Kurt Rosentreter Tax Planning Tips Q2 2018

<u>Tax Ticklers - Some Quick Points to Consider</u>

- CRA has required PayPal to disclose sales and other transaction records for Business Account Holders from January 1, 2014 to November 10, 2017. It is expected CRA will review records for unreported sales.
- Employers can now provide a tax-free party or social event to employees where the cost per person is \$150 or less (the limit was previously \$100).

Digital Currency: Basics And Tax Implications

What is Digital Currency (DC)?

DC is essentially electronic money. It's not available as bills or coins. Cryptocurrency is a type of DC created using computer algorithms with the most popular being bitcoin.



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Kurt's Comments

Consider the tax implications (income tax and GST/HST) when investing or conducting business using digital currency.

<u>Digital Currency - continued</u>

No single organization, such as a central bank creates DC. DC is based on a decentralized, peer-to-peer network. The "peers" in this network are the people that take part in DC transactions, and their computers make up the network.

DC can be used to buy goods and services, whether in store or online. DC may also be bought and sold on open exchanges (similar to a stock market).

DC is often created through a complex process known as "mining" and then monitored by a global network of computers. About 3,600 new bitcoins are created each day, with about 16.5 million now in circulation. Like all currencies, its value is determined by how much people are willing to buy and sell it for.

Tax - Buying and Selling Digital Currency

Gains or losses from selling or buying DCs must be reported on one's tax return. These may be on account of capital (taxed at half rates) or ordinary income (full rate) depending on the context. It is not clear whether purchases and sales of bitcoins and other DC are subject to GST/HST.

There are no special tax rules directed specifically towards DC. Like any property, where DC is acquired with the primary intention of selling it for a profit, any gains would be on an account of income, rather than capital. Where property is acquired for some other purpose, such as generating ongoing income (like a rental property), the gain or loss on disposition is likely on account of capital.

<u>Digital Currency – continued</u>

When evaluating a taxpayer's intention, CRA will generally consider factors such as: frequency of transactions; period of ownership; knowledge of industry; time spent on the activities; financing; and the nature and quantity of the property held.

It is also important to note that some DC do not produce income (generating neither dividends like a share, nor interest like a loan). With no plausible purpose other than resale, it becomes easier for CRA to take the position that the DC must have been purchased with the intention of selling it at a profit and therefore any gain or loss on disposition is on account of income. This may override the other factors noted above.

That said, CRA has administratively allowed gains on certain commodity investments to be on account of capital, even though they typically appear to be on account of income based on the factors above. One condition of this policy is that all such transactions are treated the same. In other words, one could not simply classify it to be on account of capital in "gain" years, and then income in "loss" years. It is uncertain whether CRA would adopt the same policy for sales of DC.

Tax - Buying and Selling Goods Using Digital Currency

Similar to sales using traditional currency, DC received in exchange for goods or services must be included in the seller's income for tax purposes. GST/HST would also apply on the fair market value (FMV) of goods or services bought or sold for DC (subject to the same rules as traditional currency). It is not clear whether the DC itself would be subject to GST/HST, meaning that the person using DC to pay for the goods or services would be required to collect GST/HST on the value of the DC.

CRA considers DC to be a commodity rather than a currency and, therefore, transactions involving DC are considered barter transactions. This means that the sale price to be recorded in income would be determined as the FMV of the goods or services provided. If that FMV is less readily available than the FMV of the DC, the value of the DC would be used to determine the sale price.

Also, being a commodity means that these assets are not eligible to be directly held in tax preferred registered accounts (e.g. RRSPs, TFSAs, RRIFs, etc.).

Government Access to Records

The IRS has been successful in issuing an Order compelling one of the world's largest bitcoin virtual currency exchanges, Coinbase, to disclose certain transaction and user information for the 2013-2015 period. It is very possible that the CRA may obtain such types of information as well.



Kurt's Comments

Consider whether family members can perform services for one's business, and what level of income is reasonable.

Family Members: Can I Pay Them a Salary?

For a small business, whether operated as a corporation, proprietorship or partnership, it is quite possible that relatives of the owners or partners may be engaged as employees. Due to the closer familial relationship between employer and employee, CRA pays particular attention to ensure that the salary is truly an eligible deduction to the business.

According to CRA, salaries to children and spouses are deductible as long as all of these conditions are met:

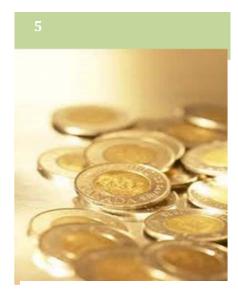
- the salary is actually paid;
- the work the family member does is necessary for earning business or professional income; and
- the salary is reasonable when considering the family member's age and the amount one would pay someone else.

CRA also states that T4s are required for all employees, including family members, and subject to payroll deductions, as appropriate. Payment in the form of room and board is not accepted by CRA.

CRA suggests that the average salary for an arm's length person providing similar services under similar conditions would provide guidance as to reasonableness.

<u>Corporate Passive Investment Income:</u> Proposed Changes

A new passive investment tax regime for Canadian Controlled Private Corporations (CCPCs) is proposed to apply to taxation years commencing after 2018. Passive income may include interest, rental, royalties, dividends from portfolio investments and taxable capital gains.



