps taken to prevent the **failure to remit**.

- However, in another July 20, 2020 Tax Court of Canada case, the director was not personally liable as due diligence to prevent failure to remit was demonstrated. In this case, there was **no evidence** GST/HST funds had been **diverted to other expenses, and significant efforts** to make remittances was conducted, including **prioritizing remittances over opportunities to benefit the business**. Racial **discrimination** and sexual **harassment** by its customers **impeded** the business's efforts to **collect revenues** including GST/HST.

Care should also be provided to **properly resign** as a director to **limit future exposure**. CRA must issue the assessment against the directors within two years from the time they last ceased to be directors.

In another July 23, 2020 Tax Court of Canada case, **failure** to comply with **all resignation requirements** under the relevant provincial **corporate law** meant that the director's **resignation** was **not** legally **effective**, even though he had submitted a signed letter of resignation to the corporation. As he was still a director, he was **still personally liable** for unremitted GST/HST and source deductions.

ACTION ITEM: Ensure all source deductions are made in a timely manner. Failing to make source deductions may expose directors personally to the liability.

U.S. TRANSITION TAX: IRS Starting Compliance Work

In general, U.S. shareholders were required to pay a **transition tax** on the **untaxed foreign earnings** of certain specified **foreign corporations** as if those earnings had been repatriated to the United States. This tax could apply to a **U.S. citizen, resident or Green Card holders** who own an **interest** in a **private Canadian corporation**. This tax applied with respect to the last taxable year of the relevant specified foreign corporation that began before January 1, 2018. The tax was includible in the U.S. shareholder's year in which or with which such a specified foreign corporation's year ended.

The IRS Commissioner of Large Business and International recently stated that the following two enforcement streams will commence in October 2020:

- **letters** will be sent suggesting the filing of amendments to those (thousands) that the agency believes may **need to more fully comply**; and
- **audits** will **commence** on those that the IRS believes failed to comply.

The audits may focus on a number of issues, including, for example, the calculation of historic earnings and profits, cash vs. non-cash assets, and foreign tax credits.

ACTION ITEM: If you are a U.S. person potentially subject to this tax, but have not filed as such, contact us to discuss your options.

RRIF/RRSP ON DEATH: Rollover to a Child or Grandchild's RDSP

Normally we think about rolling RRIFs and RRSPs to the surviving spouse upon death, however, there are other options. One such option is to roll it on a tax-deferred basis to a child or grandchild's Registered Disability Savings Plan (RDSP).

A June 26, 2020 **Technical Interpretation** discussed the ability to **roll** funds from a **deceased taxpayer's RRIF** to an **RDSP for a financially dependent child** or grandchild eligible for the **disability tax credit**. This results in the RRIF funds **not being taxable to the deceased** and only being **taxable to the beneficiary when** funds are **withdrawn from the RDSP**.

CRA noted that there is a **rebuttable presumption** that the child is **not financially dependent** if their **income** for the year prior to the parent's death **exceeds the basic personal amount plus the disability amount**. For 2020, the basic personal amount ranges from $12,298 to $13,229, while the disability amount is $8,576. Where the **child's income exceeds the threshold** and/or the **child did not reside with the deceased**, they may still qualify, depending on **all of the facts and circumstances**.

Based on the facts of the specific case CRA reviewed, they indicated that it was **reasonable to consider** this child to be **financially dependent** on the taxpayer, such that the **rollover** would be **available.** The facts included:

- the child suffered from a **mental impairment** which made him **unable to work**;
- the child previously resided with the parents but now resided in a **group home**, as the **parents'** advancing **age** made it **difficult** for them to **provide necessary care**;
- the **child resided with** the **taxpayer** on **weekends and holidays**;
- the child's sole **income**, from provincial disability support, did **not exceed the basic personal** amount plus the **disability amount** (that is, the income test was met);
- the child's income **covered only basic room and board**, with all other financial needs provided by the taxpayer;
- the **financial support** provided by the taxpayer was provided on a **regular and consistent basis** and consisted of **more than merely enhancing or supplementing an adequate lifestyle** for the child; and
- the child received no other financial support.

CRA noted that, in addition to funds from a **RRIF**, an **RRSP** or a pooled registered pension plan (PRPP), and some **registered pension plan** (RPP) **receipts**, can be **similarly transferred to an RDSP** for a financially dependent child on the **death of the taxpayer**.

ACTION ITEM: If you have a child or grandchild that is financially dependent on you and eligible for the disability tax credit, consider leaving your RRIF/RRSP to them in their RDSP.

The preceding information is for educational purposes only. As it is impossible to include all situations, circumstances and exceptions in a newsletter such as this, a further review should be done by a qualified professional.

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For any questions… give us a call.