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This is a quarterly newsletter which we send to clients, referral sources and friends. The information is meant to be educational and application of the concepts should be on an individual basis. Please do not hesitate to contact us should you require further clarification of any item.

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This publication is a high-level summary of the most recent tax developments applicable to business owners, investors, and high net worth individuals. Enjoy!

TAX TICKLERS... some quick points to consider...

- **Canada Pension Plan (CPP)** – The Federal Government has been consulting on, and intends to continue examining **possibilities to enhance** the CPP.
- **Principal Residence Exemption (PRE)** – A **vacation property**, even if situated outside of Canada, may be eligible for the PRE.
- **U.S. Real Estate** – Sales of U.S. real estate by non-residents are now generally subject to a **15% U.S. Federal withholding tax** (previously at 10%) if a waiver certificate is not obtained.
- **Canada Child Benefit (CCB)** – The new CCB will replace the Canada Child Tax Benefit and Universal Child Care Benefit **commencing July 2016**, providing a maximum annual benefit of \$6,400/child under age 6, and \$5,400/child aged 6-17. The benefit will be phased out dependent on adjusted family net income.
- **Teachers and Early Childhood Educator School Supply Tax Credit** – This new 15% refundable tax credit (maximum value of \$150/year) proposed to commence in 2016 is based on up to **\$1,000 of eligible expenditures**, such as amounts paid out-of-pocket for classroom supplies.



TIPS AND GRATUITIES: Employer's Responsibilities to Withhold CPP and EI

Gratuities or tips received by employees are **income earned from employment**. However, it must be determined whether these tips are **pensionable and/or insurable**, that is, whether the employer should be withholding CPP and/or EI. This depends on whether the tips are **considered** to have been **paid by the employer**. Administratively, CRA looks at whether the tips are controlled by the employer or are considered to have been paid by the customer (a direct tip).



A December 16, 2015 **Tax Court of Canada** case examines whether tips paid to a restaurant's workers were **subject to CPP and EI**. The restaurant's annual revenues were approximately \$6.5 million and the tips totalled \$1 million.

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The workers **divided the tips under a formula** which varied over time, with all workers, including the “front-of-the-house” employees (**servers** and the related **support staff**), and “back-of-the-house” employees (**kitchen staff, managers,** and the catering **sales coordinator**) participating. The employer had withheld and remitted CPP and EI on tips paid to the “back-of-the-house” employees, so only “front-of-the-house” employees were under Appeal.

The **Employer** testified that, although they **deposited and paid out the tips**, they considered these funds to be **held in trust for the employees** (likening it to GST/HST held for the Crown). The “**back-of-the-house**” staff were entitled to a portion of the **tips**, computed as a percentage of revenues, **under their employment contracts**. The “**front-of-the-house**” employees’ **contracts** were **silent** on the matter of tips, and they **shared actual tips** from patrons, less the portion paid to the “back-of-the-house” staff. Their **tips** were **paid** out (in cash for some time, eventually transitioning to cheques) **separate** from their wages and outside the **payroll** system.

Taxpayer loses

The Court found that **CPP and EI applied to tips paid by the employer**. The Court found that “**mere distribution**” of the gratuities by the employer, with neither control nor ownership, is sufficient to constitute **payment** by the employer. The Court also noted that **CRA’s published interpretations** (for example, at www.cra-arc.gc.ca/tx/hm/xpl/nd/tps-eng.html) differentiate between controlled and direct tips, but that this may **not** be the **correct** test – the only determinant is whether the employer **paid the tips** to the employees.

As the employer had paid the tips to the employees, CRA was correct to assess CPP and EI.

Action Item: Consider whether your business is properly withholding and remitting CPP and EI on tips and gratuities earned by your workers.

WORKING BUT NOT PAYING YOURSELF: Employment Insurance Issues

After **leaving a job**, an individual may **incorporate a business**, or invest more time in one that they already operate. The individual may then decide to leave all the money in the corporation, taking no wages. Or, perhaps, the business is unable to pay a salary as it is not making sufficient revenues. Since the individual **does not receive any personal wages**, they may be motivated to apply for **EI unemployment benefits**. It sounds simple right? Wrong.



