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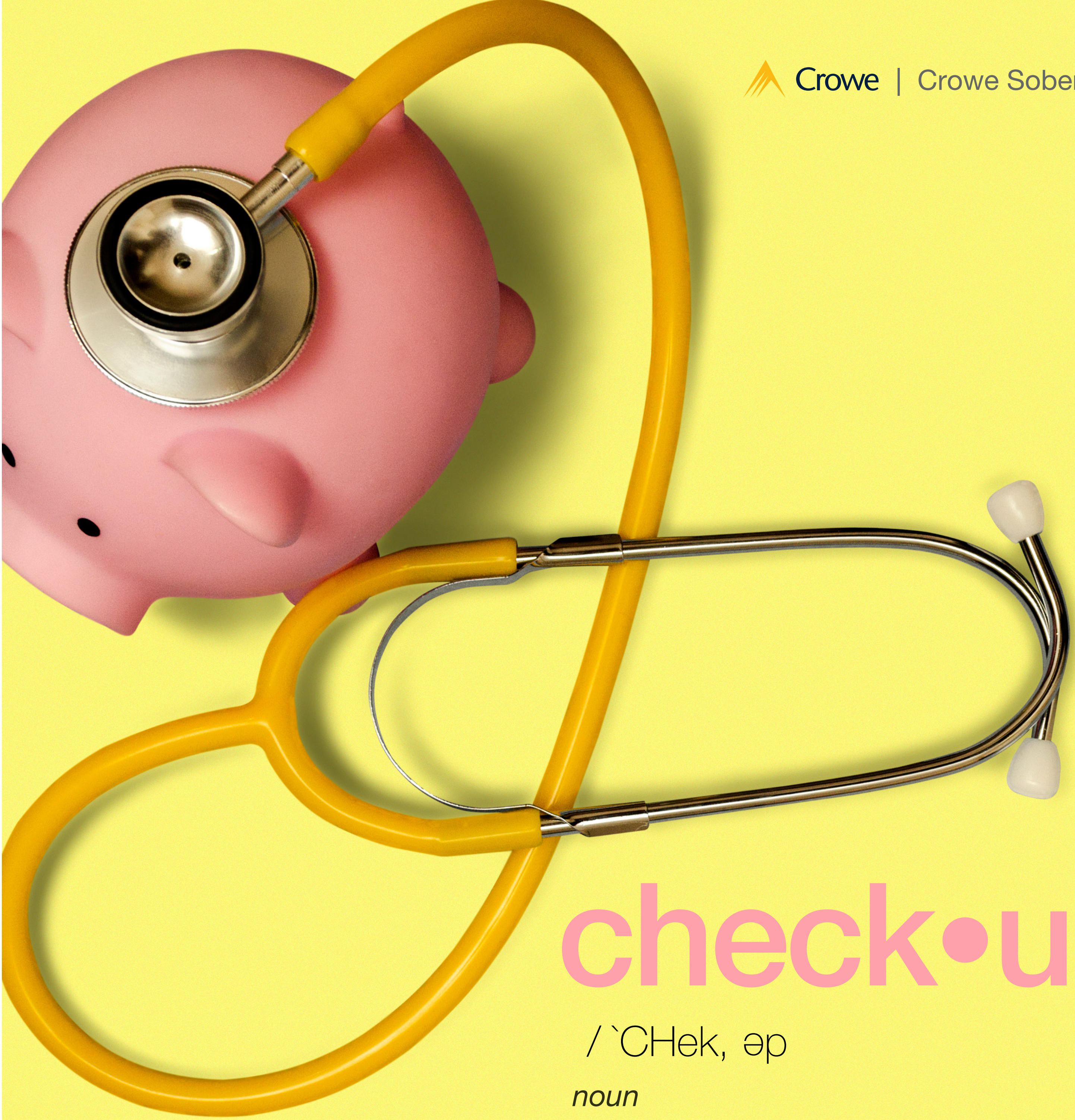

check•up

/ `CHek, əp

noun

1. a thorough examination, especially a medical or dental one.
2. tax planning, insights and advice for health professionals.

2019 Edition

ONTARIO REJECTS EXTRA TAX
Advantages from the passive income clawback.

PRESCRIBED RATE LOANS
Just what the doctor ordered.

RAIDING THE RRSP NEST EGG
Tax facts you need to know.

CLARIFYING CHILD CARE EXPENSES
And why it matters.

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In this issue

The Checkup is prepared for the general information of our clients and other friends of Crowe Soberman. Specific professional advice should be obtained prior to the implementation of any suggestion contained in this publication.

