# BBLLP Tax Tips

BBLLP Tax Tips is a quarterly publication designed to provide general information about significant tax news and updates. You can find all editions of this publication on our website located here.

## Enhancing the Value of Owner-Managed Business: Starting the Transition Ear

Many owner-managers are shocked at both the **difficulties** in **finding a buyer** for their business and the **low prices** an owner-managed business often commands.

A recent Intelligent Work article (How Does 10x-ing Value Work in an Owner-Managed Business?, John Mill) discussed guidance provided to **Harvard MBA** students regarding investing in **owner-managed businesses**. That guidance included the reality that these businesses with earnings between $750,000 and $2 million tend to be priced at **3x to 5x earnings before interest, taxes, depreciation and amortization** (EBITDA), as compared to **6x to 12x earnings** for larger companies with EBITDA of more than $5 million. In addition, most **owner-managers** are **forced to sell** due to **age or health** issues and such **distress sales** generally result in **lower multiples**.

Often, **investors do not** want to be **owner-managers**, and as such, will **employ** another individual to run the business. This further reduces the value of owner-dependent businesses.

Some strategies to **grow the value** by focusing on the **qualities** that **command higher multiples** include the following:

- competent **management** that is not **owner-dependent**;
- lean **systems**;
- engaged **employees**; and
- a solid **track record** of **EBITDA growth**.

The article suggested a **10-year track record** of **18% EBITDA growth** (an average for the successful expanding of small businesses) as an appropriate target.

***ACTION ITEM: Starting the discussion on how to maintain and enhance the value of an owner-managed business should be commenced many years before the anticipated sale or transition.***

## Salaries to Family Members: Amounts Paid Must be Traceable

Oftentimes, **family members** of the owner of a business will **work for the business**. However, these arrangements can be somewhat informal, and amounts paid may be **denied as a business expense** if the work performed and amounts paid to the worker are **not properly documented**.

A June 10, 2021 **Court of Quebec** case provides one such example of this issue. An individual (P) owned and operated a corporation (Pco) that provided trucking services. Pco **deducted** $46,000 over three years for amounts **paid to P's father-in-law and mother-in-law** for filing and driving services. Pco also deducted approximately $11,000 over two years for **payments to P's spouse** for filing services. P was assessed with income on all of these amounts.

The Court reviewed whether Pco actually paid the amounts to the family members.

**Taxpayer loses**

The taxpayer argued that, while P's **father-in-law and mother-in-law never cashed the cheques** provided by Pco, these payments represented their contributions to household expenses. However, the Court found that the **amounts were never paid**.

All payments to P's spouse were made **to a joint bank account** with P, but the payments **did not** specifically **correspond** with the amounts P's spouse was allegedly paid for her services. P argued that funds from the joint account (reflecting her compensation) were used to pay off P's spouse's credit card bills. Again, the Court found that **no payments** were actually **made to P's spouse**.

The Court noted that it believed **P's spouse did provide services** and that the result would have been **different if** the bank statements had shown **amounts paid directly** to her for her services.

As no payments were determined to have been made to P's spouse or his in-laws, **no amounts were permitted to be deducted**. Further, the Court determined that these assessments could be made



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**outside the normal reassessment period** and that the assessed **gross negligence penalties** were justified.

***ACTION ITEM: Family members should be paid for work done for the business in the same manner as other non-family members.***

## Providing Supplies to Your Contractors: GST/HST Issues

In a July 29, 2021 **Tax Court of Canada** case, a **trucking company** (the taxpayer) engaged the services of a number of **drivers** as **independent contractors** (ICs). The taxpayer **provided** the **vehicles** along with a **fuel card** (that would cover all fueling costs). However, since the contract stipulated that the ICs were responsible for the fuel, **payouts to the ICs** were **reduced** by 76 cents/km **for fuel**. These were referred to as **chargebacks**. CRA had assessed the taxpayer with HST of **13% on all** of the chargebacks (amounting to over $118,000 over a 30-month period), arguing that they were taxable supplies (in Ontario).

