



TOSI – Beyond the Basics – A Deep Dive into Planning Options

Connecting people and ideas in tax.

Kiddie Tax (TOSI) - History

- “Kiddie tax” or tax on split income (“**TOSI**”) was introduced into Canadian tax law effective January 1, 2000.
- TOSI applies on certain types of income (“**split income**”) received by a child under 18 with a Canadian resident parent.
- Where applicable, the minor pays income tax at the highest marginal personal tax rate (48% in Alberta) on TOSI income, and loses personal tax credits.
- Parents generally have joint and several liability for the tax.

TOSI Reform Saga

- July 18, 2017, Finance released V1 of the proposed reform to TOSI:
 - Unworkable legislation.
 - Unprecedented backlash.
 - 65 page Joint Committee submission on V1 discussing legislative errors and unfair/illogical consequences released October 2, 2017.
- December 13, 2017, Finance released V2:
 - Problems and complexity still persist. On March 8, 2018, Joint Committee sent an 18 page submission on V2 to Finance.
- March 22, 2018, Finance released the final V3:
 - Addressed some of the criticisms of V2.
 - Still very complex and very broad.
 - Enacted into law, effective January 1, 2018.

TOSI Reform Saga

- The 2019 Federal Budget contained no personal or corporate tax rate reductions.
- Our firm continues to hold the strong view that tax rate reductions are needed to compete with the U.S. given the strong magnetic pull that U.S. tax reform has had on investment capital.



New TOSI Rules, Effective January 1, 2018

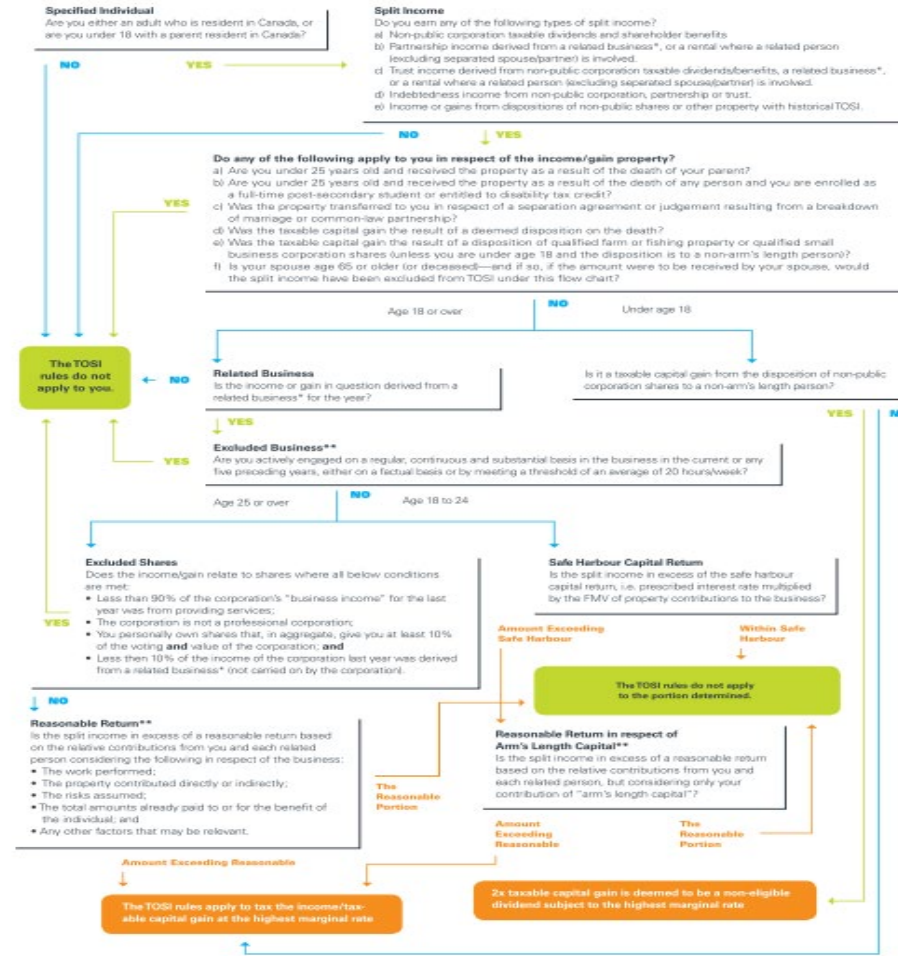
- Effectively applies kiddie tax to every Canadian, and expanded the types of income subject to TOSI.
- Special tax on TOSI = split income x top marginal tax rate.
- No personal tax credits will apply to reduce TOSI tax, other than dividend tax credit, disability tax credit, and foreign tax credit.
- To prevent same income from being taxed again, the computation for net income for tax purposes backs out the amount of split income.
- Parents generally have joint and several liability for the tax.

New TOSI Rules, Effective January 1, 2018

- *“The new TOSI rules are written like a bad escape room game. The way these rules are written, everyone is caught... unless you can escape... and the exits are not clearly marked.”*
 - Cory G. Litzenberger, CGL Strategic Business & Tax Advisors.
- We have, on good authority, that the CRA has a mandate to start auditing 2018 year for TOSI issues right away. Everyone must learn these rules now.
- Each income recipient responsible for determining if TOSI applies (no indication on any T3/T5 slips).
- Given the complexity, we found the easiest way to learn these rules is to visualize them in a flowchart.
- We will walkthrough the flowchart step-by-step.

Income Sprinkling – V3 Flowchart

SIMPLIFIED TOSI FLOWCHART
(Tax on Split Income):



* Related business generally means any business in which a related person is involved or directly/indirectly own 10% or more. However, separated spouses/partners deem not related for the year.

** Attributes generally inherited for property acquired as a result of death.

Re-Characterization of Capital Gain into TOSI Dividends

- A capital gain is re-characterized into non-eligible dividend if:
 - The vendor specified individual is <age 17 in the PY, or the vendor is a trust that allocates the gain to such specified individual;
 - Capital gain arises from disposition of unlisted shares of a corporation; and
 - Transfer of such shares either directly or indirectly in any manner whatever to a person not dealing at arm's length with the specified individual.
- Result: loses 50% inclusion rate, non-eligible dividend treatment (irrespective of whether corporation has general rate income pool ("**GRIP**"), and will generally be subject to the top marginal tax rate.
- A re-characterized dividend cannot trigger a corporate refundable dividend tax on hand ("**RDTOH**") refund since it only deems the individual to have "received" a dividend but does not deem the corporation to have "paid" such dividend.

Do Not Forget Other Rules Governing Income Splitting Besides TOSI

- Section 67 – Deduction from income must be reasonable.
- Sections 56, 74.1 to 75.1 – Income attributed back to transferor.
- Sections 15, 246 and subsection 56(2) – Tax benefit conferral.
- Section 74.4 – Imputes income where attribution done indirectly through corporations.
- Sections 74.1 and 60.03 – Explicit permission for seniors to split CPP and eligible pension income.



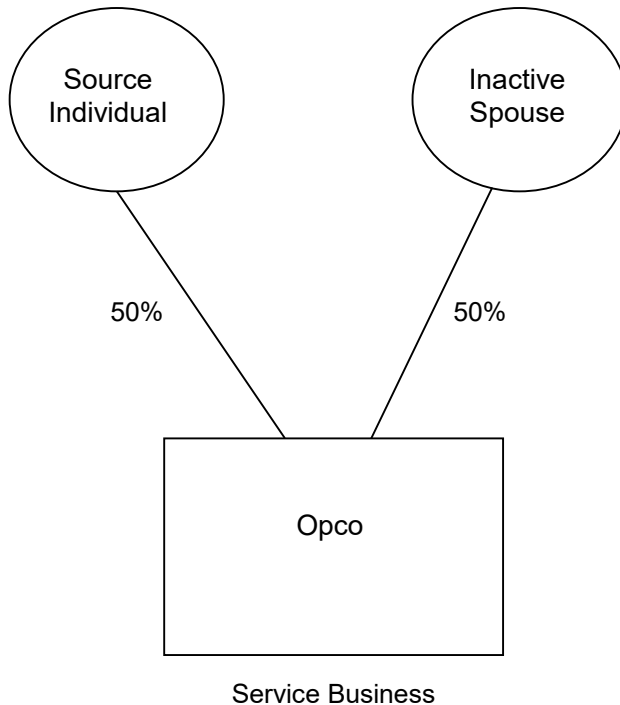
TOSI and Remuneration Strategies

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The Dollar Value of Income Splitting for Eligible and Non-Eligible Dividends

Province	Tax Savings from a Full Set of Marginal Rates	
	Eligible Dividends	Non-eligible Dividends
Alberta	\$ 33,142	\$ 33,417
British Columbia	\$ 33,278	\$ 33,273
Saskatchewan	\$ 27,581	\$ 27,515
Manitoba	\$ 27,026	\$ 27,036
Ontario	\$ 36,371	\$ 36,384

Fact Pattern



- Opco is carrying on a service business.
- Opco earned \$300,000 in taxable income in 2018.
- Opco is entitled to claim the Small Business Deduction.
 - Small Business Rate of 11%.
 - General Rate of 27%.
- Shareholders withdraw \$155,000 of cash from corp.
- Inactive spouse has never contributed to Opco's business.
- Inactive spouse has no other source of income.

Pre – TOSI (Base Case: \$155,000 Drawn from Corporation)

Pre-TOSI	Corp	Source	Spouse	Total After-Tax
Corporate Income	\$ 300,000			
Salary + CPP	\$ (87,600)			
Corporate Tax	\$ (23,400)			
Dividend	\$ (70,000)			
Salary		\$ 85,000		
Dividend			\$ 70,000	
CPP		\$ (2,600)		
Personal Tax		\$ (18,900)	\$ (8,600)	
After-Tax Cash	\$ 119,000	\$ 63,500	\$ 61,400	\$ 243,900
Total Personal		\$ 124,900		

Dividend to Spouse Subject to TOSI

With TOSI	Corp	Source	Spouse	Total After-Tax
Corporate Income	\$ 300,000			
Salary + CPP	\$ (87,600)			
Corporate Tax	\$ (23,400)			
Dividend	\$(70,000)			
Salary		\$85,000		
Dividend			\$70,000	
CPP		\$ (2,600)		
Personal Tax		\$(15,200)*	\$(29,700)	
After-Tax Cash	\$ 119,000	\$ 67,200	\$ 40,300	\$ 226,500
Total Personal		\$ 107,500		

*Source individual entitled to spousal amount.

Dividend to Source Individual

Dividend to Source	Corp	Source	Spouse	Total After-Tax
Corporate Income	\$ 300,000			
Salary + CPP	\$ (87,600)			
Corporate Tax	\$ (23,400)			
Dividend	\$(70,000)			
Salary		\$85,000		
Dividend		\$70,000		
CPP		\$ (2,600)		
Personal Tax		\$(35,600)		
After-Tax Cash	\$ 119,000	\$ 116,800		\$ 235,800
Total Personal		\$ 116,800		

Bonus to Source Individual

Bonus to Source	Corp	Source	Spouse	Total After-Tax
Corporate Income	\$ 300,000			
Salary + CPP	\$(157,600)			
Corporate Tax	\$ (15,700)			
Dividend				
Salary		\$85,000		
Bonus*		\$70,000		
CPP		\$ (2,600)		
Personal Tax		\$(40,800)		
After-Tax Cash	\$ 126,700	\$ 111,600		\$ 238,300
Total Personal		\$ 111,600		

*Bonus will increase Source Individual's RRSP room by \$11,200, to the maximum of \$26,500 for 2019.

Bonus to Spouse

Bonus to Spouse	Corp	Source	Spouse	Total After-Tax
Corporate Income	\$ 300,000			
Salary + CPP	\$(160,200)			
Corporate Tax	\$ (15,400)			
Dividend				
Salary		\$85,000		
Bonus*			\$70,000	
CPP		\$ (2,600)	\$ (2,600)	
Personal Tax		\$(18,900)	\$(14,300)	
After-Tax Cash	\$ 124,400	\$ 63,500	\$53,100	\$ 241,000
Total Personal		\$ 116,600		

*Bonus will increase Spouse's RRSP room by \$12,600

Bonus to Spouse (Subject to Section 67)

Section 67 Bonus	Corp	Source	Spouse	Total After-Tax
Corporate Income	\$ 300,000			
Salary + CPP	\$ (87,600)			
Corporate Tax	\$ (23,400)			
Non-D. Salary + CPP	\$(72,600)			
Salary		\$85,000		
Bonus*			\$70,000	
CPP		\$ (2,600)	\$ (2,600)	
Personal Tax		\$(18,900)	\$(14,300)	
After-Tax Cash	\$ 116,400	\$ 63,500	\$53,100	\$ 233,000
Total Personal		\$ 116,600		

*Bonus will increase Spouse's RRSP room by \$12,600

Cash Summary - \$155,000 Drawn from Corp (SBD)

TOSI Impacts - SBD Rate	Corp	Personal	Total	Difference	Add'l RRSP Room
Pre- TOSI	\$ 119,000	\$ 124,900	\$ 243,900	-	-
With TOSI	\$ 119,000	\$ 107,500	\$ 226,500	\$ (17,400)	-
Dividend to Source	\$ 119,000	\$ 116,800	\$ 235,800	\$ (8,100)	-
Bonus to Source	\$ 126,700	\$ 111,600	\$ 238,300	\$ (5,600)	\$ 11,200
Bonus to Spouse	\$ 124,400	\$ 116,600	\$ 241,000	\$ (2,900)	\$ 12,600
Bonus to Spouse with S67	\$ 116,400	\$ 116,600	\$ 233,000	\$ (10,900)	\$ 12,600

Cash Summary – \$155,000 Drawn from Corp (General Rate)

TOSI Impacts - SBD Rate	Corp	Personal	Total	Difference	Add'l RRSP Room
Pre- TOSI	\$ 85,100	\$ 130,200	\$ 215,300	-	-
With TOSI	\$ 85,100	\$ 114,900	\$ 200,000	\$ (15,300)	-
Dividend to Source	\$ 85,100	\$ 124,600	\$ 209,700	\$ (5,600)	-
Bonus to Source	\$ 104,000	\$ 111,600	\$ 215,600	\$ 300	\$ 11,200
Bonus to Spouse	\$ 102,100	\$ 116,600	\$ 218,700	\$ 3,400	\$ 12,600
Bonus to Spouse with S67	\$ 82,500	\$ 116,600	\$ 199,100	\$ (16,200)	\$ 12,600

Cash Summary – \$420,000 Drawn from Corp (SBD) (on \$500,000 of Corporate Income)

TOSI Impacts - SBD Rate	Corp	Personal	Total	Difference	Add'l RRSP Room
Pre- TOSI	\$ 46,900	\$ 294,200	\$ 341,100	-	-
With TOSI	\$ 46,900	\$ 263,700	\$ 310,600	\$ (30,500)	-
Dividend to Source	\$ 46,900	\$ 266,400	\$ 313,300	\$ (27,800)	-
Bonus to Source	\$ 68,900	\$ 253,400	\$ 322,300	\$ (18,800)	-
Bonus to Spouse	\$ 66,600	\$ 278,900	\$ 345,500	\$ 4,400	\$ 26,500
Bonus to Spouse with S67	\$ 44,300	\$ 278,900	\$ 323,200	\$ (17,900)	\$ 26,500

Cash Summary – \$420,000 Drawn from Corp (General Rate) (on \$500,000 of Corporate Income)

TOSI Impacts - SBD Rate	Corp	Personal	Total	Difference	Add'l RRSP Room
Pre- TOSI	\$ 2,500	\$ 314,300	\$ 316,800	-	-
With TOSI	\$ 2,500	\$ 285,200	\$ 287,700	\$ (29,100)	-
Dividend to Source	\$ 2,500	\$ 286,000	\$ 288,500	\$ (28,300)	-
Bonus to Source	\$ 56,500	\$ 253,400	\$ 309,900	\$ (6,900)	-
Bonus to Spouse	\$ 54,600	\$ 278,900	\$ 333,500	\$ 16,700	\$ 26,500
Bonus to Spouse with S67	\$ -	\$ 278,800	\$ 278,800	\$ (38,000)	\$ 26,500

Takeaways

1. Across all income levels and without regard to the corporate rate of income, paying a reasonable salary or bonus to the inactive spouse provides the best outcome.
2. Increasing the salary or paying a bonus to the source individual provides the next best result.
 - Note that Section 67 applying to the unreasonable portion of the spouse's salary is much more punitive if the denied salary is subject to the general rate.
 - At low income levels of an inactive individual, having section 67 apply may provide a better result.
 - Consider using Tax Templates Inc.'s spreadsheets to help calculate tax in various scenarios. Excellent software.
3. Any other reasonable payments that can be made to spouse or other family members?
E.g. Guarantee fees for a family member personally guaranteeing a corporate debt?

Risk of Section 67

- Provides that expenses are deductible against income to the extent they are reasonable in the circumstance.
- Does not need to be assessed by the CRA, you can add back the unreasonable portion of a salary on schedule 1 of the corporate tax return.
- Risk: CRA recharacterizes the unreasonable portion of the salary as a subsection 15(1) benefit, which would then be considered TOSI and would not provide RRSP room for the spouse.
- Worst Case Scenario: CRA deems there to be a subsection 15(1) benefit to the source individual and the salary still be taxable to the spouse.
 - We believe this result would be unlikely as the CRA should not assess tax on the same income twice. But, it is technically possible.

Reporting TOSI – T1 Form T1206

Dispositions of certain capital property (shares subject to tax on split income (TOSI))

Complete this part if you (or a trust of which you are the beneficiary) disposed of shares to a person with whom you do not deal at arm's length, and the dividends on such shares would be subject to TOSI.

Capital gain on dispositions in 2018					A
Amount of 2017 reserve (from line C of Form T1206 for 2017)			B		
Amount of 2018 reserve (calculated below)	-		C		
Line B minus line C (if negative, show in brackets)	=			+	D
Line A plus line D				=	E
					Net capital gain
Gains from box 21 of your T3 slip(s) (relating to such dispositions)				+	F
Line E plus line F				=	G

If you were under 18 years of age at the end of the year, the amount at line G is deemed to be a dividend (other than eligible dividend). Multiply the amount on line G by 1.16 and include this amount under "Taxable amount of dividends (eligible and other than eligible) from taxable Canadian corporations" on the worksheet for your return, and on lines 120 and 180 of your return. In addition, enter this amount on lines 1 and 2 as indicated in Part 1 below. Do not include this amount on Schedule 3.

If you were 18 years of age or older in 2018, enter the amount from line G on the applicable line(s) of Schedule 3. In addition, enter 50% of the amount from line G on line 3 in Part 1 below.

