# TAX NEWSLETTER

**Winter 2015**

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### *Special points of interest:*

- ***Personal tax instalments:***
  - ► ***March 15, 2015***
  - ► ***June 15, 2015***
  - ► ***September 15, 2015***
  - ► ***December 15, 2015***
- ***The deadline for 2014 RRSP contributions is March 2, 2015.***
- ***2014 personal tax return filing deadline is April 30, 2015***
- ***June 15 is the filing deadline for self-employed individuals***

## Selling a Business to the Next Generation


*Jeff Saunders, CPA, CA, Tax Partner, Teed Saunders Doyle & Co., Fredericton, NB, DFK Affiliate Firm*


As the baby boomer generation reaches retirement age, we are seeing an increase in the number of small and medium sized businesses being sold. In selling a business, many business owners want to take advantage of the Capital Gains Deduction. In basic terms, the Capital Gains Deduction allows an individual who owns shares in a "QSBC" (a Qualified Small Business Corporation), or a qualifying interest in a farm or fishing business to sell their shares and receive up to $813,600 in capital gains without paying tax. (Alternative Minimum Tax [AMT] may apply depending on the individual's other income.) This large tax break is obviously very attractive to someone selling their business.

However, there are tax rules that apply only in the special circumstances where the purchaser and vendor are not dealing at arm's length. Many sales of family businesses from one generation to the next generation will be considered to be non-arm's length transactions. A mother selling shares of her QSBC to her daughter is just one example of a purchaser and vendor not dealing at arm's length. These special tax rules are designed to prevent abuse, but they can also have significant negative tax consequences on legitimate sales to the next generation.

If we were to look at two identical transactions with the only difference being that one of the transactions is not at arm's length, such as a mother selling to her daughter, we would get very different tax results:

- Let's assume that Mrs. A and Ms. X are not related in any way, that Mrs. A owns all of the shares of Opco Ltd. (a QSBC), that Opco Ltd. has a fair market value of $800,000, and that the adjusted cost base and paid up capital of Mrs. A's shares is $100. Ms. X incorporates her own holding company, Holdco Inc., and Holdco Inc. borrows $800,000 from a bank to purchase all of the Opco Ltd. shares from Mrs. A. Mrs. A will have a capital gain of $799,900 and she can claim her Capital Gains Deduction to not pay any tax on the sale. (Up to $47,300 of AMT may apply depending on Mrs. A's other income.)
- Now if we assume that Mrs. A and Ms. X are mother and daughter and all of the other facts in the preceding paragraph do not change, then the results are very different. The special rules in the *Income Tax Act* for non-arm's length transactions will deem the $800,000 paid from Holdco Inc. to Mrs. A to be a dividend rather than proceeds on sale. So instead of receiving a tax-free capital gain of $799,900, she has now received a taxable dividend of $799,900. In New Brunswick, this taxable dividend would result in up to $288,000 in taxes.

These dramatically different results highlight one of the numerous tax issues that can arise in selling a business to the next generation. With proper advance planning and advice from your tax advisor, negative consequences like those illustrated above can be minimized or avoided.

**In selling a business, many business owners want to take advantage of the Capital Gains Deduction.**

# Saving for Future Needs: Registered vs. Non-registered Accounts?

Sharon Gross, Tax Manager, Kenway Mack Slusarchuk Stewart LLP, Chartered Accountants, Calgary, AB, DFK Affiliate Firm

With the RRSP contribution deadline of March 2, 2015 approaching, you may be wondering how registered and non-registered accounts are different. The more common registered accounts are Registered Retirement Savings Plans (RRSP), Tax Free Savings Accounts (TFSA), and Registered Education Savings Plans (RESP).

An advantage of registered accounts is that the investment income is not taxed in the year it is earned. Contributions made into an RRSP can also reduce your taxes. The longer the investments are held the better the tax savings. There is no requirement to track the cost base for tax purposes in registered accounts, avoiding some administrative annoyance. Other factors to consider are:

**Annual contribution limit**:
Non-registered: None
RRSP: 18% of prior year's earned income, less prior year pension adjustment up to $24,270 (2015—$24,930)
TFSA: 2015 - $5,500
RESP: None. Lifetime contribution of $50,000 per beneficiary; government grant of 20% of annual contribution to a maximum grant of $500/year

**Maturity date:**
Non-registered: None
RRSP: Prior to death, last day of year annuitant turns age 71
TFSA: None prior to death
RESP: 9th anniversary when beneficiary is 21 years old and not attending post-secondary education; 35th anniversary of the plan (subject to certain exceptions); when all beneficiaries are deceased

**Tax deductible contributions:**
Non-registered: No
RRSP: Yes
TFSA: No
RESP: No

**Taxable when withdrawn:**
Non-registered: No
RRSP: Yes
TFSA: No
RESP: Capital contributions – no; investment income and government grants – yes

