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TAX TALK

FOR HEALTH PROFESSIONALS

2018 Issue

THE NEW "INCOME SPLITTING" TAX RULES
What do they mean for you?

FLOW-THROUGH SHARES
Do they fit your investment needs?

NAVIGATING THE MINIMUM WAGE INCREASE
Your nanny's salary

CHARITABLE DONATIONS
Personally or through a corporation?

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In this issue

A Message from the Editor

Aaron Schechter, CPA, CA, TEP, *Aaron Schechter Professional Corporation*, Partner - Tax Group

What a crazy year 2017 was! A whirlwind of tax changes took place in the latter half, impacting many Canadian business owners, including incorporated health professionals. Many of the tax changes were directly targeted at Canada's health professional community and seemed like an attack on the tax structuring many had undertaken in the last decade and a half.

On July 18, 2017, the Canadian Government released a package of tax proposals attempting to address three tax benefits for incorporated businesses which were deemed "unfair":

1. Income splitting among family members;
2. Building up investment assets within a corporation; and
3. Converting regular income and dividend income into tax preferred capital gains.

Following public backlash and over 21,000 formal submissions to the Department of Finance from accountants, lawyers, business owners and others criticizing these proposals, a couple of changes took place. First, the Government decided not to move forward, at least for now, with its draft legislation which would have curtailed transactions converting regular income and dividend income into capital gains. Second, the income splitting measures were then tweaked in December. After revisions, it remains a series of complicated and complex rules, definitions and exclusions that have left tax professionals with some degree of uncertainty over how the measures will actually be applied moving forward.

Unfortunately, the Government has reiterated its intention to proceed with introducing rules to discourage corporations from accumulating an investment portfolio to fund an owner's retirement. Attempting to plan for this new landscape has been next to impossible, given the fact that the Government has not released any substantive details on how these new "passive income" proposals are truly intended to operate. All of this was coupled with significant tax reform in the United States just before the end of last year, Ontario Premier Wynne's decision to increase minimum wage by almost 30 per cent as well as on-going NAFTA negotiations between Canada, the United States and Mexico. The big question now: How will all of these factors impact Canada's competitiveness in the future?

All of that being said (in case you were living under a rock) we have got you covered in this edition of Tax Talk for Health Professionals. Daniel Mahne, has provided a great summary of the impact the income splitting rules will have on health professional corporations and strategies to consider when mitigating some of the tax advantages lost. Investing in flow through shares may be a good way to reduce an individual's personal income tax, and John MacFarlane explores whether it may be the right strategy for you. Jonathan Haig reminds employers of personal care workers (e.g. nannies) to review gross wages following the new minimum wage legislation. Finally, Chloe Man discusses why it may make more sense to make your charitable donations through a corporation, rather than personally.

As always, we are here to answer your questions. For all of your tax and accounting needs, please feel free to contact me. We are here to help.

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What the New "Income Splitting" Tax Rules Mean for You

Daniel Mahne, BComm, Tax Specialist

In July 2017, the Minister of Finance released draft legislation with the stated intention of curtailing certain tax planning strategies that were common practice for many Canadian business owners, including incorporated health professionals. After a brief consultation period and extensive public backlash, some of the proposed measures were dropped and others were tweaked.

In December 2017, the Minister released a technical backgrounder and new draft legislation to amend the originally proposed adjustments to the income splitting rules; however, most of the proposed measures restricting "income splitting" between an incorporated health professional and their family members, remained and are expected to be applicable commencing for the 2018 taxation year.

The ownership structure for most health professional corporations were put in place to allow the professional to income split by paying dividends to family members 18 years of age, or older. Under the new tax rules, this type of "income splitting" will generally only be permitted for health professional corporations where it can be demonstrated that the dividend recipient:

- Is 18 years of age or older and has worked in the practice at least 20 hours a week in the year or any of the previous five years and didn't receive fair market value remuneration for their labour efforts; or
- Made a "meaningful contribution" to the practice in the current or a previous year and did not receive fair market value compensation for their efforts. A "meaningful contribution" to a business can be demonstrated through a labour contribution, capital contribution or by taking on a financial risk (i.e. co-signing and/or personally guaranteeing a business loan).

In addition, there will be no restrictions on "income splitting" to a spouse where the professional is 65 years of age or older and has made a meaningful contribution to the business in the current or a previous tax year.

Given that "income splitting" with dividends between family members will no longer be an option in 2018 for the majority of situations, it is important for professionals to re-evaluate their remuneration strategy moving forward. What should be the appropriate mix of salary and dividends to be taken by the professional? How much should be withdrawn from the professional corporation in order to generate a sufficient after–personal tax income to meet the family's personal living requirements?