Calculation of reserve

Complete this calculation for dispositions made after March 21, 2011, and include the total amount of your 2018 reserve on line C above. You can claim a reserve up to a maximum of four years for each disposition. Your reserve in each year cannot be more than the lesser of the following two calculations (use a separate sheet of paper for multiple dispositions):

(i) Capital gain _____ × $\frac{\text{Amount payable after the end of the year}}{\text{Proceeds of disposition}}$ _____ = _____

(ii) Capital gain _____ × $\frac{\text{Applicable percentage for year of sale or year after sale}}{\text{}} \%$ _____ = _____

Year of sale	Year after sale
80%	1st year: 60%
	2nd year: 40%
	3rd year: 20%
	4th year: 0%

Reporting TOSI – T1 Form T1206 – Cont'd

Part 1 – TOSI-adjusted net income

The part of the taxable amount of dividends (eligible and other than eligible) described in the information section received from taxable Canadian corporations	6835		1
The part of the taxable amount of dividends other than eligible dividends, included on line 1, from taxable Canadian corporations	6834	2	
All other split income (see the definition in the information section)		+	3
Total split income: Add lines 1 and 3. Enter this amount on line 232 of your return.	6836	=	4
Net income from line 236 of your tax return		+	5
TOSI-adjusted net income: Add lines 4 and 5 (See note below)		=	6

Reporting TOSI – Mechanical Things to Watch Out For

- Ensure the paragraph 20(1)(ww) deduction for the income subject to TOSI is included on line 232 'Other Deductions' on the T1 Income Tax and Benefit Return to ensure the income is not taxed twice.
- For a dividend, include the 'grossed-up' amount in split income.
- Investment losses (capital loss, interest expense, etc.) and carrying expenses do not reduce split income.
- Donation credits do not reduce TOSI.

Reporting TOSI – Mismatch Issues: Illustration 1

- Capital Loss Issue:
 - Mr. A has capital gain of \$200,000 which is all TOSI.
 - Mr. A has capital loss of \$300,000 (from other source).
- Result:
 - Split income of \$100,000; i.e. TOSI tax of \$47,500.
 - Net loss for tax purposes of (\$100,000), as follows:
 - Excess of taxable CG over allowable CL nil, and
 - Less, 20(1)(ww) deduction to remove split income (\$100,000).
- The \$100,000 of net loss should be a non-capital loss, since 20(1)(ww) is a subdivision b deduction (computation of income/loss from business or property). Hopefully, CRA will clarify.

*Special thank you to Henry Shew of Cadesky Tax for assistance in developing the above example



Reporting TOSI – Mismatch Issues: Illustration 2

- Carrying Charge Issue:
 - Ms. B borrows to invest in BCo.
 - Interest expense \$30,000; dividend received \$100,000.
 - If dividend is all TOSI, no offset for interest expense.

- Result:

Dividend (Taxable amount)	\$116,000
Interest Expense	(\$ 30,000)
Deduction for split income	<u>(\$116,000)</u>
Net loss for tax purposes	(\$ 30,000)
Split income (TOSI)	\$116,000 ← TOSI tax of \$32,000 to \$42,000

- Under the reasonable return test, perhaps \$30,000 of the dividend is not TOSI, to which the \$30,000 of interest expense can be deducted.

*Special thank you to Henry Shew of Cadesky Tax for assistance in developing the above example



Reporting TOSI – Mismatch Issues: Illustration 3

- Donation Issue:
 - Mr. C sold shares of a private corporation (not a small business corporation). Capital gain of \$8 million all TOSI.
 - Mr. C was not concerned, top rate taxpayer anyway.
 - Mr. C made \$2 million donation expecting to receive \$1 million tax credit.

- Result:

Taxable capital gain	\$4,000,000
Deduction for TOSI	<u>(\$4,000,000)</u>
Net income	nil
Split income	\$4,000,000 ← TOSI tax of \$1.9M
Tax deduction for donation	nil, w/ 5 year CF

*Special thank you to Henry Shew of Cadesky Tax for assistance in developing the above example



Reporting TOSI – Mismatch Issues: Illustration 4

- 15(2) Shareholder Loan Repayment Issue:
 - Mrs. D is a shareholder of Opco and she borrowed \$500,000 from Opco in Year 1.
 - Mrs. D repaid the \$500,000 in Year 3.
 - Any subsection 15(2) shareholder benefit is TOSI to Mrs. D.

- Result:

Year 1

Subsection 15(2) benefit	\$500,000
Deduction for TOSI	<u>(\$500,000)</u>
Net income	nil
Split income, on which top rate tax applies	\$500,000 ← TOSI tax of \$240,000

Year 3

No paragraph 20(1)(j) deduction available even though loan is repaid, because the loan amount was “deductible” in a previous year. This caused the subsection 15(2) to become a permanent tax.





“Excluded Shares” Planning

Connecting people and ideas in tax.

“Excluded Shares” – ‘Get Out of Jail Free’ Card for Age 25 & Over

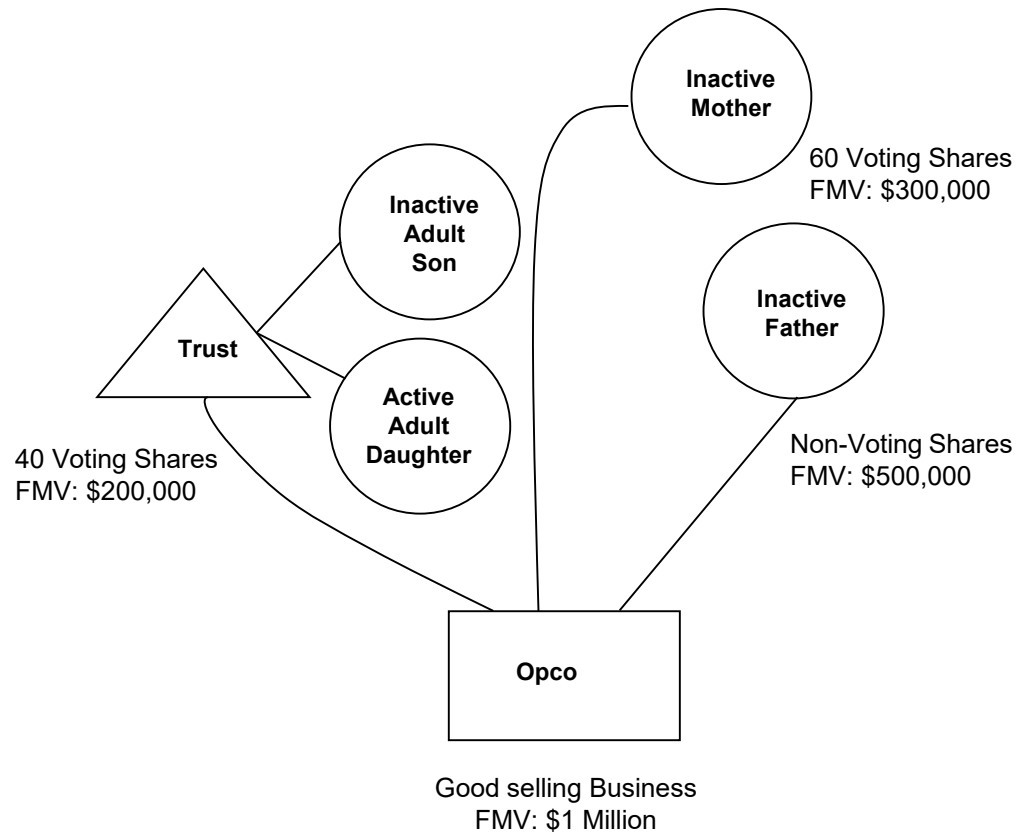
- The most powerful of TOSI exemptions.
- Exemption can be accessed by an individual who has attained age of 24 before the year.
- The individual must hold “excluded shares”.
- The exemption provides that the individual can earn unlimited income from or taxable capital gain on these excluded shares, without TOSI applying.
- Ideally, structure business in a way that shareholders hold excluded shares. This way, no need to worry about TOSI.



What Constitutes “Excluded Shares”?

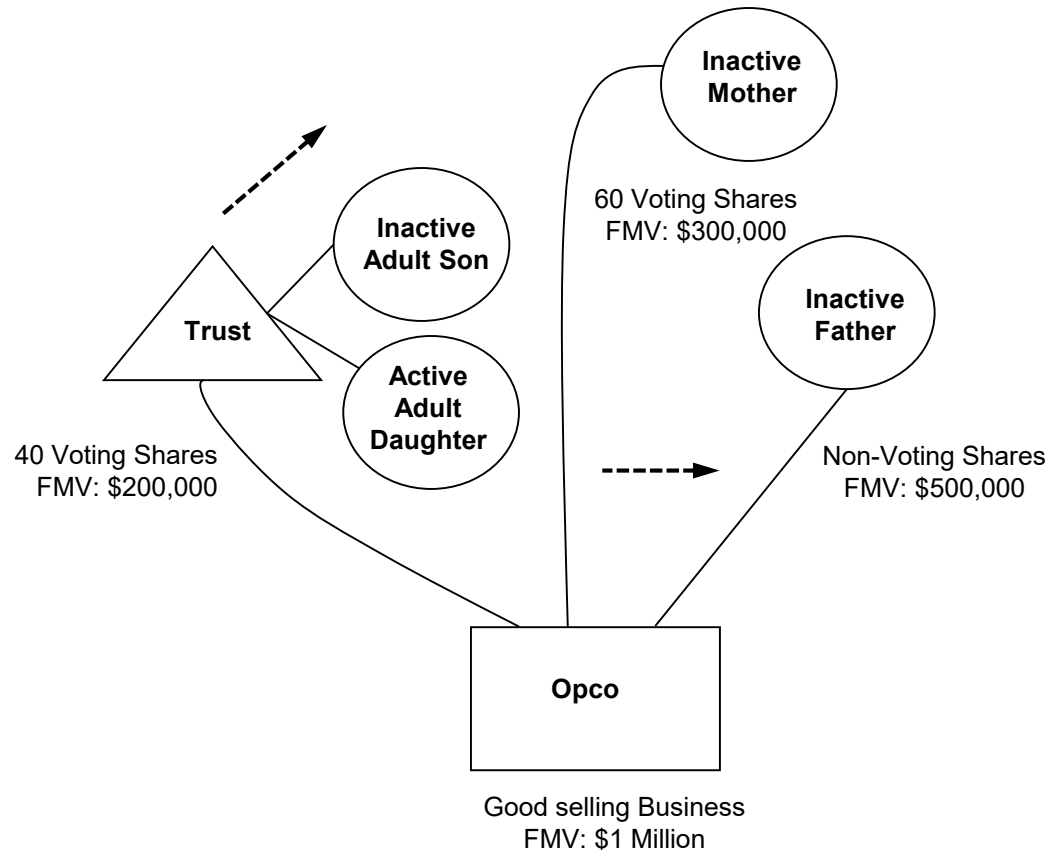
- Owned personally by the specified individual and meet all 3 conditions:
- Condition (a) -
 - i. less than 90% of the business income of the corporation for the last taxation year was from the provision of services, and
 - ii. the corporation is not a professional corporation.
- Condition (b) - immediately before that time, the specified individual owns shares of the corporation that give the holder 10% or more in votes and fair market value (“**FMV**”) [2018 *transitionalary measure: condition (b) met for 2018 if 10% test met partway thru the year, but no longer the case after 2018*].
- Condition (c) - all or substantially all of the income of the corporation for the last taxation year not derived, directly or indirectly, from one or more related businesses in respect of the specified individual other than a business of the corporation.

Example #1



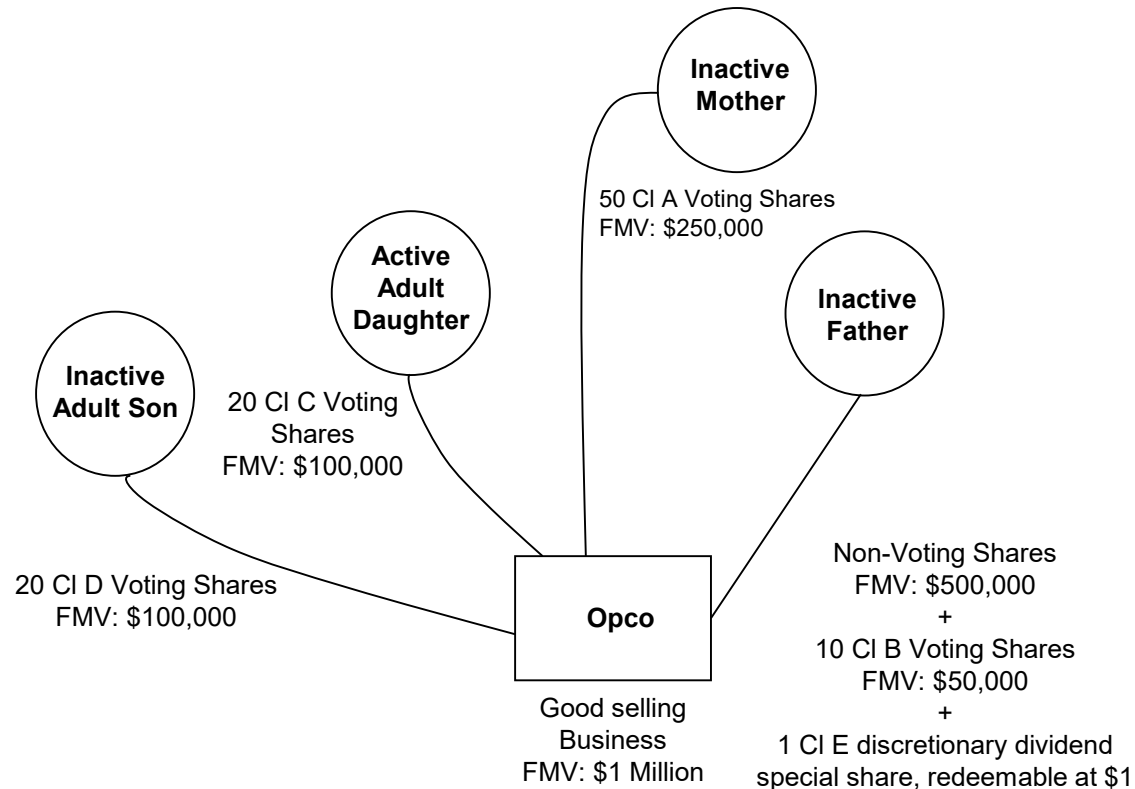
- Inactive adult son: not protected by “excluded shares”, because shares not personally owned. No personal contribution. All TOSI.
- Active adult daughter: not protected by “excluded shares”. But trust income distribution derived directly or indirectly from an “excluded business” if she works >20 works per week in Opco’s business. No TOSI.
- Inactive mother: protected by “excluded shares”. Immediately before dividend, owns shares that give her 10% or more of votes and FMV; not a service business, and income not derived from another related business other than Opco’s business.
- Inactive father: Not holding 10% of votes & value. Not excluded shares. If no “reasonable return” – should examine how he got these shares – then all TOSI.

Example #1 – Cont'd



- Planning:
 - have each family member own 10% votes and value.
 - No need for single class to exceed 10% in both votes and value.
 - CRA TI# 2018-0771811E5: “tests are to be applied at the shareholder level (i.e., based on the aggregate of all classes of shares so owned) versus on each specific class of shares owned by the specified individual.”
- Steps:
 1. Mother rolls 10 voting shares to Father under ITA 73(1), so Father has 10% votes.
 2. Trust roll 20 voting shares to each of Son and Daughter under ITA 107(2) so that each have 10% of votes and value. B
 3. ut beware of any non-tax issues.
 4. Reorganize Opco share classes so that (i) dividends to Father do not go through the voting shares rolled over from Mother – to avoid ITA 74.1 income attribution; and (ii) so that different dividend amounts can be paid to each family member.

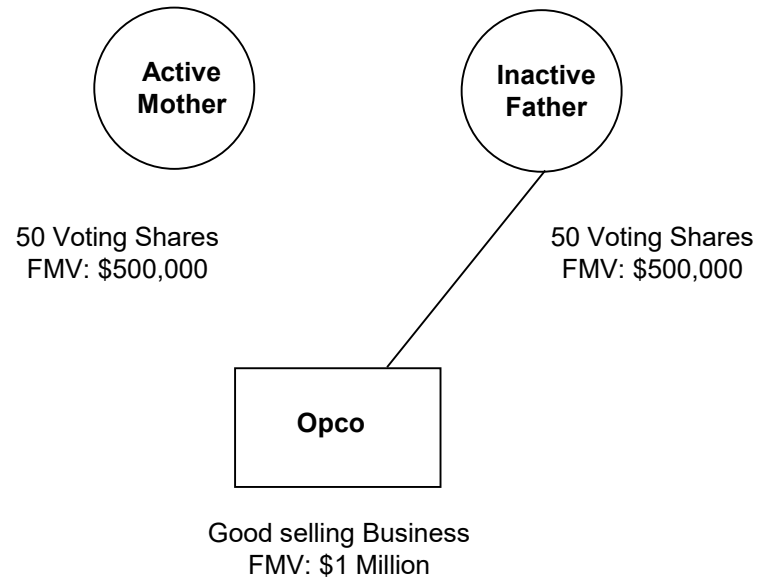
Example #1 – Cont'd



- Post Re-organization:

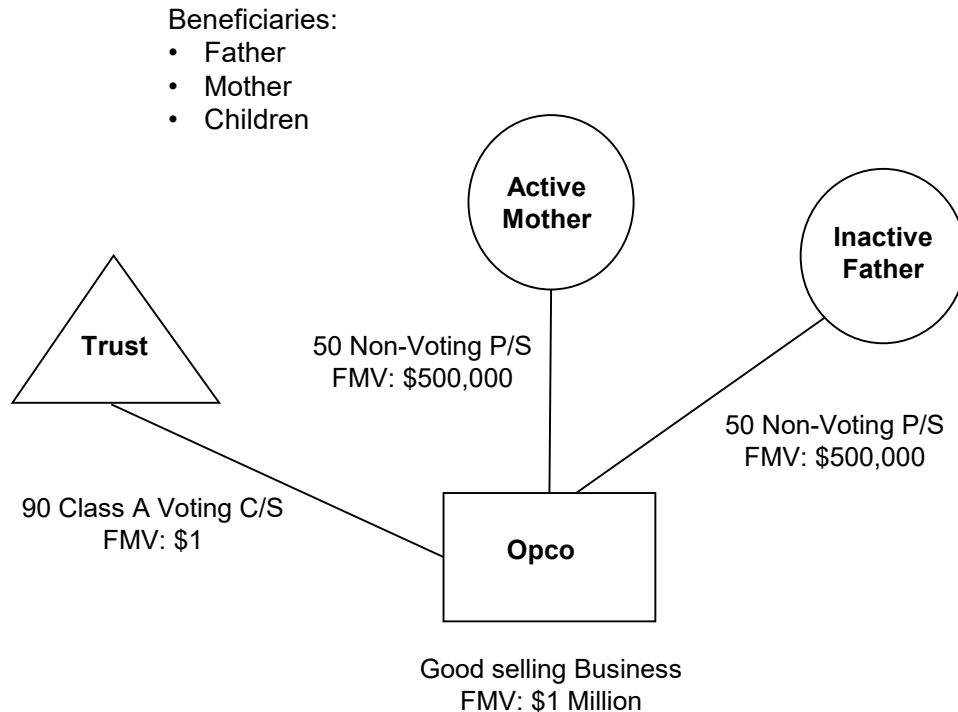
- Each family member holds more than 10% votes and value, so that future dividends protected from TOSI due to “excluded shares” status.
- Each family member holds different share classes so different dividends may be paid to each.
- Dividends cannot be paid to Father through the 10 Voting Shares transferred to him from Mother, as attribution would apply. As part of the reorganization, stock dividend a nominal PUC Class E discretionary dividend special share to Father on which future dividends will be paid to Father (but redeemable for \$1).
 - However, consider potential risk of CRA viewing the Class E to have value exceeding \$1.

Example #2



- Objective:
 - Freeze Opco
 - Pass future growth to family trust
- Planning:
 - Maintain ability to split income with non-active spouse (Father)
 - The catch? Father should keep 10% of future growth, in order to ensure 10% FMV test will continue to be met in the future.
 - It may be possible to reduce the growth shares issued to Father if value of freeze shares he holds will be substantial relative to the business.