In a February 6, 2016 **Federal Court Judicial Review**, it was noted that whether one is employed or not, is a **matter of work performed** rather than the wages received. In this case, the individual was working, however, did **not receive any personal income**. Therefore, the individual was not considered unemployed and was **ineligible for EI benefits**. The Court went on to note that the right to receive income from a business is sufficient to establish employment, even if income is not actually received.

Action Item: In situations such as the above, the individual may be required to pay back EI benefits received in addition to interest. Watch out for these scenarios!

CRA SCAMMERS: Who is Really Calling?

Over the past while there have been numerous reports of individuals (scammers) **impersonating CRA collections agents** over the phone and demanding payments for alleged tax debts. The calls can be **aggressive, intimidating**, and may even threaten arrest by the RCMP or other officials. The scammers may also request payment via various means such as regular or prepaid credit cards, wire/bank transfers, iTunes cards, or, simply, cash. In some cases, the scammer has the target’s personal information, such as their address. It has been reported that some scammers go so far as to offer to meet the target at the nearest bank machine.



If an individual receives a suspicious call purporting to be from the CRA, care should be given to ensure **no personal information is disclosed**. An individual may consider obtaining identifying information from the caller (such as a name, phone number, office location, and Agent ID number) and then calling CRA on their publically listed number (1-800-959-8281) to confirm that the call is legitimate.

The **CRA** has also stated that they **will not**:

- **email a link requesting** that recipients fill in an online form with **personal or financial details**;
- set-up an **in-person meeting** in a public place to **take a payment**;
- **demand immediate payment** by **prepaid credit card**; or,
- **threaten with immediate arrest or prison sentence**.

To **report suspected fraudulent activity**, taxpayers may contact the **Canadian Anti-Fraud Centre** at www.antifraudcentre.ca, or, call toll-free at 1-888-495-8501. If a taxpayer believes that they may be the victim of fraud or have given personal or financial information unwittingly, they

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could contact their local police service, financial institution, and credit reporting agencies.

Action Item: Let your household know that these fraudulent interactions are becoming more and more common. When in doubt, gather information, but don't give any.

MULTIPLICATION OF THE SMALL BUSINESS DEDUCTION (SBD): Significant Changes Ahead

Measures were proposed in the **2016 Federal Budget** to **prevent certain corporations** from **multiplying access** to the \$500,000 **SBD**. Some proposals include:

- Eliminating multiplication of the SBD in “complex **partnership structures**” where payments are **sent from a partnership to non-partner corporations** owned by partners, or those related to partners. Broadly speaking, this planning structure enabled each partner to benefit from the lower small business tax rate on up to \$500,000 in income earned through a personally owned corporation. The changes propose that essentially only one \$500,000 SBD limit will be available to the partnership, and related corporations, as a whole (barring access to certain exceptions).



A number of professional services firms (e.g. medical professionals, accountants, lawyers etc.) use a structure like this and will be affected by the change.

- Eliminating multiplication of the SBD where **fees are paid between corporations** where there is a **common ownership**. Basically, these new rules generally restrict access to the SBD on any active business income earned by one Canadian Controlled Private Corporation (CCPC) from providing services or property to another private corporation where the recipient CCPC, any of its shareholders, or anyone related to those shareholders, holds any ownership interest in the payor (with certain exceptions).

This **broadly-phrased** provision will apply to many structures which, for example, pay **intercorporate management fees**.

These measures will apply to **taxation years that begin on or after Budget Day, March 22, 2016**.

Action Item: Be prepared for changes in tax liabilities if your corporate or partnership structure fall within the proposed changes.

COMBINED AUDITS OF OWNER-MANAGED COMPANIES: Shareholders' Personal Information



In a June 18, 2015 **Technical Interpretation**, CRA was asked about the perceived increase in requests of **personal financial information** of the **shareholders of Canadian corporations** selected for **audit**. Further, questions were asked with respect to information that is requested in **relation to the shareholder's spouse, children or other** related parties. In some situations, the shareholders are asked to essentially complete statements of net worth.

CRA noted that the personal information from the shareholder and related parties is requested to **ensure** that business **transactions are reported within the business** and not in personal accounts. It was noted that **internal controls** and the segregation of duties are **generally weak** in some organizations. Therefore, indirect tests of income may be used to ensure the **completeness of income** reported. **Indirect tests may include:**

- **bank deposit** analysis;
- rough **net worth calculations**; and,
- **analysis of sources** and applications of funds.