Since income sprinkling with family members will still be permitted under certain circumstances, professionals may want to consider reorganizing their professional corporation's share structure. This will be most beneficial if there are currently family members that were already meaningfully contributing to the business, or where the professional is 65 years of age or older. In these situations, dividends can still be split among certain family members and not trigger the adverse consequences of the new rules.

Professionals may consider buying the shares of their professional corporation owned by family members, or have the corporation repurchase these shares. With careful tax planning, it could be possible to convert what otherwise would have been taxed as a dividend to the shareholder, into a more tax favourable capital gain.

Professional corporations may also set up an Individual Pension Plan (IPP), as an additional tax planning option. The contributions made by a corporation to an IPP are tax deductible and the accumulation of income in the plan is tax-free. The professional corporation can yield the benefits of a tax deduction while the professional may be able to benefit from splitting the pension income in the future on retirement. An additional benefit of an IPP is that contribution limits are generally much higher than the limits for Registered Retirement Savings Plans, allowing for more to be invested for the future on a tax-deferred basis.

Despite the new rules restricting "income splitting", there may be additional opportunities available for professionals to sprinkle income with family members. It is important to take stock of the current situation, determine the specific impact of the new rules and plan for the new tax landscape. Contact a Crowe Soberman tax advisor to determine whether you are impacted by the proposed rules, your options, and possible next steps in reorganizing your business structure.

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Could Flow-Through Shares Be Right For Me?

John MacFarlane, CPA, CA, Manager

Every mining, oil and gas, and renewable energy company in Canada has been faced with the same dilemma during the early stages of their existence: How can they raise enough money from investors and entice them to purchase their stock without an established revenue stream?

The Canadian Government offers certain tax incentives and benefits for investors of these resource companies, specifically to encourage people to invest. These incentives and benefits are derived from what are commonly referred to as flow-through shares (FTSs).

What is a flow-through share?

A FTS is a share which permits a resource company to pass along its development and exploration expenses to an investor. Investors are then able to deduct these expenses from their personal income tax returns.

The theory behind FTSs is simple. Generally, when resource companies are in the development or exploration stage of their life cycle, they are not generating any revenue. Without any revenue, these expenses are of no immediate value to the company and would be pooled together to be carried forward to be used in a year where the company has taxable income. As an incentive for investors to fund these operations, which may likely not result in any revenues until a much later date, holders of FTSs are able to utilize what would otherwise be corporate deductions against personal income. It is a win-win situation – the corporation receives much needed capital to fund its operations and the investor receives a tax deduction for the amount it invests.

In addition to a tax deduction, investors may also receive a non-refundable Investment Tax Credit (ITC). This ITC will depend on the nature of the expenses renounced to the investor and is equal to

15% of the eligible expenses renounced. Depending on the province in which the expenses were incurred, the specific expenses and the type of investor, there may also be an additional provincial ITC.

FTSs – the specifics

Once a company's FTSs have been authorized, the resource company can renounce its development and exploration expenses, making them available for the investor to deduct.

There are two types of expenditures that can be renounced by a resource company. The first are Canadian Exploration Expenses (CEE), fully-deductible by an investor in the year they are renounced. The second are Canadian Development Expenses (CDE), which are deductible by investors at a 30 per cent declining-balance basis beginning in the year they are renounced. The CEE or CDE that are renounced and claimed as a deduction by an investor cannot exceed the cost of the investor's original investment. Additionally, the adjusted cost basis (ACB) of an investor's investment will be reduced dollar for dollar by the amount of the expenses renounced to them. Finally, any ITC claimed by an investor will be considered taxable income for the following year.

For example, if you purchase $10,000 of FTSs in a particular year, you would be entitled to claim a deduction of $10,000 in your personal income tax return (deductible against all sources of income) and a Federal ITC of $1,500 (assume no provincial credit in this example). The ITC of $1,500 would be considered taxable income in the following year and you would pay tax on this benefit. The ACB of the investment would be reduced to $nil and any proceeds received on the eventual sale of the shares would result in a capital gain (taxable at 50%).

However, if the investor does not have a significant amount of taxable income from other sources, the deduction of the renounced CEE or CDE can result in the person being liable for Alternate Minimum Tax.

Is it worth investing in FTSs?

The main benefits of investing in FTSs are the tax savings from the write off of the investment over a short period of time, generally within the first year, and the corresponding ITC. For an investor in the highest marginal tax bracket, a FTS investment of $10,000, would result in roughly $6,000 of tax savings. This would reduce the ultimate cost of the investment from $10,000 down to $4,000. Ignoring the time value of money, as long as you thought you would be able to sell the shares down the road for more than $5,461, you would make money on the investment.