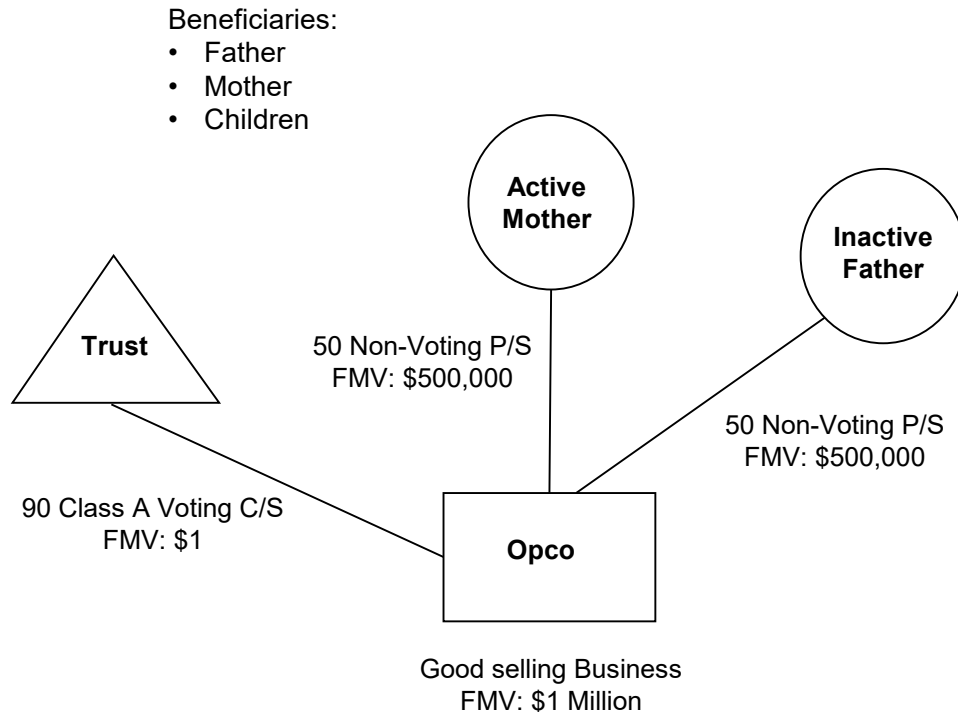
Example #2 – Cont'd



- Steps:

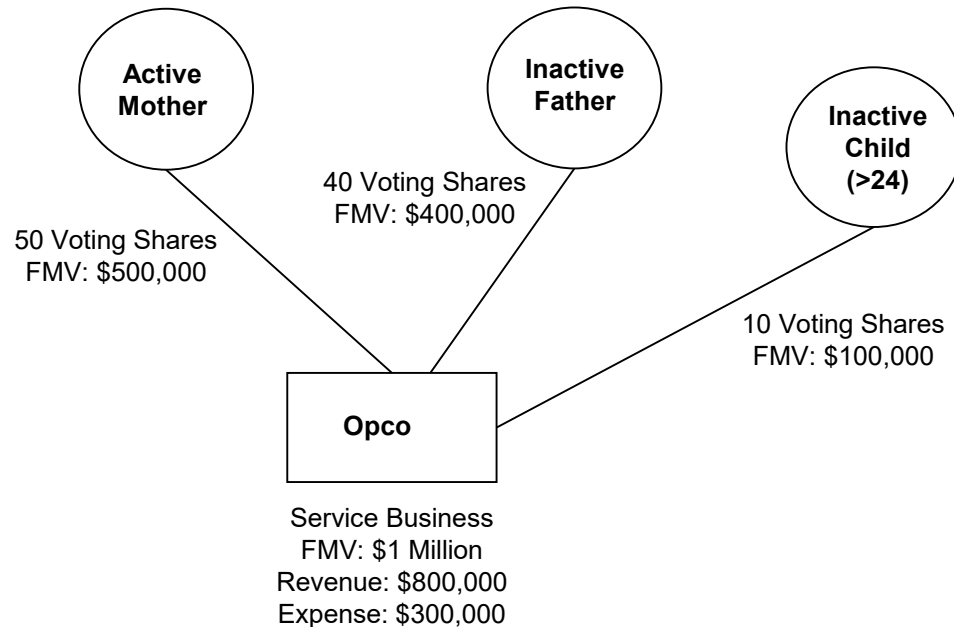
1. Father and Mother exchange their voting shares into fixed value non-voting preferred shares;
2. Family Trust subscribes for 90 new Class A voting fully participating common shares;
3. Father subscribes for 10 new Class B voting fully participating common shares. *[It is possible to issue less or no participating C/S to Father (and only issue him 10% voting non-participating shares) so that more growth goes to Trust, but if Opco's value grows beyond \$5M or Father redeems the P/S below the 10% value threshold, then Father would no longer meet the 10% FMV holding test]*

Example #2 – Cont'd



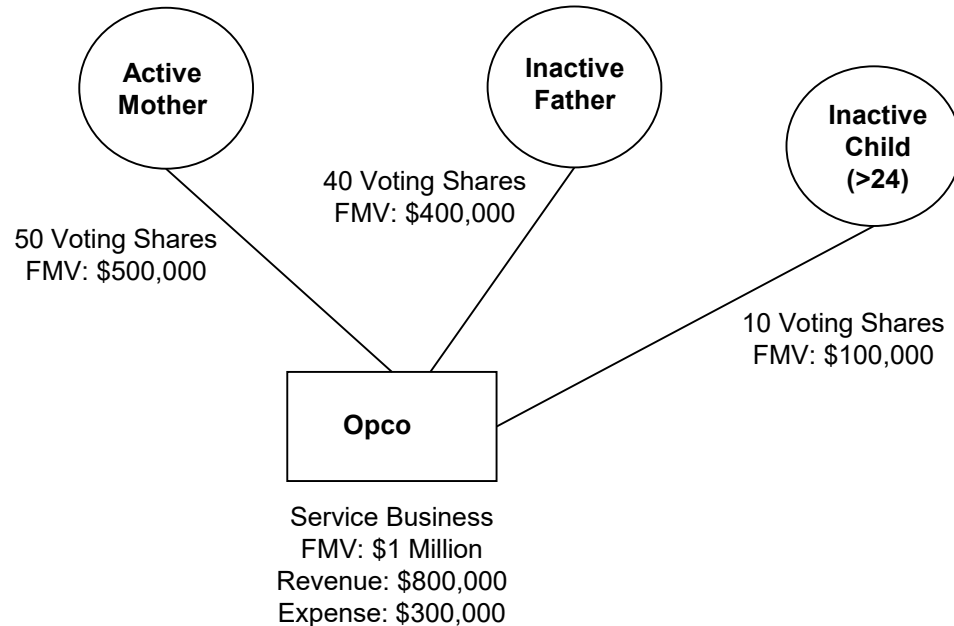
- **Result:**
 - Froze majority of value (except for 10% of growth going to Father going forward);
 - 90% of future growth going to Family Trust, in which next generation are included as beneficiaries.
- **TOSI implications:**
 - Future dividends to Trust allocated to Father and Children subject to TOSI. Distributions will not be dividends on excluded shares.
 - Future capital gains allocated by Trust not subject to TOSI, as long as Opco C/S qualifies as QSBC.
 - Opco can pay dividends on Class B to Father. No TOSI because Class B will constitute excluded shares.
 - Opco can redeem up to \$400K of Father's P/S, and deemed dividend not TOSI, because P/S constitute excluded shares as long as Father meets 10% threshold.
 - Trust distributions to Mother, or P/S redemptions by Mother, should be exempt from TOSI due to "excluded business" exemption.

Example #3



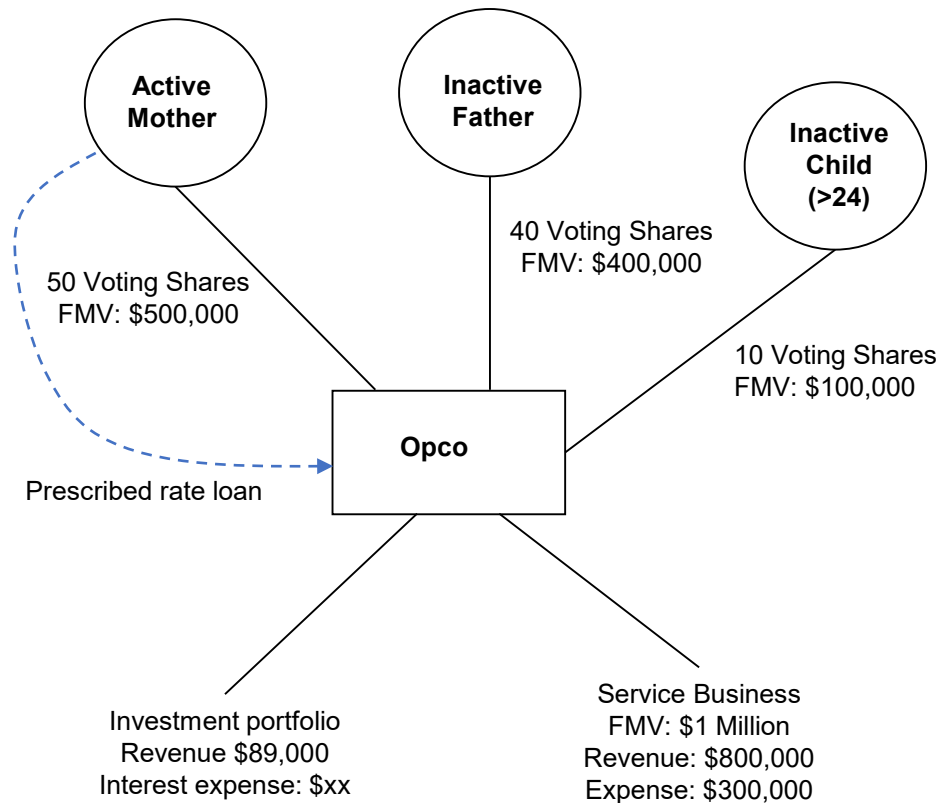
- Objective:
 - Income split with inactive Father and Child, by turning Opco shares into excluded shares.
- Issue:
 - Opco carries on a service business, thus failing condition (a) for excluded shares.
- Planning:
 - Condition (a) can be met if <90% of Opco’s “business income” for the last taxation year was from the provision of services.
 - In other words, condition (a) met if 10.1% or more of Opco’s income is not from provision of services.
 - Per CRA TI#2018-0743961C6, this is a gross income test.
 - It is not entirely clear what “business income” means, presumably it means gross income from carrying on a “business”.

Example #3 – Cont'd



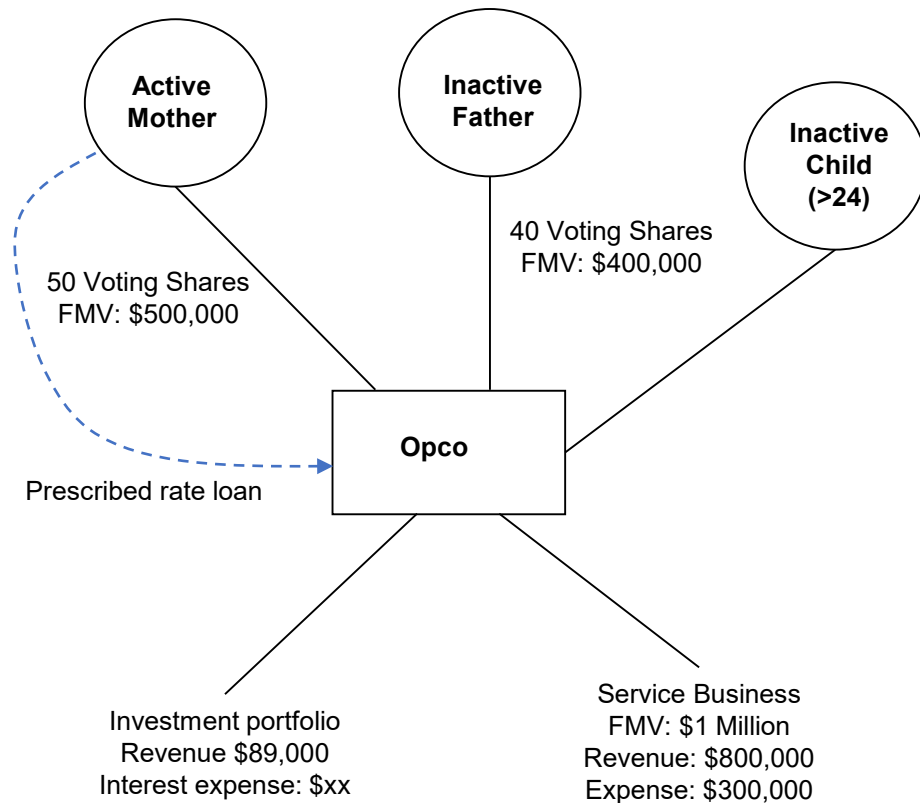
- Can gross income from an “investment business” constitute “business income”?
- Precedential case for trading activity: Vancouver Art Metal Works Ltd.. Factors to be considered:
 - Frequency of transactions;
 - Duration of holdings;
 - Intention to acquire for resale at a profit;
 - Nature and quantity of securities; and
 - Time spent on activity.
- A “specified investment business” is a “business”.
- “Business”: low threshold, includes “undertaking of any kind whatever” and includes “an adventure or concern in the nature of trade” (“**ACINT**”).
- Corporation carries a presumption of business, and delegating to an investment manager in itself does not negate a finding of a business.

Example #3 – Cont'd



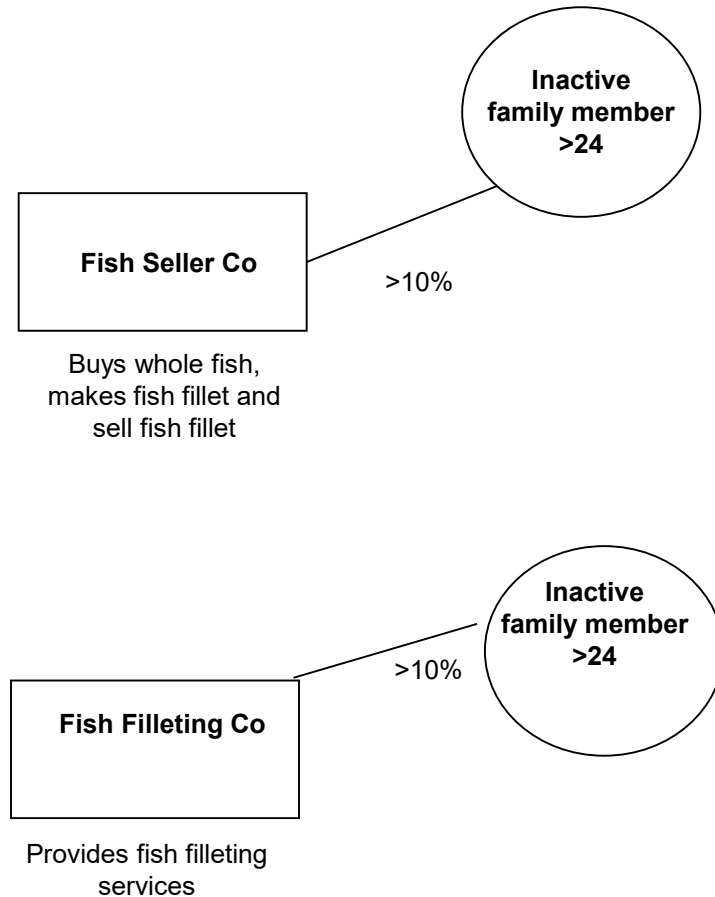
- Plan:
 - Mother (or Father) transfers in an investment portfolio that can generate investment revenue of \$89,000 (i.e. more than 10% of total revenue)
 - Transferor takes back a loan with prescribed rate interest (currently 2%)
 - Opco actively invests the portfolio.
 - Pay dividends to Father and Child in the subsequent year.
- If Opco is actively investing (not just buy and hold with no trading) and is investing with leverage (the loan), high likelihood Opco carrying on an investment business.
- Gross investment income part of 'business income', and now, at least 10.1% of Opco's business income not from services. Condition (a) and excluded share status met in the subsequent year.
- Therefore, during the subsequent year, can pay any amount of dividends to Father and Child.

Example #3 – Cont'd



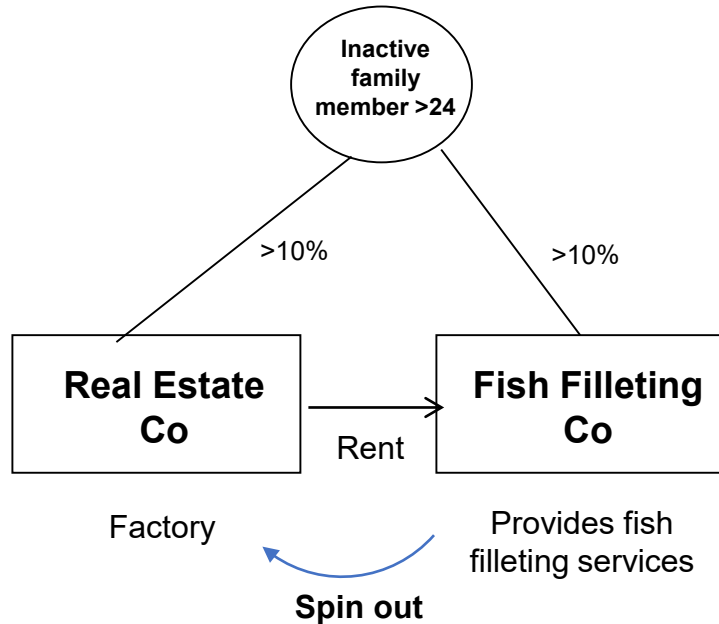
- Using prescribed rate loan prevents ITA 74.4(2) corporate attribution from applying (but this forces some income into hands of Mother).
- Note that even if the investment is a business, the income still constitute passive income for grinding the SBD. But interest expense will reduce the passive income for that purpose.
- Optional 1: portfolio can be extracted after the plan (even in the year of the dividend), if further dividends not required afterwards.
- Optional 2: if personal wealth not available, capital for portfolio can be borrowed from a Bank instead.
- Optional 3: there are investment product/strategies that potentially generate high gross investment revenues with very little capital, even though there may be correspondingly high gross investment loss so profit is nil. Technically still meet condition (a), with no passive income grind to SBD, but higher risk of GAAR.
- Note: this plan will not work for a professional corp.

Example #4



- Fish Seller Co:
 - Income from selling fish fillet
 - Its shares can qualify for excluded shares, allowing income splitting to an inactive family member who meet 10% ownership threshold.
- Fish Filleting Co:
 - Income from provision of services. Its shares cannot be excluded shares.
 - Dividends or capital gains earned by inactive family member subject to TOSI.
- Planning:
 - Change its business model to do what Fillet Seller do. Essentially same activity, but now qualify for excluded shares. Fish Filleting Co can now pay dividends to inactive family member who meets 10% ownership threshold with no TOSI applying.
 - But different economic risk. Possible, but not always practical.

