Strength in Numbers™

# Kemp Harvey Group

Chartered professional accountants

Summer 2018 Newsletter

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## Passive income tax changes relaxed


In the summer of 2017, the federal government proposed changes to the taxation of passive investment income of private corporations in Canada. Following angry feedback to the original proposals, the government introduced adjustments in their spring budget. The new measures they introduced will be applicable to company's tax years beginning after 2018.

In both sets of proposals, if a company earned over $50,000 of passive investment income, they would have been subject to new taxation rules.

The first proposal would have resulted in an increase to the tax rate on investment income. In their revised proposal, rather than increasing the tax on investment income, the budget proposed to reduce the amount of small business deduction that would be available to a company that earned over $50,000 of passive investment income.

The small business deduction allows a private company to earn up to $500,000 at the lowest federal corporate tax rate. If a business earns passive investment income over the $50,000 threshold, their available small business deduction limit will be reduced. If this income is greater than $150,000, the small business deduction will be eliminated.

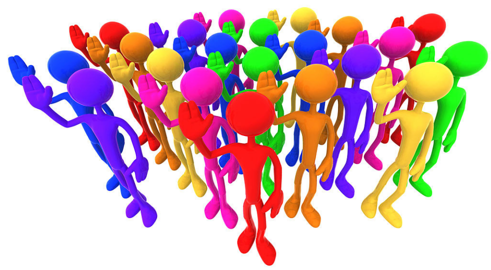
One of the main concerns with the original proposal was that one time capital gains could push a company's passive income over the threshold.

In response, the government has excluded capital gains on assets used in an active business by a company or a connected company; however, no adjustment has been made for gains on sales of passive investments.

Furthermore, capital losses from prior years are excluded, so taxpayers are unable to offset current gains with previous losses to reduce their income below this threshold.

# EMPLOYER HEALTH TAX INTRODUCED

Beginning in January 2019, the provincial government will introduce a new Employer Health Tax (EHT).



The EHT will replace the Medical Services Plan, which will be eliminated by January 1, 2020.

Businesses who have payroll costs of less than $500,000 will not have to pay any of the new EHT. Employers who have payroll costs of over $1.5 million will have to pay EHT of 1.95% of these payroll costs. Employers with payroll costs between $500,000 and $1.5 million will pay EHT of 2.925% on payroll between $500,000 and $1,500,000.

Many employer paid benefits will be included in the calculation of the total payroll costs. For example, taxable allowances, employer paid group life insurance premiums, and contributions to an employee's RRSP will be included in the calculation.

On the other hand, employer paid payments to registered pension and deferred profit-sharing plans, as well as extended health benefits and retirement compensation arrangements, will not be included.

Charities and non-profits will have different thresholds than other entities. They will pay no EHT if their payroll is less than $1.5 million, and their top threshold at which they would pay the full 1.95% rate is $4.5 million.

Employers with payroll costs over $600,000 will have to make quarterly instalments, and they will have to file and pay online. The first instalment payment will be due on June 15th, 2019, and the final return will be due with payment on March 31, 2020.

Employers can begin signing up for EHT in January, 2019. The provincial government has indicated that they will provide greater detail when draft legislation is introduced this fall.

# CALCULATION OF WORK IN PROCESS CLARIFIED

Additional clarification has been provided regarding rules related to the reporting of Work in Process (WIP) of certain professionals.

Professionals must begin reporting their WIP for all tax years beginning after March 21, 2017, at the lower of cost or fair market value. It has been clarified that if the professional is calculating their WIP based on cost, they do not have to include fixed overhead costs.

In addition, if the professional is also the owner, they do not have to include their time in the calculation.

# DID YOU KNOW...

There are several provinces in Canada who already have a payroll tax system in place, including Manitoba, Ontario, Quebec and Newfoundland and Labrador. There are different exemption structures in each province, from zero in Ontario to $1.30 million in Newfoundland and Labrador. Although the highest payroll tax in most provinces is in the range of 1.95% to 2.15%, Quebec's payroll tax is much higher. On payroll of over $5 million, payroll taxes of 4.26% are levied.

