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Accounting and Tax Made Simple!

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Tax Tips & Traps

2015 Second Quarter

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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...

- An employee or self-employed person meeting the requirements to claim a deduction for a workspace in their home could include space used to store inventory, as well as space used for the more traditional office in the home, as part of their workspace in their home.
- Closely related corporations and Canadian partnerships may elect to treat the provision of certain intercompany taxable supplies as having been made for no consideration, so no GST/HST is payable on these transactions.
- Canadians are now able to purchase beer and spirits in provinces where they don't live and bring them home for personal use.

Contact us if you have questions or wish to discuss!

OWNER-MANAGED BUSINESS TRANSITIONS: Planning in Advance

Statistics Canada has noted that by 2020 close to 350,000 business owners will be aged over 55 and that within the next 8 years approximately 550,000 business owners will exit their business.

For **business owners** moving to retirement and transitioning their business, there are **three major options** for succession:

- transition **ownership within the family**;
- **sell** the business to an **unrelated party**; and,
- cease operations and **sell off any assets available**.

In order to successfully transition the business, owners should clearly outline their **objectives**, determine what the business is **worth**, identify likely **successors**, and understand the **legal and tax** implications of the transition.

To increase the **possibility** and **value** of a sale, there are several actions that the owner may take. For example, owners should understand that the business may be viewed as a **bundle of assets**, some of which may, and others that may not, be desired by a purchaser. As such, reorganizing the **ownership of assets** in advance may be warranted.

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Action Item: If you are considering transitioning your business in the short or medium term, contact us. Early planning can help build value in the business, save significant dollars, and ease the transition challenges.

LOANS FOR VALUE: Income Splitting Opportunity

Loans from a higher income family member to a lower income family member can be an effective approach to enable **income splitting**. Lower income family members often include **spouses, minor children, or grandchildren**.

This planning technique generally **requires a loan** to bear **interest** at no less than CRA's **prescribed rate** at the time it is advanced. The lower income family member can then invest the amounts received, earn income on it, and pay tax at their lower marginal tax rate. Interest must be paid on the loan (by a particular date) between the family members or the strategy will not work.

The prescribed rate will **remain at 1%** until at least **June 30, 2015**.

Action Item: Proper execution of this type of strategy requires careful planning – contact us if you wish to investigate.

DAY TRADING IN AN RRSP, RRIF OR TFSA: Could it be Business Income?

Normally, earnings from within an RRSP, RRIF, or TFSA are tax-free. However, CRA believes that **speculative activities** within these types of accounts can constitute a **business activity**. Profits of a business carried on within these plans are **not exempt from tax**, unlike the regular income and capital gains from investment activities.

It also appears that individuals with **large balances** in their TFSAs may have been targeted by CRA. CRA has argued that, in some cases, the frequency of trades indicate that the taxpayer is running a **trading business**, and, therefore, the earnings are taxable as **business income**.

In one case, an investor increased the value of his TFSA to \$180,000 via approximately 200 trades. CRA assessed the gains as taxable.

Action Item: Caution should be afforded to individuals who may appear to be day trading or otherwise earning business income in certain registered accounts.

FAMILY TAX CUT: Joint Custody, GST/HST Credit, and Withholding Tax

There are still considerable questions and uncertainties with respect to the new **Family Tax Cut**. This credit is generally available for **families** who have a **child under 18 years of age** at the end of the year (other criteria must be met as well).

Claiming this tax credit will **not impact** a taxpayer's actual **net income** or taxable income – it is simply a **reduction of taxes** (tax credit) which mimics the effect of a transfer of up to \$50,000 of taxable income between spouses or common-law partners, to **save up to a maximum of \$2,000** in tax.

Because the actual net and taxable income does not change, the **GST/HST Credit**, Canada Child Tax Benefit (**CCTB**), and **other** federal or provincial benefits and tax credits will **not change** either.

To take advantage of the credit, taxpayers must have **advised CRA** about **children** they have. If not already done, this can be accomplished by completing CRA's **Form RC66**.

Action Item: Ensure that CRA knows about your children.

FOREIGN REPORTING: Warning Letters Sent Out

Recently, **CRA** began sending **letters** to some Canadians **strongly suggesting** that they **review** their income tax filing to ensure that any **foreign income and gains** have been properly **reported** and that proper Forms have been **filed**.

The letter is signed by the Manager of the CRA **Offshore Compliance Section** (OCS). It was recently noted by a large Law Firm in Canada that these letters are being sent to **individuals identified** as being **"high risk"** for **noncompliance** in respect of reporting foreign assets or income. The letter notes the potential for **gross negligence** penalties, and even **criminal prosecution**, where offshore assets or income are not reported and suggests **using the Voluntary Disclosure** process to avoid criminal charges or civil penalties.

Action Item: Call us if you receive one of these letters.

U.S. PERSONS IN CANADA: Potential U.S. Tax on House Sales

The **sale of a principal residence** could lead to major tax bills for Americans in Canada. This is especially true for those that have held their homes for long periods or those that live in high house value markets.