Example #4 – Cont'd

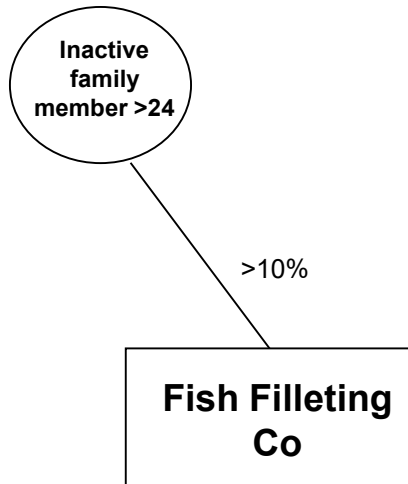


Does not circumvent TOSI

- What if, in an attempt to circumvent TOSI, Fish Filleting Co spins out its real estate / factory to a separate Real Estate Co, which charges rent to Fish Filleting Co? Since Real Estate Co's income not from provision of services, Condition (a) now met. Condition (b) also met for the inactive family member who owns 10% or more. But what about Condition (c)?
- Condition (c) requires that all or substantially all of Real Estate Co of last year (or current year, if this was a new corporation) be not derived from a related business of another corporation.
- Since all of Real Estate Co's income come from a Fish Filleting Co's business, which is a related business carried on by another corporation: fails Condition (c). Such planning does not circumvent TOSI.

Example #4(b)

What if the facts are as follows:

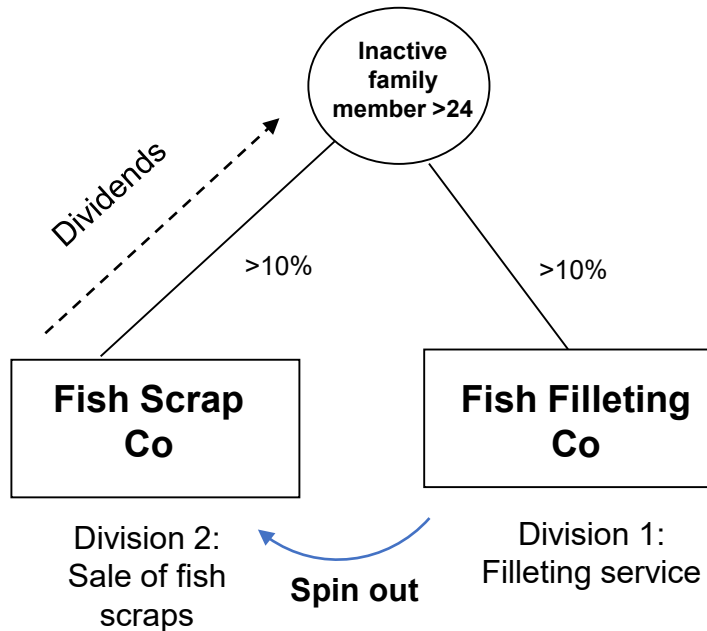


Division 1: Filleting service –
Revenue of \$1,000,000

Division 2: Sale of fish scraps –
Revenue of \$90,000

- More than 90% of Fish Filleting Co's gross revenues are from the provision of service, Condition (a) cannot be met.
- TOSI applies to dividends paid to inactive family member, even if 10% ownership threshold met.
- Planning:
 - Consider spinning out the non-service business;
 - Only suitable where the spun-out division sells directly to third party customers, and is not so inter-related to the service side of the business that the spun out corporation would be considered to be carrying on a partnership with the service corporation.

Example #4(b) – Cont'd

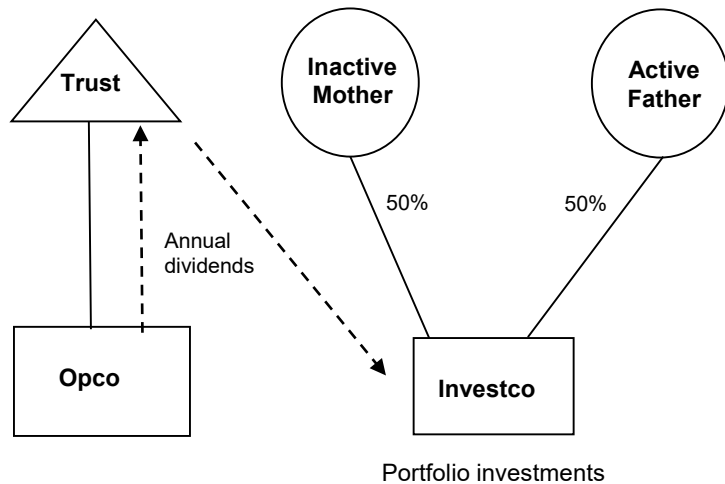


- Undertake reorganization to spin-out sale of fish scrap division to a separate corporation.
 - Need to carefully structure to not trigger tax on the spin-out.
- Fish Scrap Co sells directly to third party customers, so Condition (c) met, because its income is not derived from another related business.
- Fish Scrap Co shares can also meet Condition (a) and (b). Therefore, their shares can be excluded shares to the inactive family member, and no TOSI applies for dividends from Fish Scrap Co.
- Risk: If it is found that Fish Scrap Co is really just carrying on a partnership with Fish Filleting Co, then Condition (c) potentially not satisfied. Because it would be deriving all its income from a related business carried on by a partnership.

Example #5

Beneficiaries:

- Family members
- Investco

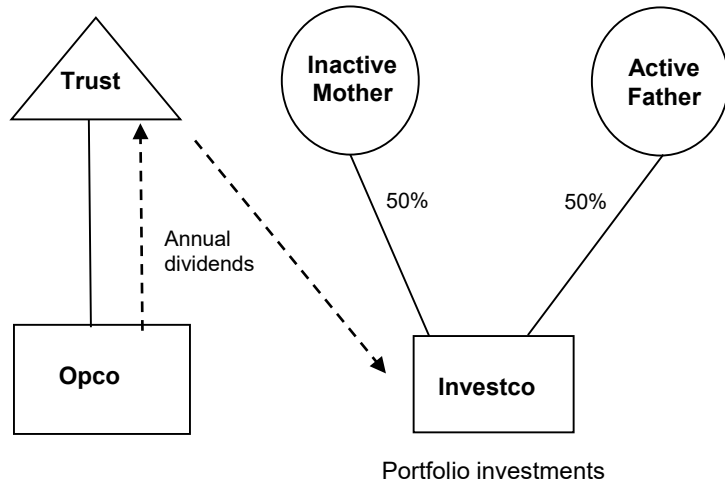


- Father active in Opco's business, and Mother is not.
- Opco shares held by Family Trust, and Investco is a beneficiary.
- Each year, Opco pays safe income dividends to Trust, which then distributed some or all of it to Investco. Dividend is tax-free to Investco under ITA112(1).
- Investco invests the cash and earns investment income. If it pays out investment earning as dividends to Father and Mother. TOSI?
 - No TOSI to Father, since he meets exclude business exemption re Opco's business, and most likely the reasonable return exemption for Investco's investments.
 - Risk of TOSI to Mother

Example #5 – Cont'd

Beneficiaries:

- Family members
- Investco

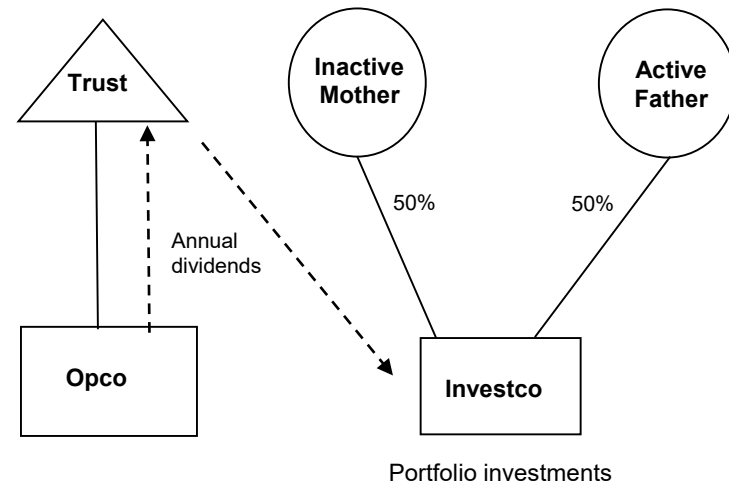


- TOSI analysis for Mother re a dividend from Investco:
 - Is the dividend derived directly or indirectly from a “related business” for the year?
 - Opco is carrying on a related business, due to Father’s engagement with Opco’s business, and likely due to family’s indirect ownership in Opco.
 - Investco carrying on a “related business” in respect of its investing? To be a related business, must be a “business”
 - As discussed, whether a business of investment exists depends on the nature and extent of activities. Business has a very low threshold, especially for a corporation carrying on any activities. Also, delegating to a manager does not negate existence of a business.

Example #5 – Cont'd

Beneficiaries:

- Family members
- Investco

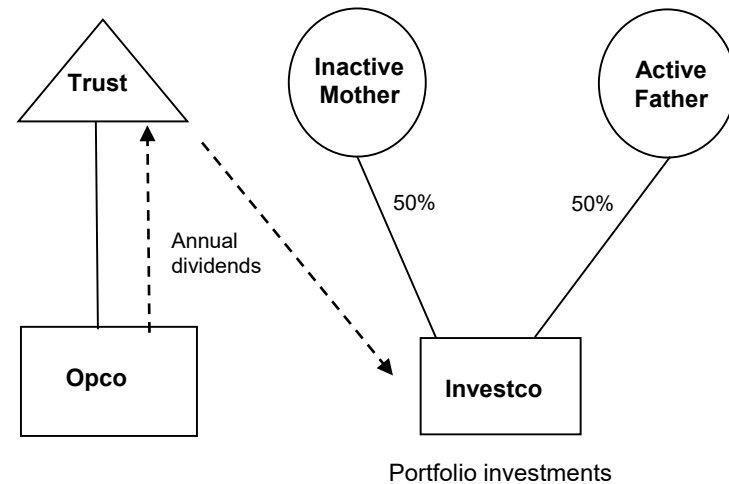


- If Investco **not** carrying on a business of investment:
 - Dividends paid out of the after-tax investment income not derived directly or indirectly from a “related business” for the year:
 - Arguably, the investment income is derived indirectly Opco’s related business since the investment capital came from Opco dividends, since meaning of “derived directly or indirectly” is very broad.
 - However, in 2018-0768801C6, 2018-0778661C6 and 2018-0768821C6, the CRA generally takes the view that investment income is derived directly or indirectly only from the investment activities, and not from the original activities that created the capital.
 - Therefore, based on such CRA views, investment income of Investco not earned from a related business (to the extent the investment activities do not constitute a business).
 - Taxpayer must be able to trace the funds that funded Mother’s dividends from after-tax investment return, and not from the Opco dividends received by Investco [planning - use cash damming techniques].

Example #5 – Cont'd

Beneficiaries:

- Family members
- Investco

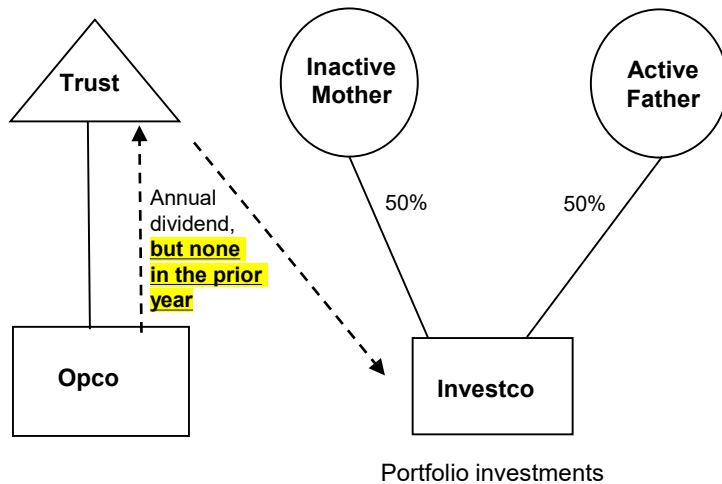


- If Investco **is** carrying on a business of investment (the more likely scenario):
 - Investco’s investment business will be considered a “related business” from Mother’s perspective. A “related business exists if:
 - A related person is actively engaged on a regular basis in the activities of Investco related to the investment earning, OR
 - A related person owns Investco shares (or property that derives its value from Investco shares) representing 10% or more of the total FMV of the shares of Investco. [This test is met for sure here]
 - Therefore, dividend from Investco to Mother will be derived from a related business for the year, regardless of source.
 - How about the “excluded shares” exemption?
 - Not apply. Will likely fail Condition (c) which requires that all or substantially all of Investco’s income for the last taxation year not derived, directly or indirectly, from another related businesses.
 - TOSI likely applies to Mother.

Example #5 – Cont'd

Beneficiaries:

- Family members
- Investco



- Planning – can we circumvent Condition (c) with better timing of the dividend distribution?
 - If Investco did NOT receive any dividend distribution from Trust in the prior year (even if Investco receives dividends in the current year, or another historical year), condition (c) can still be met since in the last tax year, all or substantially all of Investco's income in the last tax year did not derived directly or indirectly from Opco's related business.
 - This also takes advantage of the CRA's view that Investco's investment income not derived indirectly from Opco's related business simply because the capital came from Opco originally.
 - Conditions (a) [because under this scenario investment income = business income] and (b) also met.
- Therefore, consider timing Investco dividend to Mother in a year where Investco did not received an Opco dividend in the last tax year. Can then rely on excluded shares to pay unlimited dividends (including monies that trace directly to Opco dividends) to Mother during that year.
- Caution: CRA in 2018-0768801c6 warns that they would apply GAAR if "*transactions were primarily effected*" so as to get Mother to qualify for excluded shares.



“Related Business” Planning

Connecting people and ideas in tax.

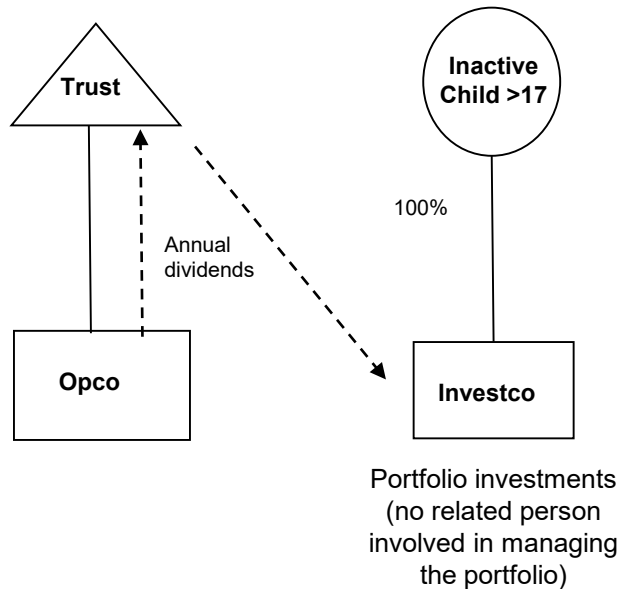
The “Related Business” Exemption

- Only available to individual who attained age of 17 before the year.
- TOSI not apply if income not derived directly or indirectly from a related business of the individual for the year.
- “Related business” in respect of an individual for a year means:
 - a) a business carried on:
 - I. by a source individual (i.e. a related person), or
 - II. by a partnership, corporation, or trust if a source individual is actively engaged on a regular basis in the activities of the business.
 - b) a business of a partnership in which a source individual has a direct or indirect interest, and
 - c) a business of a corporation if a source individual owns:
 - I. shares that represent 10% or more of the FMV of the corporation, or
 - II. property that derives all or part of its value from shares of the corporation, and such portion is worth 10% or more of the FMV of the corporation.

Example #6

Beneficiaries:

- Family members
- Investco

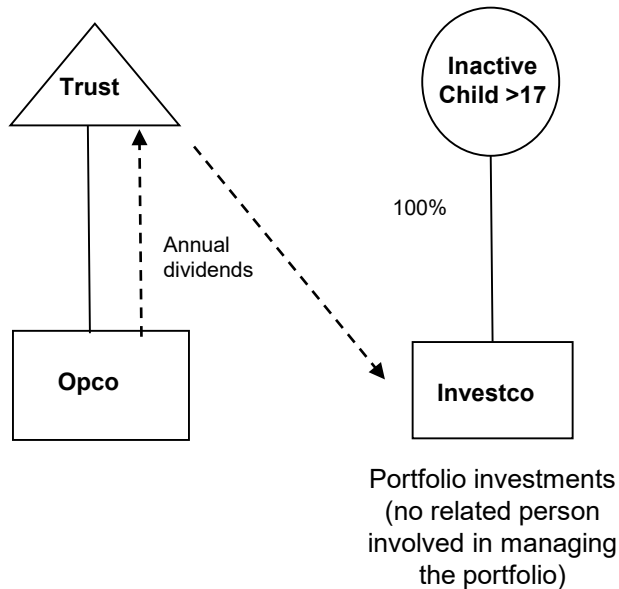


- In Example #5, we see how if Investco's activities constitute a business (most likely the case), then the investment activities constituted a related business and the dividend paid out from investment income subject to TOSI.
- But what if, Investco has only one shareholder, and no related person is involved in managing the investment (e.g. use of a portfolio manager)?
- Even if Investco has an investment business, would it be a "related business"?

Example #6 – Cont'd

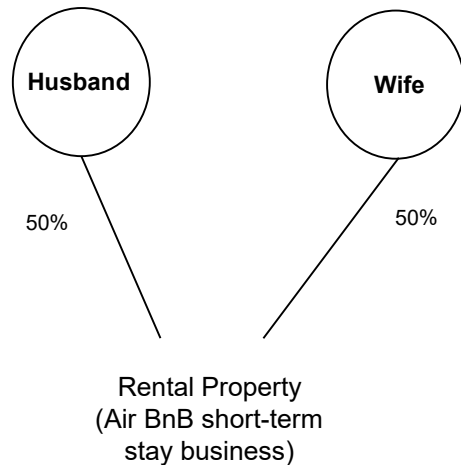
Beneficiaries:

- Family members
- Investco



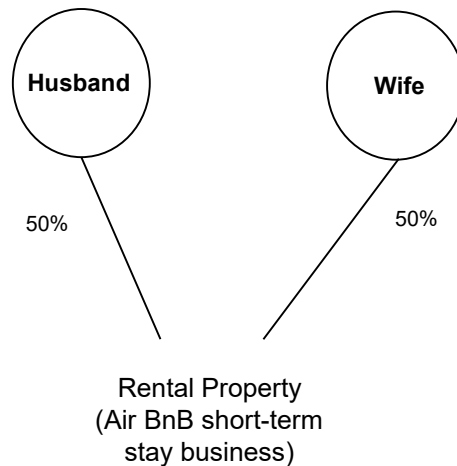
- To summarize, related business requires either:
 - a) A related person actively engaged on a regular basis in the activities,
 - b) A related person has an interest in a partnership carrying on the business, or
 - c) A related person owns directly or indirectly 10% of Investco.
- None are met. Therefore, Investco cannot have a related business, and the after-tax investment income can be paid out to the Child >18 without TOSI.
- But note that the Opco dividend still cannot be paid out (so cash damming still important), unless the excluded shares exception is met in the year.