FTSs might be right for you if:

- You are paying tax at the highest marginal tax bracket;
- You are looking for immediate tax savings;
- You have enough savings and a well-diversified portfolio to take on the associated riskier investment.

FTSs might not be the right investment for you if:

- You are not in the highest marginal tax bracket;
- You do not have any portfolio savings or investments;
- You are risk adverse when it comes to investing.

Next steps?

Do you think FTSs might be the right fit for you? Reach out to both your investment advisor as well as your accountant. Your investment advisor will be able to confirm whether this type of investment would complement your existing portfolio, and your accountant would be able to quantify the potential tax savings.

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Have You Recalculated Your Nanny's Pay?

Navigating Ontario's Minimum Wage Increase

Jonathan Haig, MAcc, CPA, CA, Manager

Effective January 1, 2018, the minimum wage in Ontario increased to $14 per hour, representing a 21 per cent increase from the previous $11.60 per hour. A perhaps unforeseen impact of this new legislation is that individuals will need to re-evaluate the amount paid to personal service employees, such as nannies and domestic workers. Many nannies negotiate their wage based on the net take-home pay (gross wage net of withholdings for income tax, Canada Pension Plan contributions, and Employment Insurance premiums), so once employers have settled on a net take home pay amount with their domestic worker, they must ensure that the corresponding gross wage is in compliance with the new minimum wage legislation.

As an example, for a nanny who works 40 hours a week, the gross annual salary at the new minimum wage of $14 an hour will need to be at least $29,120 ($14 x 40 hours x 52 weeks). For these wages, there would be payroll source withholdings of $3,314 for income tax, $1,268 for Canada Pension Plan contributions, and $484 for Employment Insurance premiums, resulting in a net salary of $24,054. This works out to roughly $463 net pay per week. This means a 40 hour per week nanny will need to be paid at least $463 per week for an employer to be compliant with the new minimum wage legislation. Also, keep in mind, for a live-in-nanny, the taxable room and board benefit cannot be included in calculating the gross wage for purposes of meeting the new minimum wage.

In 2019, the minimum wage in Ontario is expected to increase again, to $15 an hour. The same exercise will need to be performed at the beginning of next year to ensure that your nanny is paid a gross hourly wage at least equal to the higher minimum wage amount. Assuming there are no changes to the personal tax rates, Canada Pension Plan contributions, and Employment Insurance premiums in 2019, an individual working 40 hours a week will need to earn approximately $492 net, after payroll source deductions for the employer to be compliant.

Though the negotiation of the net salary may be the focus of some domestic workers and their employers, for 2018 and 2019, employers will need to take into consideration the impact of the increase to the minimum wage and ensure that they complete the additional step of calculating the implied gross wages to confirm they are in compliance with minimum wage legislation. The Canada Revenue Agency payroll calculator is a very useful tool to assist in this calculation:

https://www.canada.ca/en/revenue-agency/services/e-services/e-services-businesses/payroll-deductions-online-calculator.html

For further information, please consult with your Crowe Soberman tax advisor.

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Important Tax Deadlines

February 28, 2018

- Filing due date for T4 Summaries and slips for salaries, bonuses, and retiring allowances paid in 2017.
- Filing due date for T5 Summaries and slips for interest and dividends paid by corporations to shareholders in 2017.

March 1, 2018

- Last day to make a 2017 RRSP contribution.

March 15, 2018

- Filing due date for Employer Health Tax (EHT) returns for employers with salary and bonuses paid of $450,000 or more in 2017.
- First quarterly installment due for 2018 personal income taxes (if applicable).

April 2, 2018

- Filing due date for T5013 Summaries and Slips for professional partnerships where the partnership's total revenues plus total expenses is $2,000,000 or greater, or where any of the partners are professional corporations.
- Filing due date for annual filers of HST returns for corporations with taxation years ending December 31, 2017.
- Final payment of corporate income taxes due for most corporations with a December 31, 2017 fiscal year end.

April 17, 2018

- 2017 US personal income returns and taxes due for US citizens and green card holders residing in Canada unless an extension is filed.

April 30, 2018

- 2017 Canadian personal income taxes due; personal income tax return filing due date for most Canadian taxpayers.

June 15, 2018

- Personal income tax return filing due date for Canadian taxpayers who report self-employment income.
- Second quarterly installment due for 2018 personal income taxes (if applicable).