Proposed Changes - continued

Two significant changes are proposed. First, a limit to the small business deduction for CCPCs generating significant income from passive assets, and second, a new regime to stream the recovery of refundable tax to the payment of specific types of dividends (eligible versus non-eligible).

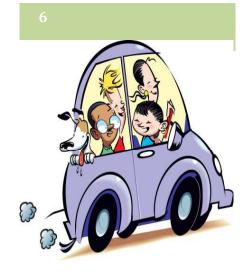
Access to the Small Business Deduction (SBD)

The first prong of the proposals will reduce access to the SBD for CCPCs having more than \$50,000 of passive income. CCPCs with passive income in excess of the threshold will incrementally lose access to their SBD, until \$150,000 of passive income is reached, at which point the entire SBD will be lost. The prior year's passive income will determine the current year's SBD limit.

For purposes of these new rules, capital gains on certain types of property will be excluded from being considered passive income. These are as follows:

- Capital gains realized on the disposition of property used principally in an active
 business carried on in Canada. The active business could be carried on by the owner
 of the asset, or by a related party. Examples include gains on the sale of the goodwill
 of an active business, and gains on the real estate from which the active business
 operates.
- Capital gains realized on shares of another CCPC all or substantially all of whose assets are used in an active business carried on in Canada, provided the seller has a significant interest (generally over 10%) in that corporation.
- Similarly, capital gains realized on an interest in a partnership all or substantially all of whose assets are used in an active business carried on in Canada will generally be excluded where the seller has a significant interest (generally over 10%) in the partnership.

Capital losses realized in a different taxation year that are applied to offset capital gains realized in the current year will not reduce passive income for these new rules.



Proposed Changes - Continued

Consistent with the existing SBD rules, the sum of passive income of all associated corporations will determine the reduced business limit available to the associated group.

The total advantage or disadvantage of earning passive investment income in a corporation, after considering personal and corporate tax costs, will depend on a number of factors such as the individual's marginal tax rate, rate of return on the investment and the province or territory of residence.

Recovering Refundable Taxes

Passive income is subject to a high corporate tax rate. However, a portion of these taxes are refunded when the CCPC pays taxable dividends.

The second prong of the passive income proposals will add a new restriction. Recovering refundable taxes will generally require the CCPC to pay out non-eligible dividends. These carry a higher personal tax cost than eligible dividends. The exception will be where refundable taxes arise from the CCPC's receipt of eligible dividends. Dividends received from most Canadian public corporations are eligible. This portion of the refundable tax can then be recovered when the CCPC pays out eligible dividends.

KURT'S COMMENTS

If your corporation has passive earnings in excess of \$50,000 and is also earning active business income, prepare for a potentially higher corporate tax bill in the coming years.

Reasonable Automobile Allowances: GST/HST Claim

A travel allowance paid to an employee for the use of their personal vehicle for business purposes will be non-taxable if it is reasonable.

Kurt's Comments

If paying reasonable allowances to employees, consider claiming an input tax credit in respect of the payment.

Automobile Allowances - continued

Where such reasonable allowances are paid, an input tax credit (ITC) may be claimed by the employer. The ITC is computed as the imputed GST/HST in the allowance, without adjustment for the fact that some costs likely did not attract GST/HST. In non-harmonized provinces/territories (such as Alberta and B.C.), the ITC would be 5/105 of the allowance. The ITC in a harmonized province is different. For example, in Ontario, with 13% HST, the ITC would be 13/113 of the allowance. Other HST provinces would apply this formula to their respective rate.

In a November 10, 2017 Tax Court of Canada case, CRA denied ITCs of \$4,935 related to motor vehicle allowances paid to employees that were also shareholders. CRA argued that the allowances were not reasonable.

Taxpayer wins

The allowances were based on the maximum per kilometre rates that the employer could deduct. The accounting for the allowances was complicated by the use of fuel cards provided and paid by the customer of the taxpayer. However, a detailed review of the accounting records demonstrated that:

- detailed log books of business and personal driving had been maintained;
- allowances were paid for business kilometres only, with careful tracking of personal use;
- fuel paid by the corporate customer had been charged back to the taxpayer; and
- the allowances paid to the shareholder-employee were effectively reduced by the customer's fuel payments.

Although the accounting for the allowances was quite complicated, the Court concluded that it complied with the law and ensured the employees received reasonable allowances limited to business driving. The ITCs were, therefore, properly claimed.



U.S. Citizens: Risks of Tax Non-Compliance

Commencing January 1, 2016, the U.S. State Department was able to deny or revoke passports to U.S. citizens having a "seriously delinquent tax debt" or no Social Security Number associated with their passport. A "seriously delinquent tax debt" is one where the taxpayer owed more than \$51,000, after January 1, 2018 (indexed going forward), in tax, interest and penalties.

An Alert on the IRS website recently noted that commencing January 2018 the IRS will begin certifying tax debts to the State Department. After receiving certification from the IRS, the State Department will not generally issue a passport.

In addition to passport denial and revocation, several states impose non-monetary non-criminal sanctions for certain taxpayers who are sufficiently delinquent on their taxes. For example, New York, California, Louisiana and Massachusetts may revoke driving privileges.

Kurt's Comments

If you have an outstanding U.S. tax liability or are concerned you may not be compliant with your U.S. tax obligations.

Contact us to discuss options.

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