Example #7



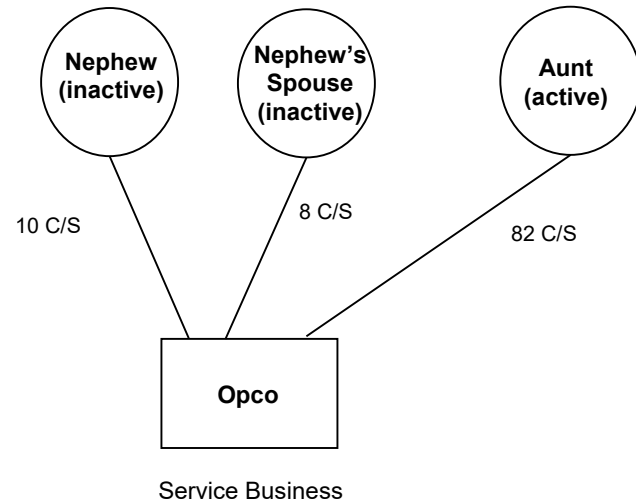
- Husband and wife own rental property.
- Short-term rentals.
- Most likely a business.
- Two people operating a business with a view to profit → a partnership.
- Split income includes partnership income from either (A) a related business or (B) rental of property if a related person is actively engaged in the rental activities.
- A business of a partnership is automatically a related business, if a related person has any direct or indirect interest in the partnership.
- Therefore, TOSI applies to the extent one of the spouses has not contributed enough.

Example #7 – Cont'd



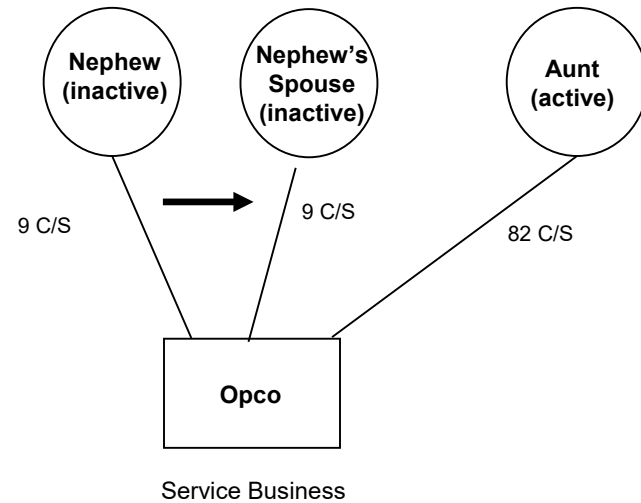
- Planning: a related business has to be a business to begin with.
- If rental activity changes into long term rental & little activities are required, activities may no longer constitute a business (fact dependent). Activities not carried on by a corporation, so no presumption of a business to overcome.
 - If not a business, then cannot be a related business, and TOSI can no longer apply to Wife or Husband.
 - But consider if avoiding TOSI is worthwhile to override business objective. Perhaps net rental income is immaterial after CCA.
- Alternative planning: inactive spouse roll its 50% interest of property to active spouse (automatically dissolve any partnership). Attribution applies to attribute 50% rental income back to inactive spouse but at that point, the attributed income no longer partnership income, so TOSI technically cannot apply to such income. Risk of GAAR?

Example #8



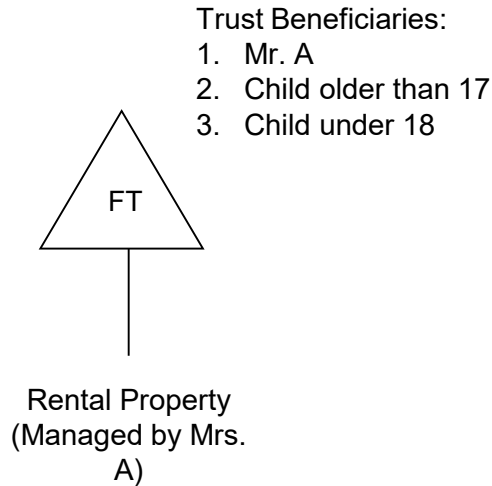
- Nephew and his Spouse have never contributed to Opco's business.
- Opco is controlled and managed by Aunt.
- Opco shares cannot be excluded shares because it carries on a service business.
- Aunt and Nephew are not "related". However, Opco's business is a related business for Nephew's Spouse because from her perspective, a related person (Nephew) owns 10% of Opco. Therefore, dividend to Nephew's Spouse subject to TOSI.

Example #8



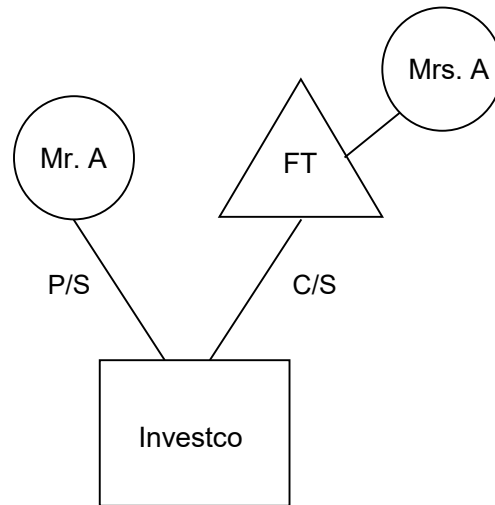
- Planning: the 10% ownership test for related business is not an aggregative test. There needs to be a related person who individually holds directly or indirectly 10% of the corporation.
- Therefore, consider spousal rollover of 1 C/S from Nephew to Nephew's Spouse.
- Now, from either Nephew's or Nephew's Spouse's perspective, no related person holds 10% or more of Opco. Also, no related person is actively engaged in the business of Opco.
- Therefore, dividend to them not derived from a related business. No more TOSI.
 - Will need to manage attribution on the 1 C/S.

Example #9



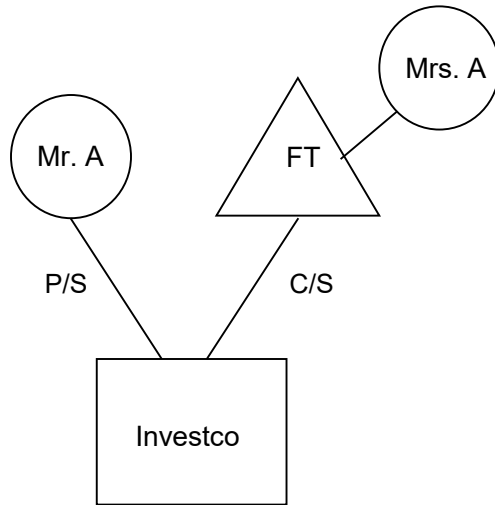
- Trust owns rental property that Mrs. A is actively engaged in.
- Mr. A and child beneficiaries not engaged in rental activities.
- If rental activity is not a business:
 - Rental income, in which a source individual is engaged, earned by trust will be considered split income. However, it will be an excluded amount to Mr. A and the child who is older than 17, due to the lack of a related business.
 - TOSI will only apply to rental income allocated to child under 18.
- But if rental activity is a business:
 - TOSI will apply to rental income allocated to all of Mr. A, child under 18, and child older than 17.
 - But TOSI can still be prevented for those older than 17 if Mrs. A and any related persons removed from management of rental.
- See CRA TI #2018-0765811C6; a more fulsome technical analysis contained in Example 17.
- Therefore, keep rental passive or remove related person from management if income splitting is the goal.

Example #10



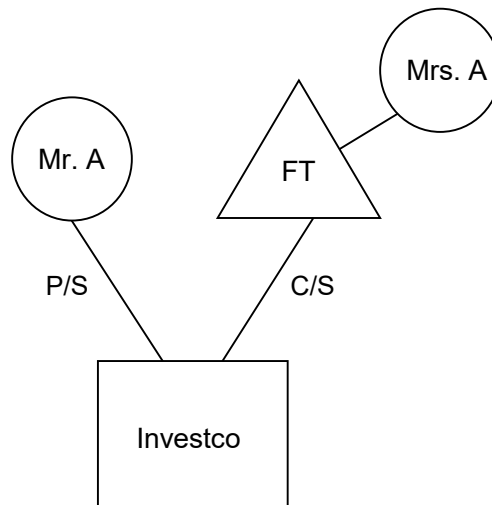
- Investco was historically an active business.
- Business was discontinued five years ago.
- Mr. A is 60 years old (so the age 65 exception does not yet apply)
- Mrs. A never contributed to any business previously carried on by Investco or in the current investment activities.
- Are dividends received by Mrs. A, through the trust, subject to TOSI?
 - Note that Mrs. A cannot meet excluded shares status because shares held by a trust.

Example #10 – Cont'd



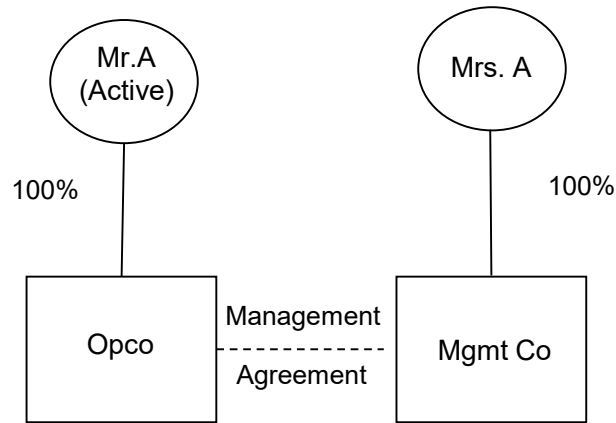
- Investco's Original Capital:
 - Regardless of whether Investco is carrying on an investment business, the original capital from the historical business is not from a “related business for the year”.
 - Entire original capital can be paid out to FT, and to Mrs. A without the application of TOSI. (See CRA TI# 2018-0779981C6)

Example #10 – Cont'd



- Investco’s investment return:
 - If the investment activities do not rise to the level of a business then there is no “related business for the year”; the investment return can be paid to FT (Mrs. A) without TOSI.
 - However, if there is an investment business, and it is a related business, then TOSI will apply to Mrs. A.
 - Planning Ideas:
 - i. Spousal rollover to reduce the amount that Mr. A holds of Investco to below 10% to escape the definition of related business for Mrs. A, and
 - ii. Hire a investment manager so that Mr. A is not actively engaged in the investment activities.
- It is important to track the source of a dividend. Investco keeps investment capital separate from the income received from investments.

Example #11



Year 1:

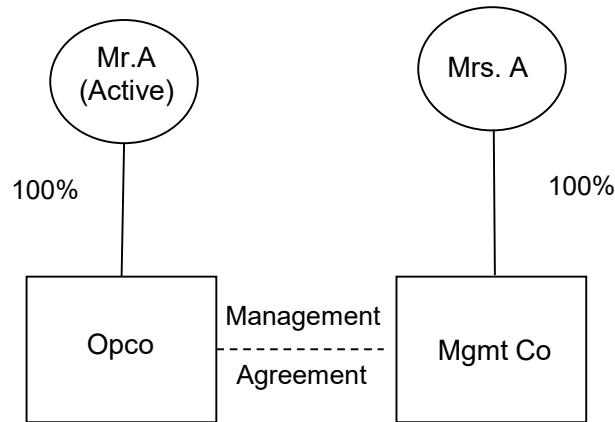
- Charged Opco \$100K Management fee.
- No dividend paid.

Year 2:

- Did not charge Opco any fees.
- Paid \$100K dividend to Mrs. A.

- If Mrs. A were actually actively engaged on a regular, continuous, substantial basis in providing management services to Opco, then TOSI won't apply because of the excluded business exemption.
- But if Mrs. A not meet the active engagement test, does staggering the year of receipt of management fee cause the related business exemption to apply?

Example #11 – Cont'd



Year 1:

- Charged Opco \$100K Management fee.
- No dividend paid.

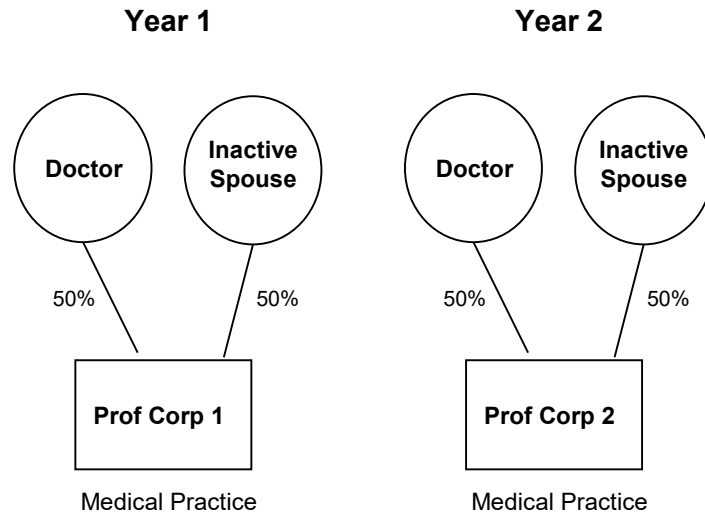
Year 2:

- Did not charge Opco any fees.
- Paid \$100K dividend to Mrs. A.

Does not circumvent TOSI

- TOSI would not apply **if** Mgmt Co's Year 2 dividend does not derived directly or indirectly from a "related business ... for the year".
- For Year 2, Mgmt Co did not derive any income from Opco's business.
- However, Opco is presumably still carrying on its business during Year 2. Thus, that related business of Opco still exist during Year 2, and Mgmt Co's funds were all derived directly or indirectly from that particular business.
- Therefore, related business exemption not apply, and TOSI would apply on the Year 2 Dividend received by Mrs. A.
 - See CRA TI# 2018-0779981C6
 - But in the event that Opco factually ceased business during Year 2, then the related business exemption should apply.

Example #12



Probably does not circumvent TOSI

- In Year 1, Doctor operated out of Prof Corp 1. No dividends paid in Year 1 to Inactive Spouse.
- In Year 2, Doctor operated out of Prof Corp 2, and ceased all activities in Prof Corp 1. In Year 2, Prof Corp 1 pays its Year 1 earnings to Inactive Spouse as a dividend.
- Does the related business exemption apply to the Year 2 dividend by Prof Corp 1?
 - The retained earnings in Prof Corp 1 was derived solely from its business during Year 1.
 - “Related business ... for the year” refers to Year 2.
 - However, if Prof Corp 2’s business in Year 2 is factually the same business as that carried on by Prof Corp 1 during Year 1 (same location, same practice name, etc.), then the CRA will likely find the Year 2 dividend to be derived directly or indirectly from the same related business that continues to exist during Year 2 (even though it is now being carried on by a different legal entity).
 - To date, no definitive guidance on this issue.



“Excluded Business” Planning

Connecting people and ideas in tax.

The “Excluded Business” Exemption

- Only available to individual who attained age of 17 before the year.
- TOSI not apply if income not derived directly or indirectly from an excluded business of the individual for the year.
- “Excluded business” in respect of an individual for a year means:
 - a) A business that the individual is actively engaged on a regular, continuous or substantial basis, or
 - b) A business in which the individual works at least an average of 20 hours per week during the portion of the year in which the business operates.

*In the year or in any five prior tax years.



The “Excluded Business” Exemption – Cont’d

- The ‘regular, continuous or substantial’ test is a question of fact, and, per TI# 2018-0783741E5, the CRA will consider:
 - “the nature of the individual’s involvement in the business and the nature of the business itself.... will generally turn on the time, work and energy the individual devotes to the business.”
 - “The more an individual is involved in the management and/or current activities of the business, the more likely ... on a regular, continuous and substantial basis. Likewise, the more an individual’s contributions are integral to the success of the business, the more substantial they would be.”
- In contrast, the 20-hour test is a bright-line test.

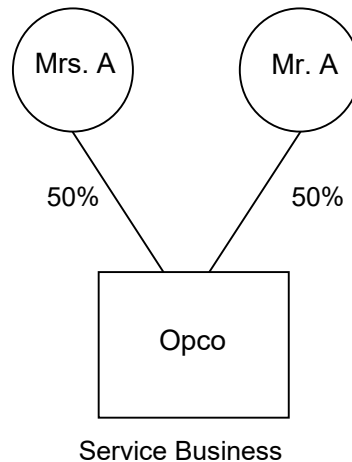
Example #13

Mrs. A:

- Has worked full time in business since its inception in 2007

Mr. A:

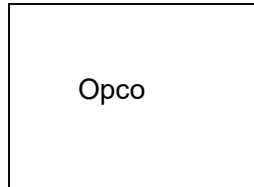
- Worked in business full time during 2007, 2009, 2010, 2012 and 2016, but otherwise inactive
- Mr. A married Mrs. A in 2010 and became 50% shareholder in 2010. Mr. A was not a shareholder prior to 2010.



- Dividends to Mr. A in 2019:

- Dividend not from a public company; derived directly or indirectly from a “related business” for the year.
- “Excluded business” exception applies, because Mr. A worked in the business on a regular, continuous and substantial basis, for 5 prior tax years.
- CRA TI #2018-0783741E5: not necessary for the five preceding years to be continuous, and the years of the qualifying activities can occur prior to the TOSI amendments.
- Since business is a service business, not qualify for “excluded shares”, but does not matter here.
- Dividends to Mr. A not subject to TOSI..
- Same for any capital gain earned by Mr. A in the future on Opco shares.

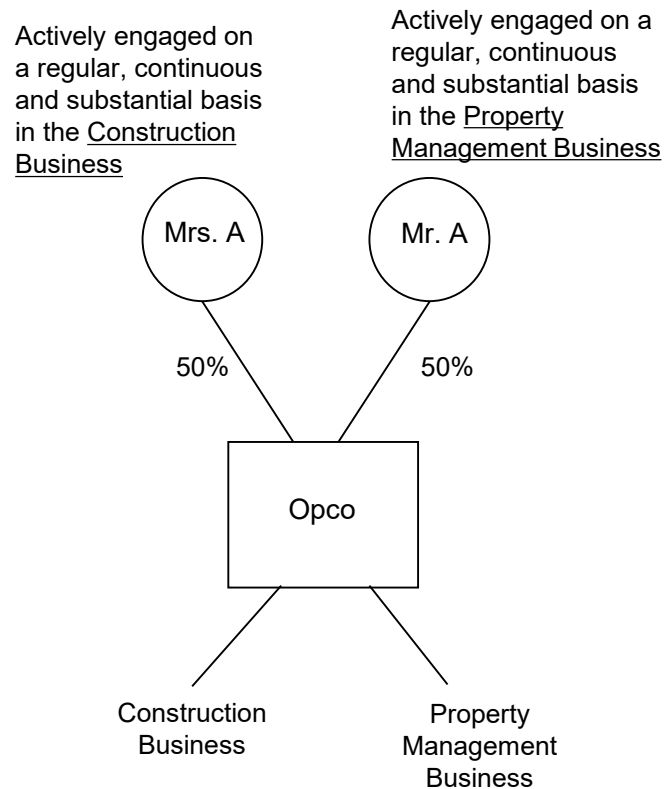
Example #14



Children help out in the business, part time.