July 2, 2018

- Filing due date for corporate income tax return for professional corporations with a December 31, 2017 fiscal year end.

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Charitable Donations: Personally or Through a Corporation?

Chloe Man CPA, CA, Senior Staff Accountant

Making donations to charities, either personally or corporately, will result in tax savings. However, depending on the particular situation, it may make more sense to donate through a corporation in order to truly maximize the tax savings.

What are the benefits of donating personally?

For individuals, eligible donations made provide a non-refundable tax credit, reducing any personal income taxes owing. Unused donations can be carried forward up to a maximum of five years, so if an individual made a donation in 2017 but has no taxes owing, they can claim the donation tax credit to reduce their taxes in a tax year up to 2022. In Ontario, an individual will realize tax savings of $20.50 for every $100 of donations on the first $200 of charitable donations made. For every $100 of donations made in excess of $200, the tax savings can be as high as $50.41.

What are the benefits of donating through a corporation?

For corporations, donations also result in tax savings, albeit in the form of a deduction from income, rather than a credit. Similar to individuals, unused charitable contributions may be carried forward for up to five years. The charitable donation deduction will reduce corporate taxes by $13.50 on the first $100 of donations made when taxable income is less than $500,000 in the corporation and by $26.50 when taxable income is greater than $500,000 in the corporation.

At first glance, it may appear that the benefit of donating personally results in greater tax savings; however, upon closer examination that is not always the case.

So which is better, personally or through a corporation?

Let's say you are an individual that falls within the highest personal income tax bracket, you have already made more than $200 of donations personally during the year and you want to make an additional charitable donation. You have $1,000 of pre-tax income in your corporation and are wondering whether it makes sense to donate directly through the corporation or to take the money out of the corporation via additional salary or a bonus. After the corporation pays its corporate tax, it would have $865 available to make the donation. The corporate-made donation would result in corporate tax savings of roughly $117, resulting in a net tax cost of $18 to make the charitable contribution. If, instead, you decided to withdraw the money and make the donation personally, after paying the personal income tax, you would have $465 available to make the donation. After claiming the charitable donation tax credit, the net tax cost of making the donation would be approximately $301 – significantly more than if the donation is made through the corporation. Additionally, the charity would be far better off if the donation was made through the corporation than if it was made personally ($865 received versus $465).

See the analysis below:

	Donating Through a Corporation	Donating Personally
Corporate Income	$1,000	$1,000
Salary/Bonus		($1,000)
Corporate Taxes	($135)	
Net After-Tax Corporate Funds	$865	$0
Personal Income		$1,000
Personal Taxes		($535)
Net After-Tax Personal Funds		$465
Tax Savings From Making Donation	$117	$234
Net Tax Cost of Donation	($18)	($301)
Amount Received by Charity	$865	$465

In another example, let's say that you want to make a $1,000 charitable donation and there is $1,000 in the corporation. In this case, if the donation was made directly from the corporation, the corporation would pay no corporate tax and the charity would receive $1,000. If, instead you pulled the money out of the corporation by way of additional salary or a bonus and then made a $1,000 donation, the donation tax credit would not fully offset the personal income tax owing on the additional salary or bonus and there would be a net shortfall of roughly $31 required to cover the personal income taxes.

See the analysis below:

	Donating Through a Corporation	Donating Personally
Corporate Income	$1,000	$1,000
Salary/Bonus		($1,000)
Donation Deduction	($1,000)	
Corporate Taxes		
Net After-Tax Corporate Funds	$0	$0
Personal Taxes		($535)
Tax Savings From Personal Donation Tax Credit		$504
Shortfall Required to Pay Personal Taxes		($31)

Individuals outside the top marginal personal income tax bracket may get different results. If a person has $150,000 of taxable income, they are slightly better off making the $1,000 donation personally.

See the analysis below:

	Donating Through a Corporation	Donating Personally
Corporate Income	$1,000	$1,000
Salary/Bonus		($1,000)
Donation Deduction	($1,000)	
Corporate Taxes		
Net After-Tax Corporate Funds	$0	$0
Personal Taxes		($480)
Tax Savings From Personal Donation Tax Credit		$504
Personal Tax Refund		$24

The general rule of thumb is that if an individual expects to have more than $206,000 of taxable income personally in 2018, it makes sense from a tax perspective to make the donation directly through the corporation. If not, then the donation should be made personally. This threshold amount changes every year, so you should check in with your tax advisor annually.

Crowe Soberman LLP has extensive experience in advising clients on their philanthropic endeavours. Please contact us for more information on how to get the most out of your donations.

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Publications Mail Agreement Number 40010965

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