**Contribution room restored after withdrawal:**
Non-registered: N/A
RRSP: No
TFSA: Yes
RESP: No

**Penalty for exceeding contribution limit:**
Non-registered: N/A
RRSP / TFSA / RESP: 1% per month

**Carry forward of unused contribution room:**
Non-registered: N/A
RRSP: Yes
TFSA: Yes
RESP: Yes

**Spousal contributions allowed/income attribution to spouse**:
Non-registered: Yes / attribution applies
RRSP: Yes / attribution may apply on withdrawal
TFSA: Yes / no income attribution
RESP: N/A

**Best for:**
Non-registered: When contributions to registered accounts are maximized
RRSP: Higher income in year of contribution than when withdrawn; tax-effective funding for retirement
TFSA: When flexibility required as funds withdrawn can be re-contributed in a subsequent year; source of emergency funds
RESP: If children to attend post-secondary education

You should consult with your tax advisor to determine the best account for you to contribute to.

# The IRS Wields the Sword but Promotes Voluntary Disclosures

*Geoffrey A. Brookes, CA, Senior Partner, Pope & Brookes LLP, Chartered Accountants, Winnipeg, MB, DFK Affiliate Firm*

U.S. citizens living in Canada are required to file U.S. tax returns, even if all of their income is from Canadian sources. There are significant penalties for those who do not report to the IRS.

In many cases, the U.S. tax will be reduced by either the “foreign earned income” exclusion from taxable income ($99,200 for 2014), or by the “foreign tax credit” (for Canadian taxes paid on Canadian source income). Often, the U.S. tax is reduced to zero by these deductions and credits. However, U.S. tax might still be owed in some cases, if:

- U.S. minimum tax applies;
- Canadian taxes were significantly reduced by:
  - RRSP deductions
  - Canadian capital gains “exemptions”
  - Dividend tax credits
  - Tax shelter investments
  - Low provincial tax rates, e.g. Alberta
- Differences arise between Canadian and U.S. tax treatment for various types of income or deductions.

Just as importantly, there are many disclosure forms required in U.S. tax filings. Failure to file these forms with the IRS can result in severe penalties, even if there is no unreported income or tax on the U.S. 1040 tax return itself!

A leading example of a U.S. disclosure requirement is form FinCEN 114 (formerly known as the “Foreign Bank Account Reporting”, or “FBAR”). This form must be filed if the total of all non U.S. financial accounts exceeds $10,000 USD (including bank accounts, GICs, securities portfolios, RRSPs, RRIFs, and other Canadian tax-deferred accounts). For this purpose, each account is valued at its highest dollar value at any time in the year, and all of the highest balances are totalled together. The penalty for failure to file is $10,000 USD per account, per year of non-filing. The penalties are much higher where the failure is “wilful”.

Any U.S. citizen who is not completely compliant with all of the IRS filings (including the many disclosure forms) should take immediate steps to deal with these issues.

For the first time, Canadian financial institutions will be reporting U.S. citizens’ banking and investment information to the IRS, through Canada Revenue Agency, with some limited exceptions. This will be reported imminently with respect to the 2014 calendar year. The buzzword for this reporting program is “FATCA” (“Foreign Account Tax Compliance Act”).

For a few years now, the IRS has offered a series of voluntary disclosure programs for non-filing U.S. citizens. These were adjusted most recently on July 1, 2014.

However, the voluntary disclosure is only applicable if the taxpayer comes forward voluntarily – i.e., before the IRS contacts them. If the taxpayer receives a letter from the IRS (for example, based on information received from a Canadian bank), then it might not be possible to take advantage of the IRS voluntary disclosure programs and the full penalties may be applicable!

There is more than one type of IRS voluntary disclosure program. The choice between these programs requires serious consideration. Once a particular program is chosen, the IRS will no longer allow the taxpayer to switch between the different alternatives for submissions after June 30, 2014.

U.S. citizens living in Canada are strongly encouraged to obtain professional advice regarding these alternatives and to proceed expeditiously while the disclosure is still considered voluntary.

## Canada Job Grant

*Lisa Lawrence, Director of Human Resources, Ginsberg Gluzman Fage & Levitz, LLP, Chartered Accountants, Ottawa, ON, DFK Affiliate*


The Canada Job Grant is a federal government program designed to assist employers offset the costs of training new or existing employees, and could benefit businesses and industries across Canada.

We never know how long grants like this will last, so determine if this is of interest to you or your clients and take advantage of it now while there is a pool of money available for training.

The Canada Job Grant offers eligible employers up to $10,000 to help cover the costs of job training. Employers are required to contribute one-third of the training costs.

As an HR director, I understand the steep cost associated with training employees to meet today's business standards. The Canada Job Grant could help alleviate stretched training budgets.

I also understand the challenges of meeting training needs, retaining staff, and making a profit. The Canada Jobs Grant may be an innovative way to enhance training initiatives for employees to grow their skill-sets and improve the business's day-to-day operations and bottom line.

To learn more about the Canada Job Grant in your province or territory, visit http://actionplan.gc.ca/en/initiative/canada-job-grant.