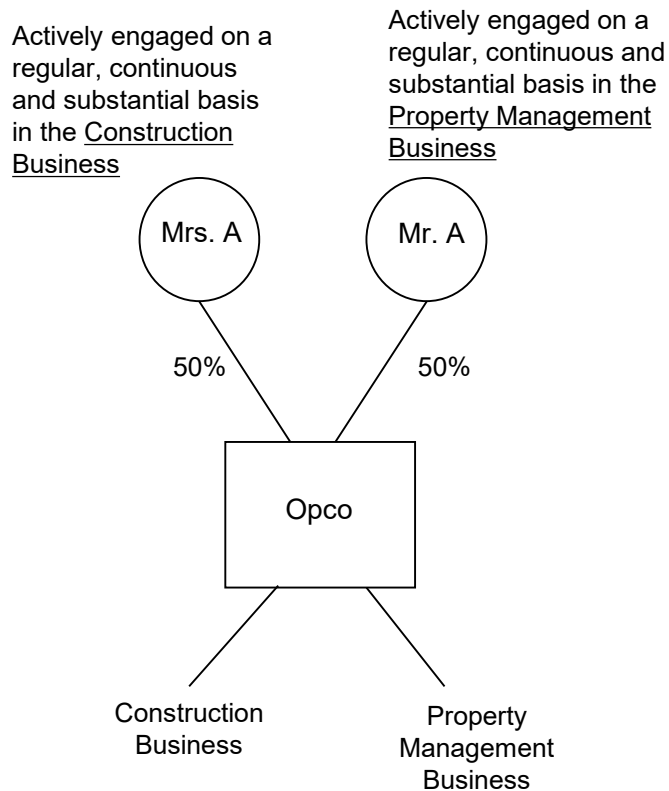
- Put the children on payroll, even at minimum wage (or less – subject to labour law consequences).
- This builds hard documentation of them working in the business.
- If a child “works in the business” for average of 20 hours per week during the portion of the year the business operates, and do that for five years, that child will never be subject to TOSI in respect of that business after age 17 and for the rest of her/his life.
 - No requirement how ‘active’ the child needs to work during those 20 hours. And no requirement for child to be an adult for the years to count.
- Even if 20 hour threshold is not met, this starts to build support for the “reasonable return” test down the road.

Example #15



- Assume the facts are such that the Construction Division and the Property Management Division are two separate and distinct business of Opco.
 - Case law on this focuses on how inter-connected the activities of the two Divisions are.
- If they are separate business, and each spouse is actively engaged in only one of the businesses, then each spouse only meets the excluded business exemption in respect of dividends from that particular business.
 - See CRA TI# 2018-0761601E5 confirming this.

Example #15 – Cont'd



- Therefore, to avoid risk of TOSI, will need to
 - i. Reorganize shares so Mrs. A and Mr. A each has a separate class of shares to allow for different dividend entitlement; and
 - ii. Have documentation to support that the after-tax retained earnings of Construction Business funds dividend to Mrs. A; and the after-tax retained earnings of Property Management Business funds dividends to Mr. A.
- However, if Opco is sold, may be impossible to properly link gains to a specific business if each spouse own the same number of common shares (unless tracking shares are used).
- Practically, our prediction is that CRA unlikely to enforce unless the profits or activity level of the two businesses are materially different:
 - E.g. Construction requires 50 hours per week from Mrs. A and generates most of Opco's profits; while Property Management only requires 20 hours per week from Mr. A and drives a small portion of Opco's profits.



Prescribed Rate Loan Planning

Connecting people and ideas in tax.

Prescribed Rate Loan Planning

- Prescribed rate loans have long been used as an income splitting tool.
- Involves a loan of cash or other property (or a transfer of property for debt consideration) to get future income or capital gains into the transferee's hands.
- Such planning needs to work around the attribution rules, which causes income to attribute back to the transferor where:
 - Section 74.1 attributes property income where the transferee is either a spouse or a person under 18 not dealing at arm's length with the transferor.
 - Section 74.2 attributes capital gains where the transferee is a spouse.
 - Subsection 56(4.1) attributes property income where the transferee does not deal at arm's length with the transferor, the loan bears no or little interest, and one of the main reasons for the loan is to shift income to the transferee.

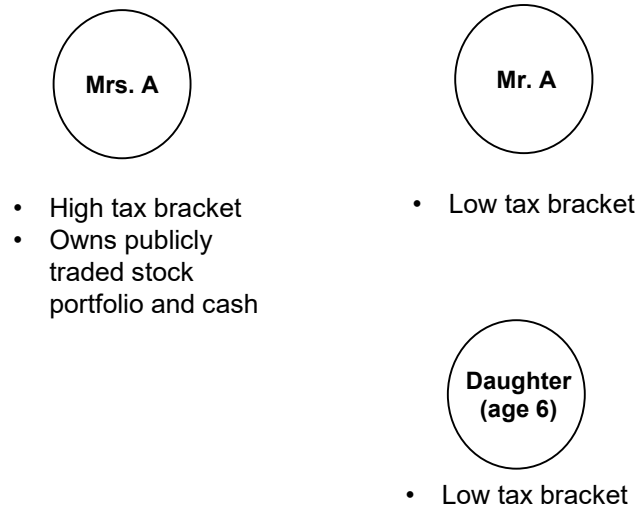
Prescribed Rate Loan Planning – Cont'd

- It is possible to avoid these attribution rules by
 - Charging interest on the loan at a rate at or more than the prescribed rate in effect at the time the loan was made;
 - Interest is paid no later than 30 days after the end of each year, throughout the history the loan is outstanding;
 - FMV consideration for any transfer of property; and
 - If the transfer of property was a spousal transfer, the transferor must have validly filed an election to elect out of the subsection 73(1) spousal rollover in the T1 return in the year of transfer.
- Prescribed rate available on the CRA website and is currently 2%.
<https://www.canada.ca/en/revenue-agency/services/tax/prescribed-interest-rates.html>
- All conditions above must be met, so it is important to ensure interests are fully paid by January 30 of each year.

Prescribed Rate Loan Planning – Cont'd

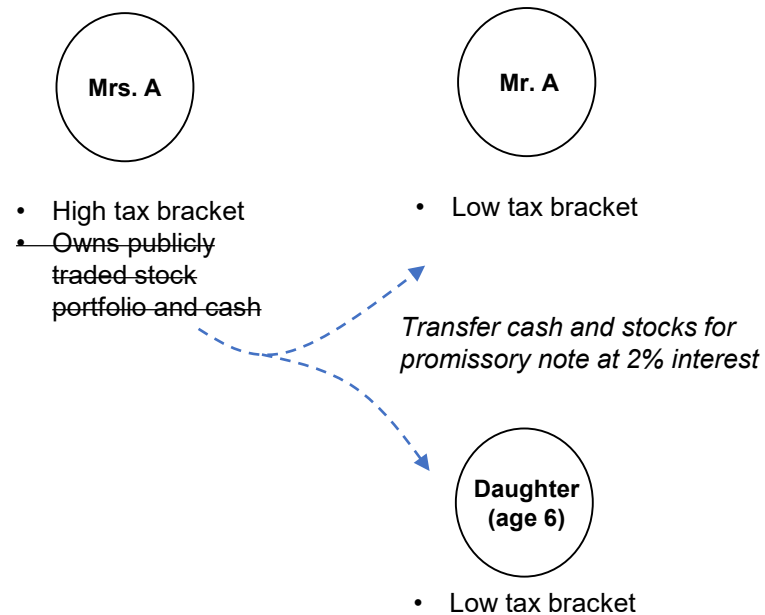
- Cautionary illustration regarding 30-day after year end requirement:
 - Prescribed rate loan set up on Sept. 1, 2018 with 2% interest;
 - Agreement requires payment of interest on each anniversary date;
 - Borrower properly transfers cash representing 2% interest on Aug 31, 2019;
 - Plan Failed! Because interest payment not made 30 days after end of a year, i.e. Jan 30. Attribution applies to the arrangement forever even if this is subsequently corrected. Will need to properly unwind and redo.
- The loan interest rate does not have to fluctuate with changes to the prescribed rate, and there is no limit to the length of the term of the loan (hence a mad rush to put prescribed rate loans in place before the rate increased from 1% to 2% on Apr 1, 2018).
- Technically, the interest can be lower than prescribed rate if the lower rate is a supportable arm's length rate – but this is seldom possible.
- Prescribed rate loan a powerful tool to income split in the world of TOSI.

Example #16



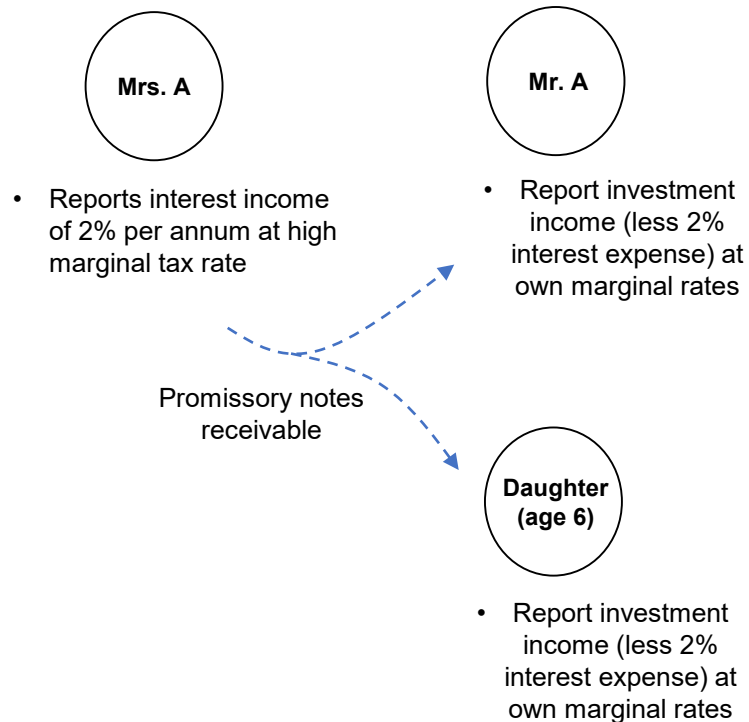
- Mrs. A is the high tax bracket individual in the family. She holds a portfolio of publicly traded securities and cash.
- Objective: to use marginal rates of Mr. A and minor Daughter.
- TOSI simply does not apply in the absence of a trust, partnership or private corporation.
- Can we use prescribed rate loan planning to shift future income and capital gains to Mr. A and minor Daughter?

Example #16 – Cont'd



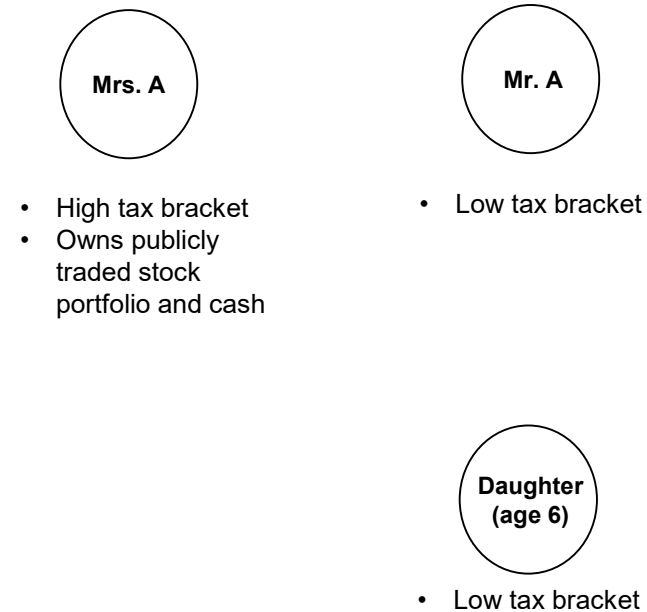
- Planning:
 - Transfer cash and public stocks to Mr. A and Daughter, take back promissory notes at FMV.
 - Promissory note carries interest at current prescribed rate (2%)
 - Interest due on or before Jan 30 of each year.
 - Mrs. A must file with her return an election to elect out of 73(1) for any transfer of stocks, which means any accrued gains recognized by Mrs. A on transfer.
 - Mrs. A may trigger capital losses by transferring underwater stocks to Daughter. No stop loss rule since parent-child not affiliated (even if minor).
 - Therefore, transfer stocks with accrued loss to Daughter and transfer stocks with accrued gains to Mr. A (to the extent of losses available).

Example #16 – Cont'd



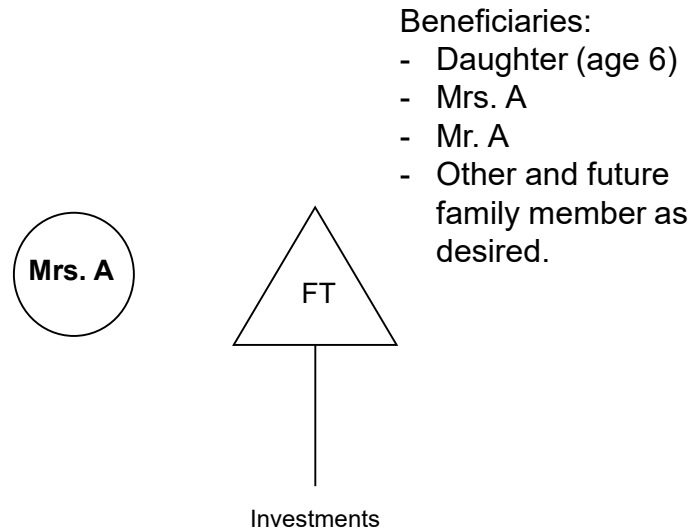
- Ensure the 2% interest payment actually paid in cash or bank account transfer each year before Jan 30.
- Future investment income and capital gains on the transferred assets, less 2% interest expense, taxed in the hands of Mr. A and Daughter, at their low marginal rates.
- TOSI will not apply, and attribution will not apply.
- Caution #1: non-tax considerations with transferring substantial wealth to a minor.
- Caution #2: arrangement nets a benefit only if Mr. A & Daughter's investment return exceeds the prescribed rate of interest. If return is lower, there is a net detriment.

Example #17



- Can we use similar prescribed rate loan planning with a family trust?
 - Prevent non-tax issues of transacting with and transferring substantial wealth to a minor.
 - More flexibility with income distribution and can accommodate income splitting with additional and future family members.
 - Mrs. A may retain control as trustee.
 - Better creditor protection.

Example #17 – Cont'd

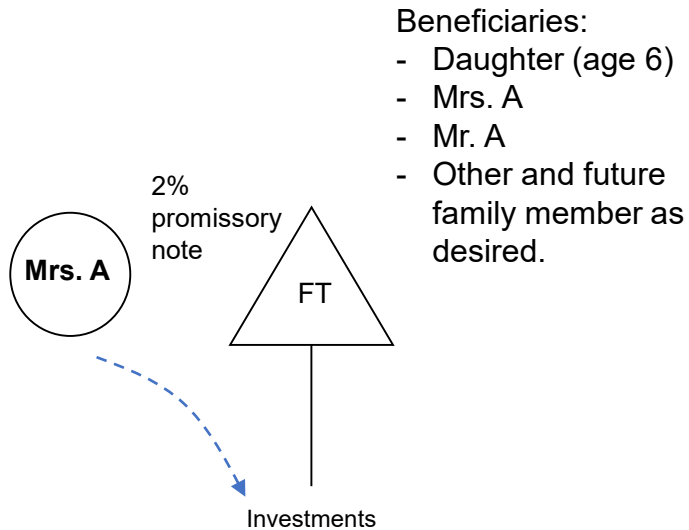


Beneficiaries:

- Daughter (age 6)
- Mrs. A
- Mr. A
- Other and future family member as desired.

- Planning:
 - Grandparent or third party (NOT Mrs. A) settles a discretionary family Trust.
 - If Mrs. A is a beneficiary, need to manage subsection 75(2) risk.
 - Mrs. A and Trust are affiliated, Mrs. A will not be able to trigger loss on transfer-in of her portfolio, while any gains will still be recognized.
 - Only transfer properties without accrued gains.
 - However, if Mrs. A and Mr. A not included as beneficiaries, Trust not affiliated with Mrs. A and Mrs. A can trigger losses on transfer-in; losses can then shelter gains realized on the transfer.

Example #17 – Cont'd



- Mrs. A disposes of cash/property to Trust for a promissory note owing by the Trust (2% interest rate, due on or before Jan 30 each year).
 - Even if Mrs. A is beneficiary, should still be able to avoid subsection 75(2). A FMV sale of property to a trust is not a contribution by Mrs. A (FCA's decision in *Sommerer*).
- An *aggressive* planning option: add Mr. A and Mrs. A as beneficiaries more than 30 days after Mrs. A transfer-in the investments, so that she is not affiliated with Trust at time of transfer. This allows Mrs. A to trigger losses on the transfer-in, but she and husband ultimately remain as beneficiaries. GAAR risk?

Example #17 – Cont'd

- TOSI applies to “split income”, which includes:
 - (a) Dividend income from a private corporation,...
 - (c) Income from a trust that can reasonably be considered:
 - to be in respect of taxable dividends received from a private corporation;
 - to be in respect of a shareholder benefit received from a private corporation;
 - income derived directly or indirectly from a related business for the year; or
 - income derived from the rental of property if a related person at any time in the year is actively engaged on a regular basis in the rental activities, ...
 - (e) Taxable capital gains from, or trust income attributable to taxable capital gain from, the disposition of private corporation shares.
- Because of subsections 104(19) and (21), dividends and capital gains allocated to beneficiaries are typically treated as earned directly by the beneficiary.

Example #17 – Cont'd

- CRA TI#2018-0765801C6:
 - If Trust earns dividends and capital gains on publicly listed securities, the amount representing the portion of the trust distribution relating to such dividends and capital gains will not be subject to TOSI.
 - Presumably this is because, due to 104(19) and (21), the beneficiary themselves earn the dividend and capital gain, and since they are not private corporation dividends and capital gains they are excluded from paragraph (a) or (e) of “split income”.
- There is uncertainty as to the technical correctness of this interpretation, because it ignores paragraph (c) of the split income definition, which theoretically still catch those distributions if the Trust’s activities constitute a related business.
 - See <https://www.moodysgartner.com/a-critical-review-of-recent-canada-revenue-agency-views-on-tosi-and-how-to-use-them-to-your-advantage/> for a deeper analysis.
- Practically speaking, likely safe to rely on CRA’s interpretation.

Example #17 – Cont'd

- What about interest income earned by the Trust? CRA TI#2018-0765801C6 provides guidance on this as well:
 - CRA refers to the test in paragraph (c) of split income → whether a portion of the trust distribution was “income derived directly or indirectly from one or more related businesses”?
 - Turns on two factual questions: (1) is Trust carrying on a business; and 2) is a source individual actively engaged on a regular basis in Trust’s business activities?
- If Trust is carrying on a business of investment, and a source individual (Mrs. A) is actively engaged on a regular basis in these investment activities, the portion of any Trust distribution relating to interest income caught by TOSI.

Example #17 – Cont'd

- Precedential case for whether a investment activities constitute a business is *Vancouver Art Metal Works Ltd*. Factors to be considered:
 - Frequency of transactions;
 - Duration of holdings;
 - Intention to acquire for resale at a profit;
 - Nature and quantity of securities; and
 - Time spent on activity.
- A “specified investment business” is a “business”.
- “Business”: low threshold, includes “undertaking of any kind whatever” and includes “an adventure or concern in the nature of trade” (“**ACINT**”).
- Delegating to an outside manager not in itself negate the finding of a business
 - “The law is clear that whenever an agent carries on business on behalf of a principal, the principal is deemed to be carrying on that business.” (*Baxter*, 2006 TCC 230)
 - But if it prevents a related person from being “actively engaged on a regular basis” then it may prevent finding of a “related business”.