**Taxpayer loses – no fuel was received**
Since the taxpayer **never physically received** the fuel, the taxpayer argued that it **never** actually **provided a supply** (or resupply) to the ICs. However, the Court determined that the taxpayer was considered the **original recipient** because the taxpayer was **liable for** the payment of the **fuel** card debts. The taxpayer then would have been considered to **immediately resupply** the fuel to the ICs in exchange for chargebacks reconciled at the completion of the delivery.

Further, the Court determined that the taxpayer was **not acting as an agent for the ICs** since it was in the taxpayer's best interest to ensure that fuel could always be purchased seamlessly (i.e. without the possibility of interrupting the delivery due to an IC's financial difficulty), and the independent contractor **agreement was clear** that the parties were **separate and not acting in an agency** arrangement.

**Taxpayer wins – place of supply**
CRA had assessed on the basis that the **resupply of fuel** to the ICs occurred at the taxpayer's office in **Ontario**, the place from which the **payments were made** and reconciled. However, the Court found that the supply was actually provided in the place where the **fuel was purchased and inserted**. Since **69% of the fueling costs** related to expenditures **outside of Canada**, the Court found that the **same percentage** of total chargebacks was **not taxable supplies**. The GST/HST to be charged on resupply was reduced by this amount.

The Court also noted that some of the fuel costs were also likely incurred **within Canada** but **outside of Ontario**, meaning that the GST/HST charged in some cases would likely **vary from the 13% assessed**.

**Audit triggered by inaccurate bookkeeping**
The fuel and maintenance chargebacks had been **originally incorrectly coded** in the accounting records as **payments for "rental"** of the taxpayer's trucks to the ICs. As trucks supplied in Ontario by rental likely would have been subject to a full 13% HST charge, one can understand where CRA's position may have originated. The clarification occurred at the notice of objection phase. Had the chargebacks been correctly coded from the beginning, some of the problems and dispute costs may have been avoided.

***ACTION ITEM: The details of supply agreements to contractors should be reviewed to determine if GST/HST should be charged. Also, if uncertain how to code an item for bookkeeping purposes, seek guidance from an accounting professional as incorrect treatment may trigger an audit.***

## Director Liability: Properly Resigning

Directors can be **personally liable** for unremitted employee **source deductions** and **GST/HST** unless they exercise **due diligence** to **prevent failure to remit** these amounts on a timely basis. CRA cannot personally assess the director more than **two years** after the individual properly **resigns** as a director.

In an August 11, 2021 **Tax Court of Canada** case, the Court reviewed **whether** the individual **properly resigned** as a **director**. CRA assessed the taxpayer as a director personally for $305,390 of **unremitted source withholdings** for the 2008 to 2014 years on the basis that he never properly resigned.

The taxpayer was appointed as a director in 1999 at the commencement of his employment as a programmer. In 2011, the taxpayer sent an **email resigning his employment** to the **corporation's owner**, followed by a phone call. The **taxpayer provided nothing in writing** to the corporation (as a legal entity separate from its owner). The taxpayer asserted that as the assessment was issued in

2016, more than two years after he allegedly resigned as a director, the assessment should be vacated.

**Taxpayer loses – resignation**
In referencing the **Ontario Corporations Business Act**, the Court reiterated that the **resignation** of a **director** is **effective** at the time a **written resignation** is **received by** the **corporation** or at a time specified in the resignation. As no written resignation of his position as a director was sent by the taxpayer or received by the corporation, the Court ruled that the **taxpayer had not resigned**. In other words, as the taxpayer was both an employee and a director, resigning as an employee was not automatically a resignation as a director.

**Taxpayer wins – CRA's assessment**
After reviewing testimony and various documents, the Court found that the **underlying assessment was overstated**. As the Court did not have evidence to reduce the assessment to the proper amount, the **appeal was allowed** in full.

While this was an Ontario case, similar rules regarding resigning as a director exist in other jurisdictions.