A Message from the Editor

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

Change is good. Some people fear it, while others relish it. Change forces us to *reflect* on our current situation; *rethink* how we may have been doing things in the past; and provides opportunities to *react* differently moving forward.

Taxes and financial planning are always changing. Governments of the day introduce new tax rules, which, more often than not, cause taxpayers to *reflect*, *rethink* and *react* differently in a new environment. The tax changes which have significantly impacted Canadian business owners, including health professionals, in the last couple of years are a perfect example. It has necessitated taxpayers and their advisors to *reflect*, *rethink* and *react* in ways that were unimaginable a few years back.

Let's look at the new Tax on Split Income ("TOSI") rules, which were proposed in 2017 and became law in 2018. In my opinion, and a view shared by almost all tax advisors, is that these rules are unnecessarily complicated and ambiguous. The result is a set of rules very few people understand which are subject to more than one interpretation. The Canada Revenue Agency is quickly realizing this and it seems that we are now getting almost weekly technical interpretations and examples from them to help guide us through the rules.

Nonetheless, the TOSI rules have caused many health professionals to *reflect* on their current situation. Specifically, they are asking their advisors what options are now available to minimize their taxes and maximize their capital. A seasoned professional, who incorporated and has been splitting income with family members since the 2000s, is in a much different situation than the young professional who just graduated and is looking to start his or her practice. The TOSI rules have also forced many health professionals to *rethink* how they have been splitting income with family members. What was once standard tax planning, has now been made extremely restrictive. As a result, taxpayers are *reacting* differently to this new landscape. Taxpayers are now starting to look at other more complex tax minimization strategies which have different inherent risks *vis-à-vis* what was previously considered standard tax planning while others may be considering delaying incorporating.

We have not been immune to change either. You will notice a great new look and new name for our annual newsletter. "The Checkup" replaces four years of the "Tax Talk for Health Professionals" newsletter, and while the name is shorter, we promise it will continue to be packed with insightful and informative content.

In this edition, I will discuss how the passive income clawback of the low corporate income tax rate is actually not such a bad thing. In fact, in Ontario, I believe there is a hidden tax benefit to finding yourself in the clawback rules. Daniel Mahne has provided an article on a *bona fide* tax saving strategy for high-income earners to continue to income split with low income family members by using a prescribed rate loan. If you need additional funds, Daniel Ling discusses the tax implications of withdrawing funds from your RRSP. Finally, Alessandra De Palma summarizes a recent court case which confirms an expansion of eligible child care expenses to include recreational and educational activities in certain circumstances.

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

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Ontario Rejects Extra Tax on Passive Investment Income

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On July 18, 2017, the federal government proposed a set of tax changes that had a direct impact on Canadian business owners, including incorporated health professionals. While the original proposals received pushback from many Canadian taxpayers and their professional advisors, the government ultimately settled on introducing a clawback to the low corporate income tax rate when a corporation earns investment income above $50,000. In short, when a corporation now earns more than $50,000 of investment income in a taxation year, its eligibility for the low corporate income tax rate on the first $500,000 of business income, currently 12.5 per cent in Ontario ("small business deduction limit"), will be reduced in the following year by $5 for every $1 of passive income earned above the threshold. A corporation's small business deduction limit will be fully ground down when its investment income is $150,000 or more.

When these rules were enacted in 2018, it was cause for much concern. An incorporated health professional subject to the small business deduction limit grind down was going to be left with much less in their pocket after their professional corporation distributed the after-corporate tax income than had the individual simply received a salary from his or her corporation or earned the professional income personally. Many people scrambled to find ways to continue to earn investment income in a corporation without causing the income to be recognized immediately for tax purposes (for example, earning investment income within a life insurance policy, holding capital appreciating-only investments, etc.).

This all changed in Ontario when the newly-elected provincial government announced it would not be following suit with the federal government's tax change. In other words, no matter how much investment income a corporation in Ontario earned, Ontario was still willing to preserve the low provincial corporate income tax rate on the first $500,000 of business income.

So what do the numbers look like now?