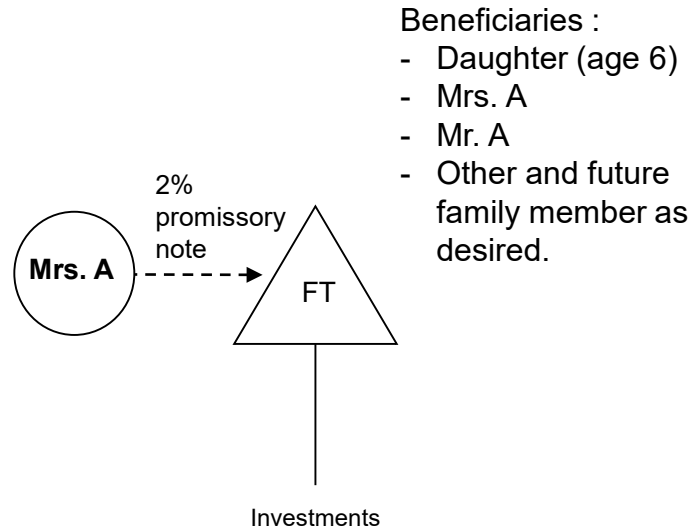
Example #17 – Cont'd

- What about rental income earned by the Trust?
- CRA TI#2018-0765811C6:
 - Can be caught by paragraph (c) split income either of two ways:
 - Rental activity is (i) not a business, and (ii) a related person is actively engaged on a regular basis in the rental, or
 - Rental activity is a related business, i.e. (i) it is a business, and (ii) a source individual is actively engaged on a regular basis in the rental.
 - With the former, even though it is described in paragraph (c), the related business exemption will save a beneficiary who attained age 17 last year.
 - With the latter, TOSI applicable to the beneficiary.
 - Therefore, as long as Trust keeps rental activity to a level below a business, TOSI should not apply to any beneficiaries age 18 and over.
 - Alternatively, ensure no source individual/related person is “actively engaged on a regular basis in the rental activities” → third party property manager.

Example #17 – Cont'd

- Factors indicative of activity not constituting a business: long term lease, no additional services to tenants, etc.
- CRA Archived IT-434R:
 - “5. Where a building is rented en bloc (e.g., an office building), with the landlord providing (in addition, of course, to the accommodation) only maintenance of the building as such and perhaps heat and air conditioning, the rental clearly is one of property and does not constitute the carrying on of a business. The same situation is considered to exist where a building is rented piecemeal (e.g. an apartment block) and the tenants are provided with only those basic services which, by custom, have come to be regarded as an inherent part of that kind of property rental, e.g.: heat, water, elevator service, telephone in lobby, indoor or outdoor parking spaces, laundry room with equipment for tenants, maintenance of the building itself (including janitor and window washing service, repainting of apartments), maintenance of adjacent areas (including snow and garbage removal service) and maintenance of any appliances and furnishings provided in the rented accommodation.
 - 6. If, however, services additional to those mentioned above are provided, it is possible that the landlord may be carrying on a business rather than merely renting real property, and the more services he provides the more it becomes arguable that this is so...”

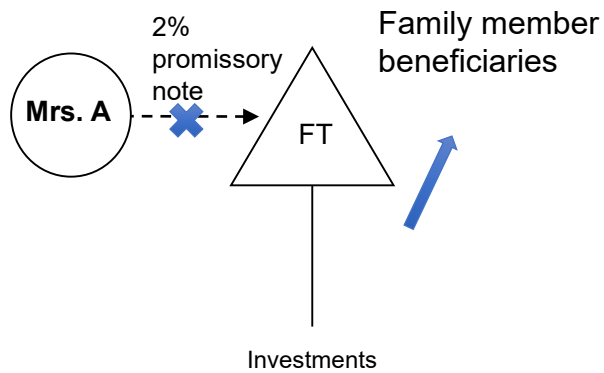
Example #17 – Cont'd



Summary:

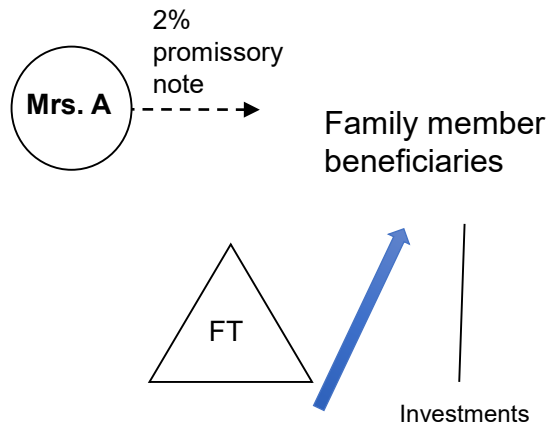
- No TOSI on portion of trust distributions received by beneficiaries relating to
 - Dividends from publicly traded securities
 - Capital gains from publicly traded securities
- Re portion of trust distribution from interest income
 - No TOSI if either (i) Trust not carry on a business of investment, or (ii) no related person is actively engaged on a regular basis in the investments.
- Re portion of trust distribution from rental income
 - No TOSI if no related person is actively engaged on a regular basis in the rental activities.
 - No TOSI for beneficiaries aged 18 or over as long as rental activities below threshold of a business.
- No attribution of income back to Mrs. A as long as (i) 2% interest is paid on or before Jan 30, and (ii) Trust paid FMV for the initial transfer.

Example #18



- Family now decides to unwind the structure.
 - Either because 21 year anniversary is pending, or family member now ready to receive wealth.
- Option 1:
 - Trust repay Mrs. A with either cash or investment (will trigger gain on investment liquidation or transferred on repayment).
 - Capital distribution to the beneficiaries; tax deferred under subsection 107(2).
 - Attribution will apply after the distribution, for future income earned by Mr. A and any minor family member beneficiaries.

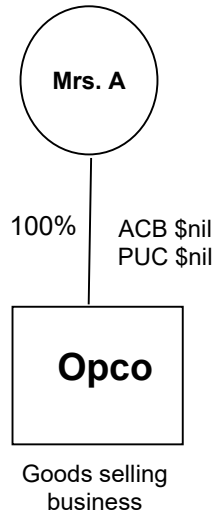
Example #18 – Cont'd



- Option 2:
 - Distribute the investment, along with the promissory note liability, to the beneficiaries.
 - Subsection 107(2) applies so that all assets transferred on tax-deferred basis.
 - Legally, may require causing the promissory note to be encumbered to the investment assets; then distributing the encumbered assets to the beneficiaries.
 - No TOSI to beneficiaries.
 - Attribution? Not entirely certain prescribed rate loan arrangement continue to apply to the beneficiaries; subsection 74.5(6) back-to-back loan rules appears to apply to cause this result, but query whether an anti-avoidance rule can be used in this manner.
 - However, if beneficiaries are now adults, then attribution only a risk for spouse of Mrs. A.
 - To mitigate this risk, consider having spouse repay assumed loan to spouse by rolling assets back.

Example #19(a)

- High tax bracket
- Have cash available personally



Low family members in low tax rate brackets:

- Mr. A
- Daughter (age 16)
- Son (age 20)
- Daughter (age 25)

None active in Opco's business.

- Can loan planning be used to utilize family members' low tax brackets?
- Yes, but much more limited, due to Opco being a private corporation and carrying on a related business.
- Here, Opco does not carry on service business, so excluded shares possible for individuals >24.

Example #19(a) – Cont'd

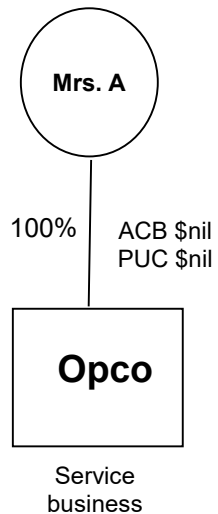
- For Mr. A:
 - No prescribed rate loan needed.
 - Use a combination of
 - spousal rollover (so Mr. A obtain shares with 10% votes and value), and
 - freeze and new nominal value share subscription (so Mr. A gets a separate class of discretionary dividend share with his own money)
 - Excluded shares exemption allow unlimited dividend to Mr. A on the new share. No attribution.
- For Daughter (age 25):
 - Mrs. A loans or gift enough cash to Daughter (age 25) so that Daughter can purchase 10% votes and value in Opco.
 - No attribution if funds are gifted (because Daughter is over 18 – 74.1 not apply).
 - If Mrs. A loan the funds, must charge 2% prescribed rate due every Jan 30. Otherwise 56(4.1) attribution applies – irrespective of Daughters' age.
 - Excluded shares exemption allow unlimited dividend to Daughter (age 25).

Example #19(a) – Cont'd

- For Son (age 20):
 - No excluded shares exemption.
 - Age category permits excluded business, but irrelevant since Son not active.
 - Age 18 to 24 – entitles to “safe harbour capital return” and “reasonable return ... having regard only to contribution of arm’s length capital” exemptions.
 - Safe harbour capital return is essentially prescribed rate of 2%.
 - Arm’s length capital excludes any borrowing, or any amount transferred from a related person (other than as consequence of death).
 - In this case, the best Son can obtain is safe harbour of 2%.
 - Mrs. A can gift funds to Son to invest in Opco; Son can earn 2% from Opco either as dividend or interest. No TOSI.
 - Mrs. A should not loan the funds, since charging prescribed rate to for Son to earn prescribed rate would be meaningless.
- For Daughter (age 16):
 - TOSI cannot be circumvented.

Example #19(b)

- High tax bracket
- Have cash available personally



Low family members in low tax rate brackets:

- Mr. A
- Daughter (age 16)
- Son (age 20)
- Daughter (age 25)

None active in Opco's business.

- What if Opco carries on service business? No excluded share exemption possible.
- In this case, only prescribed rate planning possible is:
 - Loan funds to Mr. A and Daughter (age 25), at prescribed rate of 2%, payable Jan 30.
 - Mr. A and Daughter (age 25) use borrowed funds to invest in Opco, either equity or debt.
 - Mr. A and Daughter (age 25) may earn a “reasonable return”.
- Question for fact: what is a reasonable return on an equity or debt investment in a private company in Opco's industry and its circumstances?
 - Maybe 5% to 8%?
 - Income splitting benefit is the delta between that % and the 2% prescribed rate.

Prescribed Rate Loan and Corporate Attribution

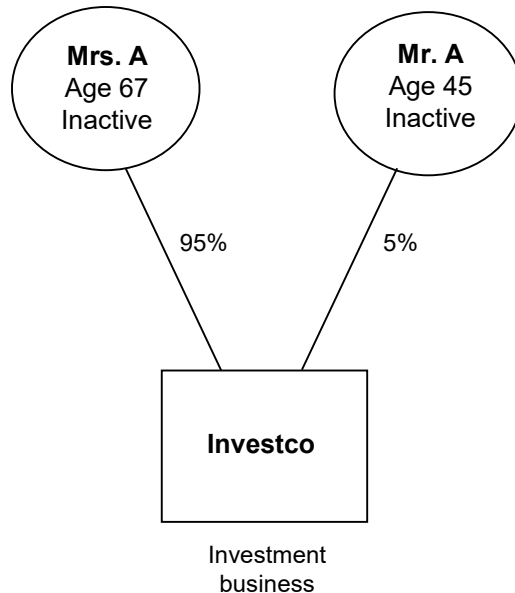
- Out of scope for this presentation, but note that prescribed rate loan can also be used to manage subsection 74.4(2) corporate attribution risks.
- See Example 3.



Other Planning Ideas

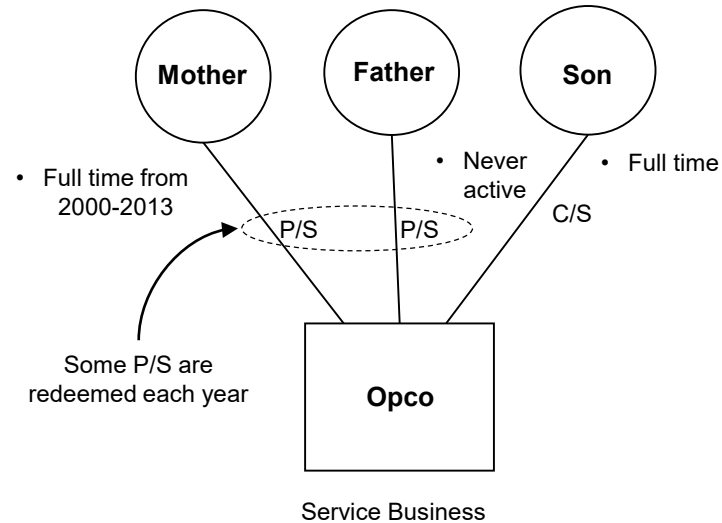
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Example #20



- Dividend to Mr. A
 - Investco’s investment business is automatically a “related business” to Mr. A because a related person (Mrs. A) owns 10% or more in the corporation.
 - “Excluded business” or “excluded shares” exemptions not available to Mr. A.
 - However, because Mrs. A is 65 or over, and had the dividend been paid to Mrs. A, it would have been exempt from TOSI to her (because Mrs. A held “excluded shares” in Investco), Mr. A would be exempt from TOSI on the dividend.
- There was uncertainty about this position, because Mr. A’s dividend not technically paid on the excluded shares of Mrs. A. However, this example is taken from CRA’s presentation to CPA Canada, so it looks like we have a favourable interpretation from CRA on this.

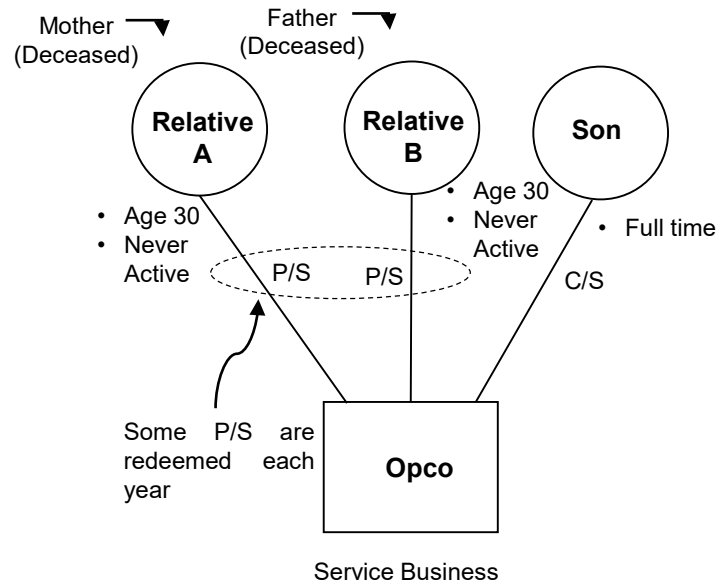
Example #21



- Redemption of shares by Mother:
 - Proceeds that exceed paid-up capital (“**PUC**”) represents a dividend.
 - Since it is dividend from a non-public corporation, potentially split income.
 - Dividend derived from “related business”.
 - But is an “excluded business”. No TOSI.
- Redemption of shares by Father:
 - Not an “excluded business” for Father.
 - Not “excluded shares”.
 - Must determine how much of the redemption deemed dividend is “reasonable return”.
 - But once Mother turns 65, TOSI not apply.

Example #21 – Cont'd

- Couple of years later, Mother and Father died. Their shares were inherited by Relative A and Relative B respectively

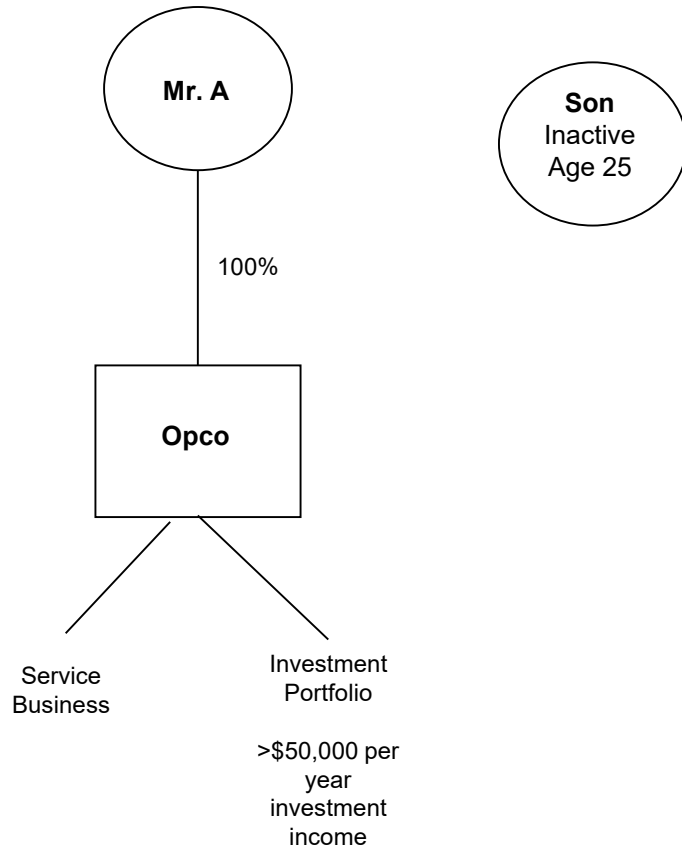


- Redemption of shares by Relative A:
 - Acquired shares as consequence of Mother’s death.
 - Inherits Mother’s attributes for purpose of “excluded business” and “reasonable return”
 - Business deemed “excluded business” of Relative A. TOSI not apply.
- Redemption of shares by Relative B:
 - Acquired shares as consequence of death of Father.
 - Since Father has not worked on a regular, substantial and continuous basis for 5 prior tax years, not “excluded business” to Relative B.
 - Inherits contribution of work/property/risk assumed/prior payments of Father (if any), and can take those into consideration in determination the reasonable portion of the deemed dividend.

****Planning**** Shares from active deceased should be sprinkled to beneficiaries?

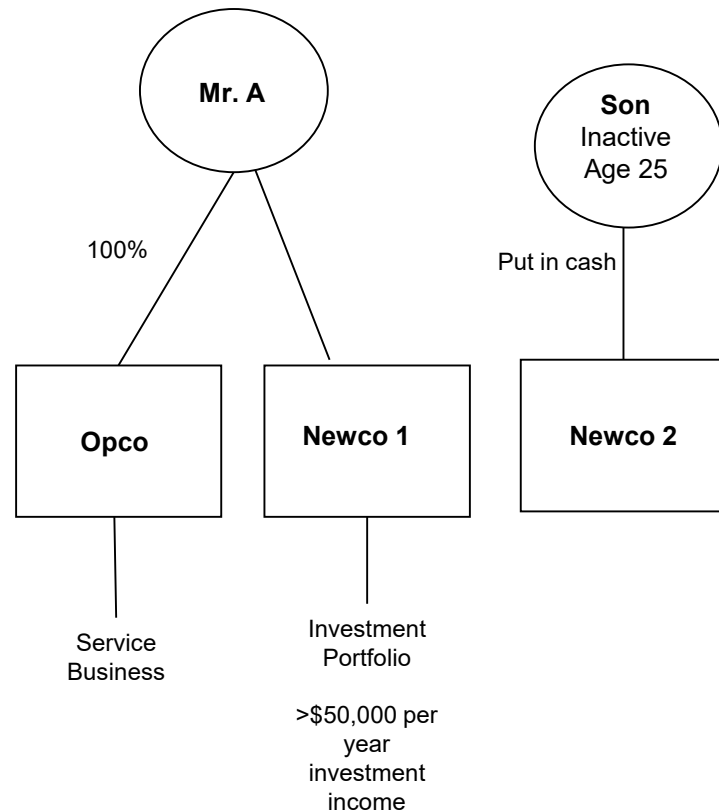
Perhaps... if Relative B got 1 share from Father and 1 share from Mother, is Relative B exempted from TOSI completely because of the 1 share inherited from Mother, or exemption applies only to that 1 share? Unclear, further guidance from CRA needed.