***ACTION ITEM: If you intend to resign as a director, ensure that the resignation of yourself as a director is received by the corporation.***

## Life Insurance Policies: Using Tracking Shares

When a shareholder **passes away**, their shares are **deemed** to be **disposed** of at **fair market value** (FMV) unless a tax-free rollover is available and used. This can cause a **tax liability** at a time when no cash is available. Holding a **life insurance policy** in the corporation in respect of the owner-manager can fund these tax liabilities or provide cash to buy out the shares from the estate.

In some cases, **whole-life insurance policies** are used as tax-sheltered **investment tools**. However, a **problem** may arise in that the **FMV** of the insurance policy is deemed to be its **cash surrender value** (CSV) for the purpose of determining the FMV of the shares of the corporation. In other words, obtaining such a policy potentially **increases the gain** experienced on the shares upon deemed disposition at death. Also, the insurance proceeds may not go to the desired party.

**Insurance tracking shares** can be used to address these issues. They are essentially shares whose **value is directly attached to a policy's** CSV, death benefit, or both. They can be issued as preferred shares **without access** to **voting rights**, **dividends from business profits**, or participation in **value growth** of the rest of the business. If obtained at the initiation of the life insurance policy, the shares can be **purchased for nominal consideration** because the FMV of the policy should also be nominal. The insurance tracking shares could be redeemed after death, with the related dividend being tax-free by using the increased capital dividend account from the payout of the insurance policy.

As the policy increases in value due to the investments, so do the tracking shares, which would be held by the specific parties intended to benefit from the increases, such as the individual's children. Two May 19, 2021 **Technical Interpretations** confirmed CRA's 2005 position that the **CSV** would be **allocated** between the common shares and the insurance tracking shares based on the **rights and attributes of each class**, using the same valuation principles that would guide the allocation of the value of other corporate assets.

If done correctly, the **proceeds** of the **common shares** on death would **not be affected** by the increase in **insurance policy** value. However, it is important to note that a **specialist should be used** in setting up these shares as significant precision in the share attributes is required to ensure that it functions as intended.

***ACTION ITEM: Holding a life insurance policy in a corporation can be a useful tool to assist with continuity upon death of an owner-manager. The use of insurance tracking shares can mitigate increases in capital gains upon death when using such policies.***

## Holding Digital Assets in RRSPs: Pitfalls and Possibilities

Recently, individuals have become more interested in investing in digital assets such as **cryptocurrencies** (Bitcoin, Ethereum, Dash etc.); cryptocurrency **liquidity mining and yield farming**; and **non-fungible tokens** (NFTs). The next question often asked is whether such items can be held in tax-advantaged accounts such as an RRSP.

An RRSP's **tax-preferred treatment** only extends to **"qualified investments."** Broadly speaking, **qualified investments** only include **money** and **securities** that are listed **on a designated stock**

**exchange**. As such, **digital assets** like **cryptocurrencies and NFTs** are **not qualified investments**, so they cannot be held in an RRSP.

However, the investment market has seen a recent surge in **cryptocurrency-based exchange-traded funds** (ETFs). Many of these are **traded on designated stock exchanges**, so these cryptocurrency ETFs may be **qualified investments**. A September 20, 2021 Walletbliss article (**Best Crypto ETFs in Canada (2021): Cryptocurrency For All**, Simon Ikuseru) lists Canadian Bitcoin and Ethereum ETFs noted as being eligible RRSP and TFSA investments.

Caution must be afforded as a **penalty tax** applies if the RRSP acquires a **non-qualified investment**, with the penalty tax equal to **50% of the fair market value** of that investment. In addition, the **RRSP** is **taxable** on any **income** from the non-qualified investment and on any **capital gain** (not the normal 50% taxable capital gain) from disposing of the non-qualified investment.