# Minor income splitting adjustments introduced

As part of the 2018 budget, the government announced that there will be no further changes to income sprinkling rules that were revised in December 2017. The government had made these revisions in December because of the outcry from taxpayers across the country to the original proposals. These new rules are effective January 1, 2018.

For several years, the government has enforced rules to restrict income splitting through a "Kiddie Tax". Dividends from private corporations which are paid to children under the age of 18 are taxed at the highest tax rate under these rules.

Last year, the government looked to expand the "Kiddie Tax" and apply it to more individuals. The new rules are commonly referred to as "Tax on Split Income" (TOSI).

The new TOSI rules apply to spouses, children aged over 17, grandparents, and siblings. The original proposals had also included aunts, uncles, nieces and nephews, but these individuals were removed from the new proposals.

In order for dividends paid to these individuals to not be TOSI dividends, they must be paid for work completed on a regular, consistent

and substantial basis. The government has said that working an average of 20 hours per week during the year or in five previous years would meet these requirements. The five years do not have to be consecutive. This has been called the "excluded business test".

For seasonal businesses such as farms or fisheries, these guidelines would only be applicable when the business is operational.

There are some additional exceptions to the application of TOSI, through the "excluded shares test". If the taxpayer is over 24 and owns 10% of the shares of the company, these rules may not apply. However, the company must not be a professional corporation, which would include medical, legal, dental, and accounting companies. It must also receive less than 90% of its revenue from services. Finally, 90% of its income has to be derived from non-related businesses.

For individuals over 24, the government will also consider other factors, such as whether the individual has contributed capital to the company, whether the amount received is commensurate to the relative risk assumed with their ownership, as well as other factors that the government considers relevant.

Because of the vagueness of these last points, it may be years before precedents are set as to what is considered a reasonable dividend.

For children aged 18 to 24, they can have their TOSI reduced by 1% of the amount that they contributed to the company. If they received financing for this contribution from an unrelated source, they can have TOSI reduced to what would be considered to be a reasonable return on their contribution.

For spouses, these rules no longer apply once they turn 65, assuming that the dividend would not considered to be a TOSI dividend if it had been received by the other spouse.

## Did you know...

If an employer provides a free party or social event to all its employees and the cost is $150 per person or less, it is not considered to be a taxable benefit. Transportation and accommodation costs are not included in the $150 per person amount. If the cost of the party is greater than $150 per person, the entire amount will be considered to be a taxable benefit.

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## Short term accommodations taxed

Effective October 1, 2018, new rules will be in place for short term accommodation providers in British Columbia.

As of that date, unless an owner is listing their property on an online accommodation platform such as Air BNB, or they have an exempt property, they must be registered for Provincial Sales Tax (PST), and if applicable, Municipal Regional and District Tax (MRDT).

The rate of tax for PST is 8%, and the MRDT can be up to 3%. If the provider is registered on an online accommodation platform, the platform will start collecting the taxes for them.

In the past, there were exemptions available if a provider had less than 4 units of housing available. This exemption will be removed when the new rules come into place.

It will be replaced by an exemption from registration for providers who have revenue of less than $2,500 in the last 12 months, can reasonably expect to have revenue of less than $2,500 in the next 12 months, and are not registered on an online accommodation platform.

Long term accommodations are still exempt under the new rules. However, there has been a reduction in the number of days needed to qualify for this exemption.

Previously a unit had to be rented for a month to be considered long term accommodation. Under the new guidelines, the rental property only has to be rented for 27 days to qualify.

Online classified listings and listing services that do not collect tax on behalf of the owner are not online accommodation platforms for the purposes of the new regulations.

Providers may also need to charge Goods and Services Tax on their accommodations. There have been no changes to these regulations.

## Provincial education credit eliminated (again)

There has been another change to the education tax credit for students in British Columbia. As discussed in the Autumn newsletter, the previous provincial government had planned to eliminate the provincial education tax credit. When the new government came to power, they cancelled the plans for eliminating this credit. However, in the provincial budget this spring, it was announced once again that the credit would be eliminated, as of January 1, 2019.