

FOR YOUR CONSIDERATION In the 2nd quarter of 2018

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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 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).
- Although such cases are rarely successful, two taxpayers were awarded nearly \$1.7 million in relation to CRA's malicious prosecution.



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.

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.

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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.

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, RRIFFs, 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.

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

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**.

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

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CORPORATE PASSIVE INVESTMENT INCOME: 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.

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.

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.

Action Item: 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.



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.

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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 **logbooks** 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.

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

CONSTRUCTION ACTIVITIES: Reporting Obligations for Subcontractors

A July 17, 2017 **Technical Interpretation** examined the **conditions** which would **require** the filing of a T5018, Statement of Contract Payments.



Where a person or partnership **primarily** derives their **business income** from **construction** activities for a reporting period, a **T5018** should be **filed** for any subcontractor payment or credit made relating to goods or **services** received in the **course of construction activities**. The reporting period may be a **calendar** or **fiscal year** but cannot be changed once selected (unless authorized by CRA).

The term “**construction activities**” is broadly defined. It includes, for example, the erection, excavation, installation, alteration, modification, repair, improvement, demolition, destruction, dismantling or removal of all or any part of a building, structure, surface or sub-surface construction, or any similar property. Such activities are considered to be those normally associated with the on-site fabrication and erection of buildings, roads, bridges, parking lots, driveways, etc. which are intended to be permanently affixed to the land on which they are built.

It is a **question of fact** as to whether a particular activity is a **construction activity**, and whether the business income for the reporting period is derived **primarily** from such activity. If a T5018 is not required, consideration should be given to the requirement of a **T4A**, Statement of Pension, Retirement, Annuity, and Other Income.

CRA has also noted that there are **businesses** that have a **significant amount of construction** done for them or by them, **but** the activity is **not their principal business**. For example, a natural gas company may do a large amount of construction to install pipelines, however, its principal business is gas transmission, not constructing pipelines. It would not be required to file T5018s.

Penalties are levied on the payer when T5018s are not timely filed. Penalties range from \$100 to \$7,500, depending on the number of T5018s and the number of days they are late.

Action Item: If you are in the construction industry, ensure you are filing T5018s appropriately.

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.

Action Item: 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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CRA MOBILE PHONE APPS: Tools for Individuals and Businesses

CRA provides a number of mobile phone apps that taxpayers (individuals, corporations, etc.) can use to assist with their tax obligations.

CRA BizApp – An app for **small businesses owners** to view and pay **outstanding balances**, view **account transactions**, view **expected GST/HST returns**, and view the **status** of filed **GST/HST** and **corporate income tax returns**.

CRA Business Tax Reminders – An app for **businesses** which sends pop-up **notifications** and/or calendar



reminders for individual and business **due dates** for installments (individual, corporate and GST/HST), returns, and remittances (payroll and GST/HST).

MyBenefits CRA – An app for **individuals** which provides a **quick view** of an **individual's benefit and credit payment** details and eligibility information.

MyCRA – An app for **individuals** which provides access to **key tax information** such as **notice of assessments, tax return status, benefits and credits**, and **RRSP and TFSA contribution room**. It also allows individuals to request a proof of income, manage online mail, update contact information, and update direct deposit information.

Action Item: Consider using one of these apps to assist with your tax filing obligations.

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.

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