***ACTION ITEM: If interested in holding digital assets in a tax-sheltered savings account such as an RRSP, make sure that item is a qualified investment.***

## Withdrawing From Family RESPs: Flexible Planning Possibilities

A July 21, 2021 Money Sense article (My three kids chose different educational paths. How do I withdraw RESP funds in a way that's fair to them and avoids unnecessary taxes?, Allan Norman) considered some **possibilities and strategies** to discuss when **withdrawing funds** from a **single RESP** when children have **different financial needs** for their education. Some of the key points included the following:

- There is likely a **minimum educational assistance payment** (EAP) **withdrawal** that should be taken, even by the child that needs it least.
- The **EAP includes government grants** (up to $7,200) **and** accumulated investment **earnings** on both the grants and taxpayer contributions.
- The **grants can be shared**, but only **up to $7,200** can be received **per child**, with unused amounts required to be returned to the government.
- Only **$5,000 in EAPs** can be **withdrawn** in the **first 13 weeks** of consecutive enrollment.
- The **withdrawal amount** is **not restricted by school costs**.
- The **children** are **taxed on EAP withdrawals**.
- It is generally **best to start withdrawing the EAP** amounts as **early** in the child's enrollment as possible, when the child's taxable **income is lowest**. If the child is expected to experience lower income in later years, there is flexibility to withdraw EAP amounts in those later years instead.
- The **level of EAP withdrawn** for each child **can be adjusted**. As individuals are taxed on the EAP withdrawals, planning should consider the children's other expected income (e.g. targeting less EAPs for years in which they will be working, perhaps due to co-op programs or graduation). Consider having the **EAP completely withdrawn** before the year of the **last spring semester** as the child will likely have a higher income as they start to work later in the year.
- To the extent that **investment earnings remain** after all EAP withdrawals for the children are complete, the **excess can be received by the subscriber**. However, these amounts are not only taxable, but are subject to an **additional 20% tax**. Alternatively, up to $50,000 in withdrawals can also be **transferred to the RESP subscriber's RRSP** (if sufficient RRSP contribution room is available), thus eliminating the additional 20% tax. An immediate decision is not necessary as the funds can be retained in the RESP until the 36th year after it was opened.

***ACTION ITEM: The type, timing, and amount of RESP withdrawals can significantly impact overall levels of taxation. Where an RESP is held for multiple children, greater flexibility exists. Consult a specialist to determine what should be withdrawn, at what time, and by whom.***

## Workspace in Home Claims: CRA Reviews

For the 2020 year, many employees were **required to work from home** due to the COVID-19 pandemic. Those employees generally had two deduction possibilities: using the **flat method** of claiming $2/day the individual worked from home, or doing a **detailed calculation** to claim the actual costs associated with working from home. While the first option was only a temporary relieving measure for the 2020 year, the Liberal election platform promised to extend access to this deduction for the 2021 and 2022 years.

In the summer of 2021, CRA started to **review these claims**. A tax journalist from the Financial post, was one of the individuals selected for review. He discussed his experiences in an August 5, 2021 article (What you need to know if the **CRA reviews**

your **home office expense** claims, Jamie Golombek). The author had used the detailed method to claim **actual workspace in home expenses** and was asked to provide (among other items):

- an employer-signed **Form T2200** and a **Form T777** setting out the claims;
- receipts and **supporting documents**, noting that credit card statements, bank statements, or cheques would not be sufficient support;
- for the **workspace** itself, the **calculation details** for the percentage claimed, including **space used** for employment and personal purposes and a copy of the **floor plan of the residence** with the **home office**; and
- for **cell phone expenses**, CRA requested copies of the **mobile contract**, monthly **account summaries**, proof of payment, and a **breakdown** of the **minutes and data** used to earn employment income.

Similar to other deductions against income, not all claims are reviewed; nonetheless, taxpayers should be prepared to provide this level and type of detailed support.

Also, in a **Technical Interpretation**, CRA confirmed that the **temporary flat-rate** claim of $2 per day (maximum $400) can be deducted by **adult children** living at home provided that they **contribute** towards the **payment** of eligible **home office expenses** and meet the relevant eligibility criteria.

***ACTION ITEM: Be prepared to provide detailed supporting documentation for workspace in home claims made under the detailed method.***