	No Clawback	**Full Clawback**
Active Business Income Earned by Professional Corporation	$500,000	$500,000
Corporate Income Tax Rate	12.5%	18.5%
Corporate Income Tax	$(62,500)	$(92,500)
Total Available for Distribution	$437,500	$407,500
Personal Income Tax	$(207,375)	$(164,139)
Total Amount Retained	$230,125	$243,361
Effective Tax Rate on a Full Distribution of Professional Income Earned	54%	51%

By opting not to follow the federal government's lead, the Ontario provincial government has turned the intended disadvantage into an advantage for Ontario corporations and their owners. The result of being subject to the federal small business deduction clawback, but not the Ontario clawback, is a corporate income tax rate of 18.5 per cent; however, instead of after-corporate income tax distributions being subject to personal income tax rates as high as 47.4 per cent on non-eligible dividends, individuals in Ontario will be afforded the opportunity to characterize the distributions as eligible dividends which are subject to personal income tax rates no higher than 40 per cent. The combined effective income tax rate for an Ontario individual who wants to pull money out of his or her corporation will drop from 54 to 51 per cent where those corporations earn a significant amount of investment income.

In summary, there is no longer a need for any knee jerk reactions if your professional corporation earns passive investment income. In fact, it is now a tax planning opportunity!

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Just What the Doctor Ordered - Prescribed Rate Loans

Daniel Mahne, BComm, MTax,Tax Specialist

In a graduated-rate, individual-reporting, personal income tax system, there is a tax advantage if a high-income earning taxpayer can shift income to a lower tax rate family member. Canada's personal income tax system structure has created an incentive for taxpayers to plan into such opportunities. As a result, many income-splitting techniques have developed over time in an effort to reduce a family's overall taxes. Governments have also capitalized on winning over the popular (or sometimes unpopular) vote by introducing their own politically-motivated income splitting opportunities which have eventually found their way into being codified into the Income Tax Act.

The Income Tax Act, however, also attempts to restrict or disincentivize certain non-government-accepted income-splitting techniques. For instance, if an individual gifts money to his or her spouse to invest, generally, the investment income earned is attributed back to the lender. That being said though, with proper planning and structuring, lending money to a spouse or other lower-income family members will not result in investment income being attributed back to the lender and can achieve tax benefits from income splitting.

The Prescribed Rate Loan

This method of splitting income relies on an exception typically referred to as the “loan for value” or “prescribed rate loan” exception. A prescribed rate loan involves an individual loaning money on an interest bearing basis to either a trust established for lower income earning family members, say a spouse and/or children, or to these individuals directly. The funds received are then invested by the loan recipient(s). In order to avoid attribution of the investment income back to the lender, two conditions must be satisfied:

1. The interest rate charged on the loan must be equal to or greater than the lesser of:
   a. The prescribed rate (an interest rate established quarterly by the Canada Revenue Agency ("CRA")) in effect at the time the loan was made; and,
   b. An arm's length amount of interest;

   and
2. The amount of interest must be paid no later than 30 days after the year for all years in which the loan is outstanding.

Currently, the prescribed rate of interest for loans put into place between January 1, 2019 and March 31, 2019 is 2 per cent.

Additionally, there is no restriction with respect to duration of the loan, so it can, theoretically, be outstanding indefinitely and the parties are able to lock-in the current relatively low prescribed rate of interest.

It extremely important to note that the interest must be physically paid (not simply by way of an accrual) no later than January 30th of the following year. If this interest due date is missed, the plan is tainted and attribution on the investment income will commence.

Example

Take the example of a high-rate individual who invests $1 million and earns a 10 per cent return. After personal income taxes, the individual will have earned approximately $46,000. Instead, say the individual loans $1 million to a child who has no other sources of income using a prescribed rate loan, which carries an interest rate of 2 per cent per annum. If the child earns the 10 per cent rate of return, the family will have $71,000 after personal income taxes are paid.

Further, if a $500,000 prescribed rate loan is made to each of the individual's two children, the family will net $77,000 after personal income taxes are paid.

Prescribed Rate Loans and the New TOSI Regime

The tax community has been buzzing over the new Tax on Split Income ("TOSI") rules, which were generally put in place to restrict the ability of business owners to income split. The TOSI rules are written so broadly and with a significantly unfortunate degree of vagueness that they may extend to situations which they likely were never meant to apply to.

For instance, if a trust carries on a sufficient level of activity which the CRA deems it to be an investment "business", and the lender is involved in those activities, the prescribed rate loan planning may not achieve its objective of income splitting if the income in question is interest income. It is unclear what activities would cause the trust to be carrying on an investment business, but it appears there may be a low threshold. Individuals should seek professional advice before setting up a prescribed rate loan using a trust. Until further guidance is provided by the CRA or the tax courts, it may be best for an individual to make a prescribed rate loan to one or more low income individuals directly rather than through a trust.