CRA has confirmed that obtaining certain **personal financial information** for shareholders and their family living in the same household is a **requirement** in some small and medium enterprise audits.

Action Item: If such an audit request is received, contact us to help respond efficiently.

CREDIT CARD COMPARISON: Do You Have the Best Card for Your Needs?

Rate Hub provides an array of calculators and tools at www.ratehub.ca/credit-cards to help **individuals** and **businesses** select the **most appropriate credit card** for their needs.



In particular, the tools **quantify** the **dollar value of benefits** (such as **sign-up bonuses** and **annual spend rewards**) and costs (such as **annual fees**). These tools can also factor in an individual or business' **different types of spending** (such as groceries, gas, travel, etc.).

Beyond the strict dollar value of reward programs and costs, the service also **compares ancillary benefits** such as travel and baggage insurance offered.

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By comparing cards head to head, it is easy to see which card is the most appropriate option.

Action Item: Go to this website and review if your credit card is providing the most value to you or your business.

CRA ONLINE SERVICES: My Account Update

In early 2016, CRA updated the “My Account” online service (intended for the individual taxpayer’s exclusive use). This service allows individuals to:

- view **CRA correspondence**, assessments, and balances;
- view some **income slips** for the current and previous years (T4, T5, T3, etc.);
- view certain personal limits like **RRSP** and **TFSA contribution room** available;
- change **CRA correspondence options** to emails rather than paper letters;
- change or **adjust returns**;
- **change address and phone number(s)**;
- change **marital status**;
- apply for **child benefits**;
- **submit documents** if requested by CRA;
- arrange to receive amounts by **direct deposit**;
- pay by **pre-authorized debit**;
- authorize a **representative**;
- print a **proof of income statement** (this looks much like the historical Notice of Assessment);
- request a **remittance voucher**; and,
- register a **formal dispute**.

To sign up, go to, www.cra-arc.gc.ca/myaccount/ and click on “CRA register”. Individuals will need to enter personal information along with some details from their last Notice of Assessment. It is also important to note that if registered to receive personal correspondence and **notifications from CRA via email**, the taxpayer **must be signed up for My Account** to view the full message.



Action Item: Consider signing up for this service to view timely updates and information from CRA.

INSURABLE EARNINGS: Related Employee

Consider the situation where Persons A and B are a **married couple** and own 60% and 40% respectively of Corporation A (A Co.). They are also both **employed by A Co.** and,

therefore, receive a salary. Will the salaries that they receive be considered **insurable for Employment Insurance (EI) purposes**? That is, would EI **withholdings** have to be remitted to CRA, and would the person be **entitled to receive EI benefits**?

The EI **legislation is complex**, however, it can roughly be boiled down to the following:



For EI to apply, the **first step** is to ensure that the individual controls **no more than 40% of the voting shares** of the business. In this situation, since A owns 60%, she would not be earning insurable amounts. However, B **may still be subject to EI**.

The **second step** is to determine whether B is **related** to a person who either **controls the employer corporation**, or is a **member of a related group** that controls the employer corporation. **Immediate family** members and their spouses are generally **considered related** to each other. In essence, if A and B control more than 50% of a corporation, their earnings are not considered to be insurable.

There is, however, an **exception to the second step**. If an **arm’s length person** would have been offered, and accepted the **same circumstances, or terms and conditions of employment**, as the related individual (Mr. A), then earnings once again **become insurable**. This exception is not applicable to individuals deemed not insurable by the first step (the individual controls more than 40% of the voting shares).

In a February 4, 2016 **Tax Court of Canada** case, a 40% owner (married to the 60% owner) intended to rely on this exception. Although there were many factors both for and against his position, he was **not successful** in showing that his employment was insurable. During testimony, the 60% owner (his spouse) indicated that she **laid off her husband** because he was a “**big salary**”, which in the Court’s view was suggestive of a non-arm’s length arrangement. In other words, his contract was **not similar to one that would be offered to an arm’s length party**. Whether or not a contract is similar to an arm’s length one can be complicated and is frequently the subject of court cases.

Action Item: The stakes are high in these scenarios. If the owners consider the employment insurable, but it is later determined not to be, EI benefits received will have to be paid back (though the payor may be eligible for a refund of some EI remitted). In the opposite scenario, the owners will be liable for unremitted EI. Discuss your situation with a professional prior to making the determination to avoid costly errors and administrative complications.

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