Example #22



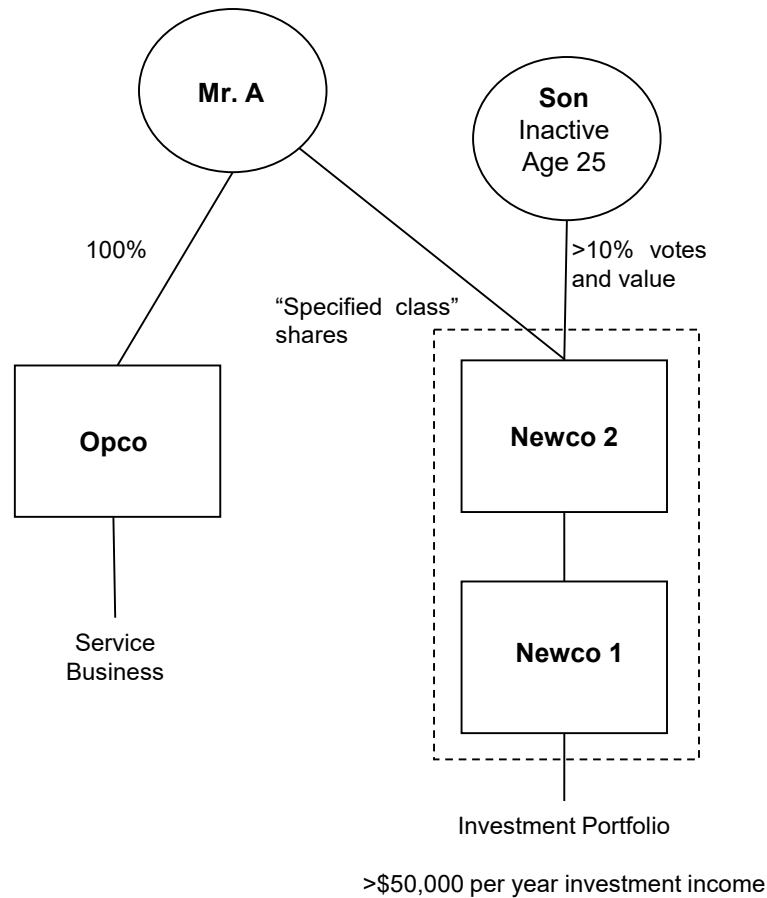
- Mr. A owns Opco
- Opco runs a service business, and holds a substantial investment portfolio of publicly traded securities.
- Investment income exceeds \$50,000 per year, causing Opco's SBD to be ground down.
- Objective:
 - Prevent SBD grind in Opco
 - Income split with Son

Example #22 – Cont'd



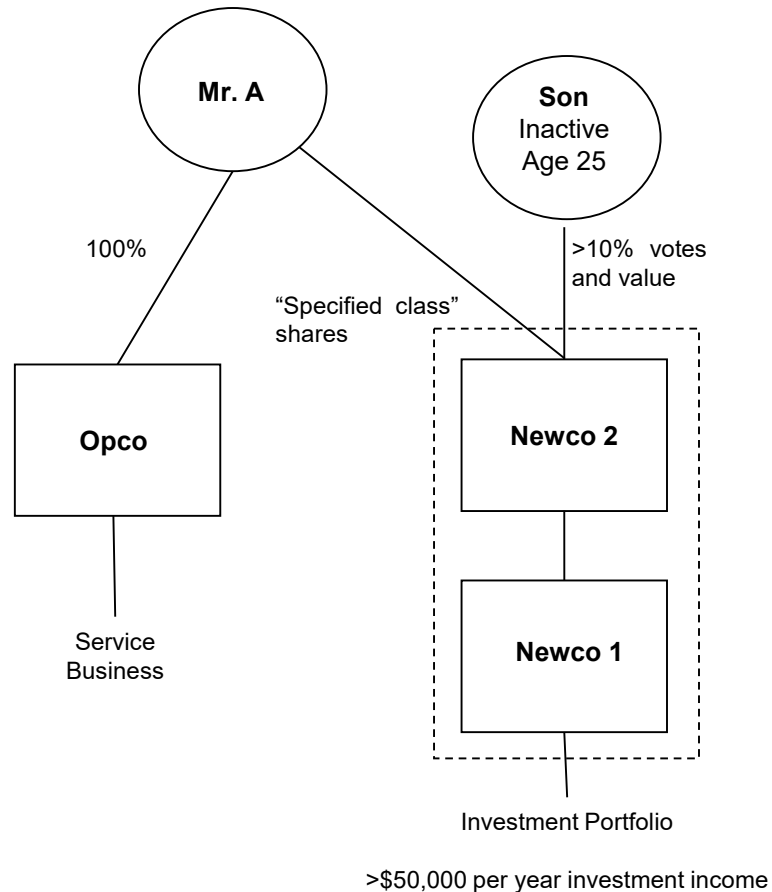
- Opco spins-out investment portfolio in a tax-deferred manner to a new sister company (Newco 1). This will be carried out using a set of transactions commonly known as 55(3)(a) related business butterfly.
- Son incorporates Newco 2, owns all voting common shares.
- Son must put in sufficient cash or other value into Newco 2, so that Son has >10% of the value of Newco 2 after the investment portfolio is transferred in at the next step.
 - This can be Son's own cash, or cash gifted from Mr. A, or borrowed from Mr. A at prescribed rate, or borrowed from a third party.

Example #22 – Cont'd



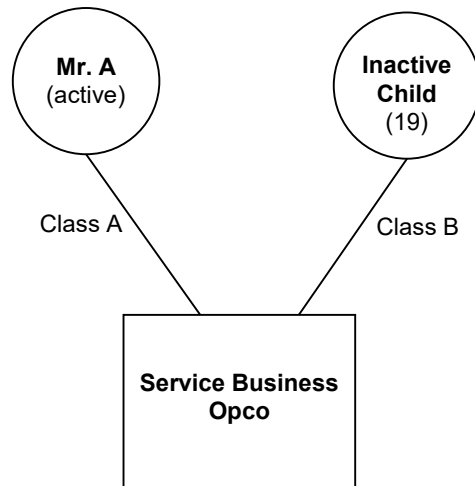
- Mr. A transfers all of Newco 1 for “specified class” of shares of Newco 2, which generally means:
 - Non-voting and non-convertible
 - Fixed dividend rate, lower than prescribed rate
 - Redeemable for a fixed price.
- Newco 1 and Newco 2 merges.
- Make sure that Mr. A has no *de facto* control over Amalco.
- Specified class of shares not counted for purpose of association rules. Hence, Opco not associated with Amalco. Opco’s SBD no longer subject to passive income grind.

Example #22 – Cont'd



- Investment income can be paid out from Amalco with no TOSI to Son:
 - If investment activities constitute a business, then excluded shares. In that case, can even pay out the original investment capital itself to Son.
 - If investment activities not constitute a business, then investment income not from a related business.
- Anti-avoidance rules?
 - Have a business reason for existence of Amalco (creditor proofing, succession planning, etc.) to avoid subsection 256(2.1).
 - New subsection 125(5.2) should not apply, because Opco did not transfer any property to another corporation that is not associated with it at the time of the transfer.

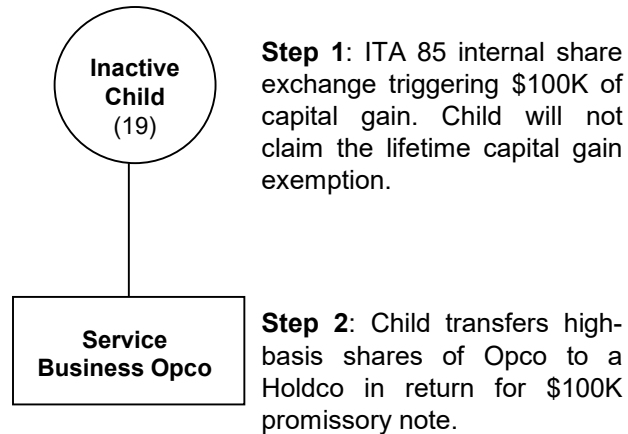
Example #23



Assume QSBC Shares, which entitles shareholders to claim \$840K lifetime capital gain exemption.

- Dividends to Inactive Child will be subject to TOSI.
- Cannot be excluded shares since (i) child not over 24, and (ii) Opco runs a service business.
- Effective tax rate on dividend subject to TOSI is 32% for eligible dividend and 42% for non-eligible dividend.
- ****Planning**** Given that the Government walked back from its July 18 proposal on rules that prevent conversion of dividend into capital gain (24% tax rate), does this present an opportunity?

Example #23 – Cont'd



KEY: the Opco shares must qualify as QSBC shares at time of Step 1.

- Child will report the \$100K of capital gain (will not claim any of his or her \$840K lifetime capital gain exemption even though s/he is entitled to it).
- Capital gain from disposition of qualified small business corporation shares is “excluded amount”, even if it is a non-arm’s length sale (but note that if <18, a non-arm’s length transaction would not work).
- Therefore, capital gain not subject to TOSI, taxed at Child’s marginal rate.
- Note that even if Child is at top marginal rate, or if TOSI applies, the max rate on capital gain is 24% in Alberta. Significantly lower than the top marginal rates on dividends (32% to 42%).
- Child can then draw tax-free cash from promissory note.
- Will need to properly manage ITA 84(2) risks, but quite doable many variations of this planning possible. GAAR risk is very low, as the Courts have consistently took the position Act has no general policy against surplus stripping.

Spousal RRSP planning

- Don't forget that an individual may contribute to a spousal RRSP using their RRSP deduction limit.
- The Spousal RRSP also allows the individual who makes the contribution to claim the RRSP deduction. This ensures the higher income spouse gets the immediate tax deduction.
- Upon retirement, withdrawals from the Spousal RRSP are taxed in the hands of the lower income spouse.
- While not glamorous, the Spousal RRSP will provide a spouse with an income stream that utilizes marginal rates.



Practical Comments on Dealing with the Reasonableness Test Provided in the TOSI Rules

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Reasonable Return

Labour Contribution Factors Considered by CRA

- The nature of the tasks performed.
- Hours required to complete tasks.
- A competitive salary/wage for tasks in relation to businesses of similar size and industry.
- Education, training and experience.
- Degree of activities and nature of activities in relation to those of business of a comparable nature and size.
- Time spent on the activity in comparison to time spent in other activities or undertakings.
- Particular knowledge, skill or know-how that the individual possessed.
- Business acumen.
- Past performance of functions.

Reasonable Return

Property Contribution Factors Considered by CRA

- The amount of capital contributed to the business.
- The amount of loans to the business.
- The FMV of property (tangible and intangible) transferred to the business, including technical knowledge, experience, skill, know-how.
- Whether the individual has provided property as collateral for loans or other undertakings.
- Whether other source of capital or loans are readily available.
- Whether comparable property are readily available.
- Whether property are unique or personal to the individual.
- Opportunity costs.
- Past property contributions.

Reasonable Return

Risk Assumption Factors Considered by CRA

- Whether the individual is exposed to the financial liabilities of the business, whether through guarantees of mortgages, loans or lines of credit or otherwise.
- Whether the individual is exposed to statutory liabilities related to the business.
- Extent of the risk that contributions made by the individual to the business may be lost, whether in whole or part.
- Whether any risk is indemnified or otherwise limited in the circumstances, whether by agreement or otherwise.
- Whether the individual's reputation or personal goodwill is at risk.
- Past or ongoing risk assumption.

Reasonable Return

Total Amounts Paid Factors Considered by CRA

- All payments of any kind.
 - Salary or other remuneration or compensation;
 - Dividends;
 - Interest;
 - Proceeds; and
 - Fees.
- Any benefit or deemed benefit of any kind.
- It is important to note that historical remuneration is a factor. Paying too much remuneration (including salary/bonus) before 2018 – for example where the taxpayer “sprinkled” to the max in 2017 – will reduce the reasonable amount that can be paid in 2018 and after.

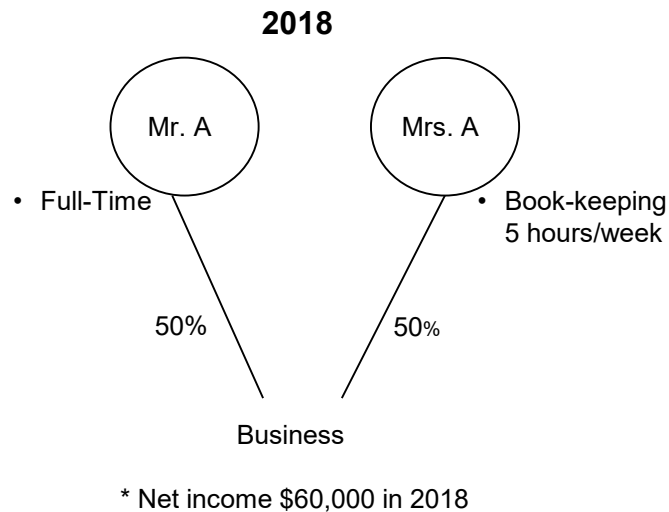
Managing the Reasonableness Standard

- Although TOSI effective 2018, the four factors look-back to entire history of the business. This is particularly important for retired business owners who will need to justify reasonableness with historical functions performed.
- CRA doc #2018-0761601E5:
 - CRA will consider timesheets, schedules, and logbooks.
 - Pre-2018 years, to assess reasonableness of assertion that 20 hour test met historically, CRA may also consider:
 - The type of business and duties performed as they relate to the main activities of the business;
 - The individual's education, training and experience; and
 - Particular knowledge, skills or know-how of the individual.
 - CRA encourages the ongoing maintenance of record going forward (timesheets, schedules, and logbooks).

Managing the Reasonableness Standard

- Practical tips for dealing with the reasonableness standard going forward:
 - Consider giving each specified individual working in the business an official job title, business cards, profile on website, and ideally designated working area.
 - Consider putting working family member shareholders on hourly payroll (even if at minimum wage) – per-hour payroll is good evidence to later substantiate the 20 hour test, which would permit unlimited dividends in addition to salary.
 - Annual performance review should be undertaken and documented for each specified individual, describing how each individual performed according to their job function.
 - Where possible, minutes for meetings should show which specified individuals are present.

Example



- Mrs. A's 50% portion of business income:
 - Carrying on business with view to profit, so this is a partnership.
 - Mrs. A's partnership income derived directly or indirectly from a "related business"; it is a related business both because of Mr. A's engagement, as well as his ownership.
 - Not "excluded business"/"excluded shares".

Example – Cont’d

- Portion of Mrs. A’s \$30,000 income subject to TOSI based on the “reasonable return” test, i.e. what is reasonable having regard to the relative contribution of each person relating to each factor below:
 - What is her relative contribution of work performed?
 - She worked only 5 hours per week vs. Mr. A’s full time work; she bookkeeps while Mr. A runs all aspects of the business. But turns out, Mrs. A has more prior education/training/experience in the industry in which the Business operates. Let’s say, all taken into consideration, from a work performed perspective, her relative contribution is 20%.
 - What is her relative contribution of property contributed?
 - Let’s say Mrs. A and Mr. put in the same amount of starting capital. So 50%.
 - What is her relative contribution of risk assumed?
 - Let’s say Mrs. A personally owns 100% of a condo, on which the business’ line of credit is secured on; but also, as general partners both Mr. A and Mrs. A are personally taking on liability risks. So, let’s say her contribution is 75%.
 - What is the relative amounts that were paid to her or for her benefit?
 - Since they are 50/50 partner, they take the earnings equally.
 - Any other relevant factor? Let’s say none.

Example – Cont'd

- To summarize:
 - Mrs. A's relative contribution are: 20% based on work performed; 50% based on property contributed; 75% based on risk assumed; 50% based on amounts already paid.
 - Are all four factors above equally important to the success of the business? Depends on the facts. Let's assume that the line of credit is almost never used, so Mrs. A's assumption of risk in respect of that line of credit is not really that important.
 - A reasonable conclusion must be reached in the reporting of Mrs. A's income.
 - Maybe the right answer is \$10,000 of Mrs. A's \$30,000 is subject to TOSI (48% taxation), and \$20,000 is taxed at her marginal rates. CRA may disagree though.
 - Despite CRA's assurance that they will accept a good faith attempt, it is still completely subjective - no right answer; in fact the right answer could be only \$2,000 subject to TOSI. Practically, an analysis of what is reasonable needs to be attempted and documented. For small amounts, the CRA auditor or appeal officer will likely accept a filing position as long as there is an attempt at reasonableness (so, saying nothing is subject to TOSI may not be wise in this situation).

How Should Accountants' Files be Documented (Reasonable Return)

- In your CaseWare or Working Paper files:
 - Prepare a historical asset (tangible and intangible) contribution schedule (both equity and debt contributions and) for each specified individual – this should not be too arduous since the shareholder capital account and shareholder loan account should be a good starting point.
 - Keep on file any personal guarantees by any specified individuals.
 - Ideally, tax returns of all specified individuals should be coordinated. Allocation of reasonable income/gain theoretically similar to allocating small business limit amongst associated companies.
 - Keep copies of the following for each specified individual (if available):
 - Official job title, business cards, profile on website.
 - Annual performance reviews describing how each individual performed according to their job function.
 - Minutes for meetings should show which specified individuals are present.
 - Annually updated profiles each specified individual's labour and/or expertise contributions that include the factors CRA considers (see slide 30).

How should Accountants' Files be Documented (Excluded Business)

- In your CaseWare or Working Paper files:
 - Documentation to support the 'bright line' 20 hours/week test:
 - Historical tax returns, payroll records, or timesheets (for establishing 5 previous years).
 - Narrative to describe an individual's work performed and value to the business for each year he or she worked.
 - Current year timesheets.
 - Documentation to support the factual actively engaged on a regular, continuous, and substantial basis test:
 - Description of the business activities and cycle if unusual (e.g. farming/fishing).
 - Extenuating circumstances that affected the individuals ability to engage in the business (e.g. parental leave, illness).
 - Unique demands of the business (e.g. where very little work is required to generate income, online sales).

How should Accountants' Files be Documented (Excluded Share)

- In your CaseWare or Working Paper files:
 - Documentation that splits the clients business income between service income and income from goods.
 - Table of shareholdings representing the value and votes of shares held (see example on next slide).
 - Documentation that tracks the sources of income of the corporation from other related businesses.

How should Accountants' Files be Documented (Related Business)

- In your CaseWare or Working Paper files:
 - Listing of individuals involved in the business; identifying which individuals are “actively engaged on a regular and continuous basis” or not.
 - Table of shareholdings representing the value and votes of shares held.

Example:

Individual	Number	Class	Redemption Amount	Fair Market Value (“FMV”)	% of FMV	% of Votes
A	100	A Voting Common	n/a	\$ 1,500,000	34%	9.09%
B	100	B Non-voting Common	n/a	\$ 1,500,000	34%	0%
C	1,000	C Voting Preferred	\$ 1,000,000	\$ 1,000,000	23%	90.91%
D	400,000	D Non-voting Preferred	\$ 400,000	\$ 400,000	9%	0%
Total				\$ 4,400,000	100%	100%

- Documentation tracking the source of a dividend (i.e. from which business or original capital did the dividend derive from).

How should Accountants' Files be Documented (18 – 24 Arm's Length Capital)

- In your CaseWare or Working Paper files:
 - Documentation that tracks the sources of arm's length capital of the specified individual.
 - Keep a copy of the prescribed rate during the time the capital is used by the business (safe harbor capital return).
 - Documentation of the return that arm's length capital could expect.



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