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Raiding the RRSP Nest Egg

Tax Facts You Need to Know

Daniel Ling, MTax, CPA, CA, Manager

When withdrawing funds from a Registered Retirement Savings Plan ("RRSP") before its maturity, there are several income tax consequences to consider.

Withholding Tax

Generally, when an RRSP withdrawal is requested by an individual, the financial institution is required to withhold a portion of the amount withdrawn and remit it to the Canada Revenue Agency ("CRA") as a withholding tax. The withholding tax is based on an individual's residency and the amount withdrawn. Unless an individual is living in Quebec, an RRSP withdrawal made by a Canadian individual is subject to a withholding tax of:

Amount Withdrawn	Withholding Tax
$0 - $5,000	10%
$5,001 - $15,000	20%
$15,000+	30%

For individuals who are non-residents of Canada, the withholding tax is 25 per cent, which may be reduced by a tax treaty between Canada and the individual's country of residence.

If several withdrawals are made and the CRA concludes that the separate withdrawals have been made to minimize the withholding tax, the CRA will consider the series of withdrawals as a single withdrawal and will apply the appropriate withholding tax to the total amount withdrawn.

For the year in which an RRSP withdrawal is made, the financial institution will issue the annuitant a T4RSP slip which will be used in preparing the individual's personal income tax return. The gross amount of the withdrawal will be added to the individual's income and the withholding tax will be applied as a tax installment.

If an individual wishes to make a withdrawal from his or her RRSP without withholding taxes, the parties must first request approval from the CRA. Permission will be granted by the CRA if the individual completes and files Form T3012A, Tax Deductions Waiver on the Refund of your Unused RRSP, Pooled Registered Pension Plan ("PRPP"), or Saskatchewan Pension Plan ("SPP") Contribution from your RRSP and can demonstrate they meet certain conditions.

Spousal Attribution

The income inclusion from an RRSP withdrawal may not always be included in the income of the annuitant. When an individual has made a contribution to a spousal or common-law RRSP in the current year or one of the previous two calendar years, the RRSP withdrawal is taxed as income of the contributor rather than the annuitant.

Withdrawing Unused RRSP Contributions

The withdrawal of RRSP contributions that have not been deducted for income tax purposes or designated as part of the Home Buyer's Plan ("HBP") or Lifelong Learning Plan ("LLP") ("unused RRSP contributions") may be made tax-free, under certain circumstances. While the withdrawal of an unused RRSP contribution is reported on a T4RSP slip and included in an individual taxpayer's income, generally, an offsetting deduction is available if:

1. The individual has not deducted the unused contributions for personal income tax purposes; and
2. It must be reasonable that the CRA will consider that the unused RRSP contribution was initially:
   - Made with the intention of being fully deducted for the year or immediately preceding year that the contribution was made; or
   - Not made with the intention of withdrawing and deducting an offsetting amount.

If an individual qualifies for the deduction, Form T746, Calculating Your Deduction for Refund of Unused RRSP, PRPP, and SPP Contributions, should be completed and filed with the individual's personal income tax return. In addition, as previously discussed, if Form T3012A, Tax Deductions Waiver on the Refund of your Unused RRSP, PRPP, or SPP Contribution from your RRSP, is filed and approved prior to the withdrawal, the withholding tax on the withdrawal may be waived.

Excess RRSP Contributions

Unused RRSP contributions may arise when an individual contributes an amount to their RRSP in excess of their RRSP contribution limit. RRSP contributions which exceed an individual's RRSP contribution limit by more than $2,000 are subject to a penalty tax of 1 per cent per month unless the excess contributions are withdrawn before the end of the month in which the excess contributions were made.

If subject to the 1 per cent penalty tax, Form T1-OVP, 2018 Individual Tax Return for RRSP, PRPP, and SPP Excess Contributions, must be completed and filed with the CRA within 90 days after the end of the year in which the excess contributions originated. Interest and penalties may apply if the form and/or payments are late.

The penalty tax on an excess RRSP contribution may be waived if a letter explaining how the excess contribution arose because of a reasonable error and describing what steps are being taken to eliminate the excess contribution is submitted and approved by the CRA.

Home Buyer's Plan and Lifelong Learning Plan

The HBP and LLP allow individuals to withdraw prescribed amounts from an individual's RRSP on a tax-free basis as long as repayments to the RRSP are made within prescribed due dates. The HBP allows no more than $25,000 to be withdrawn from an RRSP for the building or purchase of a qualifying home if the individual did not occupy a home that was owned by the individual or the individual's spouse or common-law partner since January 1st of the fourth year before the year the funds were withdrawn. The LLP permits no more than $20,000 to be withdrawn from an RRSP for the purpose of enrolling the individual or the individual's spouse on a full-time basis in a qualifying education program at a designated education institution. Amounts withdrawn under the HBP generally need to be repaid to one's RRSP within 15 years, beginning no later than 60 days after the end of the second year following the withdrawal. Amounts withdrawn under the LLP generally need to be repaid to one's RRSP within 10 years, beginning no later than the fifth year following the year of withdrawal.