For U.S. purposes, the first **\$250,000 of a gain may be exempt**. This may be increased to \$500,000 depending on the residency/citizenship status of the spouse. Gains above these thresholds may be subject to **tax at, for example, 20%**.

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Even if there is no change in **value** of the **property** in Canadian dollars, gains in U.S. dollars may occur as a result of the **appreciation** of the Canadian **dollar**. For U.S. tax purposes, the cost and selling price must be measured in U.S. dollars at the point when the transactions occurred. For example, if a home cost \$1,000,000 CDN when \$1.00 CDN was worth \$0.65 U.S., the cost would be \$650,000 U.S. If it were sold for the same CDN dollar amount 10 years later when the exchange rate was par, the proceeds (selling price) would be \$1,000,000 U.S., leaving the taxpayer with a \$350,000 U.S. gain for tax purposes.

In Canada, gains on a **principal residence**, if all criteria are met, do not create a tax liability. Therefore, there is **no Canadian tax paid** with which to **reduce U.S. tax** liabilities via a foreign tax credit.

As reported in a January 22, 2015 Telegraph article, **New York born Mayor of London, England**, Boris Johnson, was **caught** by this rule and was required to pay an estimated **£100,000 tax debt** ahead of an upcoming business development trip to the U.S. Mr. Johnson has since stated that he intends to **renounce** his American citizenship.

Action Item: *There can be significant tax issues for Americans in Canada. Ensure to inform us if you are an American, or potentially could be an American (e.g. you or your parents were born in the U.S.).*

GST/HST COLLECTED IN ERROR ON NATUROPATHIC SERVICES: What to Do Now?

The 2014 Federal Budget added **naturopaths** and **acupuncturists** to the list of **exempt health care** providers effective for supplies made after **February 11, 2014**. However, Bill C-31 containing this provision did not receive **Royal Assent** until **June 19, 2014**. As such, many naturopaths and acupuncturists may have collected GST/HST in error until June 19, 2014 and perhaps even after this date if they were not aware of the change.

The **Canadian Association of Naturopathic Doctors (CAND)** released GST/HST Exemption Update 8 – GST/HST Collected in Error, which discusses **two options** naturopathic doctors can take if they incorrectly collected GST/HST on their exempt services:

- **Refund or credit** the amount to the patient.
- **Advise the patient** that they can claim a rebate of the GST/HST paid from CRA on **Form GST189**.

Additional details on both of these options can be found in the Update.

Action Item: *If you have incorrectly paid GST/HST on exempt naturopath or acupuncturist services, consider applying for a rebate with CRA.*

DIRECT DEPOSIT: No More Government Cheques?

CRA has indicated that it is attempting to minimize the amount of cheques issued and, instead, **encourages** people to receive **payments** via **direct deposit**.

CRA stated that when a taxpayer registers for direct deposit, the taxpayer is **not authorizing** CRA to withdraw money from their bank account. CRA can **only withdraw money** from a taxpayer's account when a **garnishment** (legal procedure) is in place.

Registering to receive payments via **direct deposit** can be done by mail (by filling out the Direct Deposit Enrolment Form), online (by using My Account), or by phone (1-800-959-8281).

Businesses can sign up for direct deposit by filling out Form **RC366, Direct Deposit Request for Businesses**, and then mailing it to a Tax Centre.

Action Item: *Consider enrolling for direct deposit to receive Government payments, including personal and corporate tax refunds.*

TAX SCAMS: Caution!

On January 25, 2015, CRA updated their webpage entitled "**Beware of Fraudulent Communications**" to indicate that they have become aware of a **new scam** involving **email money transfers**. CRA notes that they send payments only by direct deposit or cheque and never by email money transfer.

The reminder also notes that **CRA does not:**

- **request personal information** of any kind from a taxpayer by **email**;
- **divulge taxpayer information** to another person **without formal authorization**; and,
- **leave personal information** on an **answering machine**.

The page also contains links to examples of fraudulent letters, emails and online refund forms.

Action Item: *Stay vigilant for potential scams. Contact us if you receive a communication (telephone, email or other) from someone who claims to be a CRA agent before responding or giving any personal details.*

GET CYBERSAFE: Protect your Business and Self

With the growing number of high profile cyber-attacks, now may be the time to review **cyber security risks**. The Federal Government website, **www.getcybersafe.gc.ca/** is a great resource for understanding such risks and the actions one may take to mitigate them.

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The website identifies **major risk areas** such as **banking and finance**, **email**, **social networking**, **downloading and file sharing**, and **online shopping**.

It also contains various publications such as a **Guide for Small and Medium Business** which provides practical advice on how to better **protect businesses** and their **employees** from cybercrime.

Beyond the business sphere, the site also provides a resource on **cyber bullying** for parents and teens.

Action Item: Review your business and personal cyber risks.

The preceding information is for educational purposes only. As it is impossible to include all situations, circumstances and exceptions in a newsletter such as this, a further review should be done by a qualified professional.

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For any questions... give us a call.

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