Next steps?

There are many factors to consider when withdrawing funds from an RRSP. If you would like specific tax advice regarding your particular situation, please contact one of the tax professionals at Crowe Soberman.

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Clarifying Child Care Expenses

And Why it Matters

Alessandra De Palma, Specialist, Tax

Expenses eligible for the child care deduction have traditionally included daycare, before school and/or after school care fees, payments to a nanny or babysitter and day camp amounts. What these expenses have in common is that the main purpose of the provider of the services is to solely care for the child's needs. Recently, taxpayers have been attempting to stretch the interpretation of qualifying expenses to include expenses of a recreational and/or educational nature.

Kwan v. The Queen

In the tax court case of Kwan v. The Queen (2018 TCC 184), the issue was whether Mr. Kwan was entitled to the deduction claimed for child care expenses which included a variety of after-school and summer activities (including math, chess and skiing classes) for his two children, ages 10 and 12. The Minister denied Mr. Kwan's child care expense claim on the basis that the expenses incurred did not qualify as child care expenses because their main purpose was the fulfilment of an educational or recreational objective, rather than a primary care need.

Section 63 of the Income Tax Act (Canada) ("ITA") defines child care expenses as:

…an expense incurred … for … child care services including babysitting services, day nursery services or services provided at a boarding school or camp if the services were provided

(a) to enable the taxpayer…

(i) to perform the duties of …employment

(ii) to carry on a business …

(iv) to carry on research in respect of which the taxpayer … received a grant, or

(v) to attend a designated educational institution…

Section 63 of the ITA permits a taxpayer to generally deduct qualifying child care expenses of up to $8,000 for an eligible child under seven years old, and up to $5,000 for an eligible child between the ages of seven and 16 years.

Mr. Kwan and his spouse each worked full-time. When the court reviewed the nature of the expenses in light of the Section 63 ITA definition, it decided to look at the purpose for which the expense was incurred and not deny a genuine child care expense solely because the activity was recreational or educational in nature. By applying a purpose test, the court concluded that the majority of expenses were incurred in order to allow both parents to work full-time and were, therefore, deductible as child care expenses. Further, the court disallowed expenses which took place during school hours and on weekends on the basis that the children could have been in school and there was no evidence that Mr. Kwan was required to work or that his spouse was not available for the children's care on weekends.

The Takeaway

Mr. Kwan prevailed because the Tax Court of Canada decided that the word "including" in the ITA does not limit qualifying child care expenses to only "babysitting services, day nursery services or services provided at a boarding school or camp". This case reaffirms the notion that determining whether a child care expense is deductible to a taxpayer hinges on whether incurring the expense allows the taxpayer to work, carry on a business, perform research for which they received a grant, or, in some cases, go to school. The type of program or activity is not the question. Conversely, this case questions the eligibility of the child care deduction for taxpayers who work or carry on a business on an irregular schedule, during times where their children are or ought to be in school.

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

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Important Tax Deadlines

February 28, 2019

- Filing due date for T4 Summaries and slips for salaries, bonuses, and retiring allowances paid in 2018.
- Filing due date for T5 Summaries and slips for interest and dividends paid by corporations, partnerships and trusts in 2018.

March 1, 2019

- Last day to make a 2018 RRSP contribution.

March 15, 2019

- Filing due date for Employer Health Tax (EHT) returns for employers with salary and bonuses paid of $450,000 or more in 2018.
- First quarterly installment due for 2019 personal income taxes (if applicable).

April 1, 2019

- 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, 2018.
- Final payment of corporate income taxes due for most corporations with a December 31, 2018 fiscal year end.

April 15, 2019

- 2018 US personal income returns and taxes due for US citizens and green card holders residing in Canada unless an extension is filed.

April 30, 2019

- 2018 Canadian personal income taxes due; personal income tax return filing due date for most Canadian taxpayers.

June 17, 2019

- Personal income tax return filing due date for Canadian taxpayers who report self-employment income.
- Second quarterly installment due for 2019 personal income taxes (if applicable).

July 2, 2019

- Filing due date for corporate income tax returns for professional corporations with a December 31, 2018 fiscal year end.

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