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Owner-Managers — 2022 Year-End Tax Planning Tips

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As the owner-manager of your company, it's a good time to take stock of your tax situation, as the end of 2022 approaches. A careful review can help ensure that you are receiving distributions from your company in a tax-efficient manner, and that you are meeting your small business tax obligations. This year, the federal government introduced several new and complex tax rules that could affect your company in the near future, such as the new mandatory disclosure rules, and in some cases, the new excessive interest and financing expenses limitation (EIFEL) rules. Even though they have not yet been enacted, you should take this time to consider whether these rules will apply to you to ensure that you are ready for when they come into effect.

Remember, the tax rules affecting small businesses are complex and can have far-reaching effects on you, your family and your private company. As a result, we recommend you meet with your KPMG Enterprise Tax Adviser as soon as possible—well before the end of the year—to review your tax situation.

Year-end planning checklist

You can use this checklist to help you assess your 2022 tax situation and plan ahead for 2023. This checklist provides important questions and tips to consider when evaluating your compensation, as well as family and business tax considerations, among others. While these tips assume your company has a December 31 year-end, you can still use most of these ideas to improve your overall tax position whenever your company's year-end comes up.

Checklist — Top tax issues to consider before 2023

Key tax changes – 2022 and beyond

- ✓ Will you have to report any “notifiable transactions”, “reportable transactions” or “uncertain tax treatments” under the new mandatory disclosure rules?
- ✓ Is your company a non-CCPC that is subject to the new substantive CCPC rules?
- ✓ Does your company earn investment income through a CFA?
- ✓ Will the small business deduction be available to your company based on the expanded taxable capital range?
- ✓ Do you qualify for the temporary tax rate reduction for zero-emission technology manufacturers?
- ✓ Will your company’s interest and financing expenses deduction be limited by the new EIFEL rules?

Your compensation

- ✓ Do you have an effective dividend/salary mix?
- ✓ Should you accrue your salary or bonus?
- ✓ Should you pay dividends in 2022 or 2023?

Your family

- ✓ Should you hire a family member?
- ✓ Are distributions from your company subject to TOSI?
- ✓ Should you lock in an income splitting loan to a family member or family trust?
- ✓ Have you reviewed your business succession plan?

Your business

- ✓ Have you calculated “safe income” before paying inter-corporate dividends?
- ✓ Are you required to reduce your company’s small business deduction?
- ✓ Are you properly timing the purchase and sale of depreciable assets?
- ✓ Should you repay shareholder loans?
- ✓ Have you applied for apprentice and co-op tax credits?
- ✓ Has your company made CPP and EI overpayments?
- ✓ Can you reduce the taxable benefit on your company car?
- ✓ Should you sell investments with unrealized capital losses/gains?
- ✓ Do you operate a professional practice that has work in progress?

Your estate

- ✓ Have you reviewed your will?

Other planning opportunities

- ✓ Have you made a charitable donation?
- ✓ Have you considered other tax planning opportunities?

Key tax changes – 2022 and beyond

Will you have to report any "notifiable transactions", "reportable transactions" or "uncertain tax treatments" under the new mandatory disclosure rules?

You may be required to report certain transactions in 2023, under the proposed new mandatory disclosure rules. Specifically, if you or your company undertakes transactions that are considered "notifiable transactions" or "reportable transactions" under the new rules, you must generally report these transactions to the CRA within 45 days of the transaction date. Notifiable transactions are generally transactions that the CRA has identified as abusive or potentially abusive. For example, you may be required to disclose information about a transaction to transfer trust property to beneficiaries on a tax-deferred basis before a trust's 21st anniversary. Reportable transactions are generally transactions that include contingent fees, or certain confidential or contractual protections, where it can reasonably be considered that one of the main purposes of entering into the transaction is to obtain a tax benefit.

In addition, if your company has at least $50 million in assets at the end of the year, you must generally report any "uncertain tax treatments" reflected in your company's 2023 audited financial statements, prepared in accordance with International Financial Reporting Standards (IFRS) or other country-specific generally accepted accounting principles (GAAP) relevant for companies listed on a stock exchange outside Canada (e.g., U.S. GAAP). The rules require you to report uncertain tax treatments to the CRA by the filing-due date for your company's corporate income tax return.

Keep in mind that there are significant penalties and consequences for failing to report a notifiable transaction, reportable transaction or an uncertain tax treatment to the CRA. See *TaxNewsFlash-Canada* 22-48, "Highlights of the 2022 Federal Fall Economic Update" and *TaxNewsFlash-Canada* 22-43, "Prepare Now for Upcoming Mandatory Disclosure Rules" for more details on the new mandatory disclosure rules (which are not yet enacted).

Is your company a non-CCPC that is subject to the new substantive CCPC rules?

If your company is not a Canadian-controlled private corporation (CCPC), it may be affected by the proposed new substantive CCPC rules in 2022. These rules provide that a private corporation resident in Canada, that is not a CCPC, but is factually or legally controlled by Canadian resident individuals is generally subject to the same tax on investment income as CCPCs. For more information on the substantive CCPC rules (which are not yet enacted), see *TaxNewsFlash-Canada* 22-24, "2022 Federal Budget Highlights".

Does your company earn investment income through a CFA?

If your company earns investment income through a controlled foreign affiliate (CFA), you should be aware that the tax deferral you and your company may have previously enjoyed may no longer be available in 2023. For more information on the proposed elimination of the tax deferral using CFAs (which is not yet enacted), see *TaxNewsFlash-Canada* 22-24, "2022 Federal Budget Highlights".

Will the small business deduction be available to your company based on the expanded taxable capital range?

Your company may be able to benefit from the small business deduction in 2023, where it did not previously qualify. The government has introduced an expanded taxable capital range of $10 million to $50 million (instead of $10 million to $15 million), which will be used to reduce your company's small business deduction. For more information on the expanded taxable capital range (which is expected to be enacted soon, and apply to taxation years beginning on or after April 7, 2022), see *TaxNewsFlash-Canada* 22-24, "2022 Federal Budget Highlights" and *TaxNewsNow*, "Federal budget bill #2 receives first reading". Note that we discuss the reduction of the small business deduction in more detail below.

Do you qualify for the temporary tax rate reduction for zero-emission technology manufacturers?

If your company is a zero-emission technology manufacturer, you should consider whether you qualify for a reduced small business tax rate of 4.5% (instead of 9%) or general corporate tax rate of 7.5% (instead of 15%) on eligible zero-emission technology manufacturing profits. The reduced tax rates apply to taxation years beginning on or after January 1, 2022. The reduced rates will gradually be phased out starting in taxation years that begin in 2029, and will be fully phased out for taxation years that begin after 2031.

Will your company's interest and financing expenses deduction be limited by the new EIFEL rules?

Your company may be affected by the proposed new EIFEL rules, which limit the amount of interest and other financing expenses that certain corporations and trusts may deduct on their income tax return. Finance recently released a revised version of these proposals, which narrows their applicability in some cases, provides new rules to address foreign affiliates, and delays their implementation date to taxation years beginning on or after October 1, 2023. Your adviser can help you determine whether these complex rules may affect you. For more information on the EIFEL rules (which are not yet enacted), see *TaxNewsFlash-Canada* 22-53, "Finance Revises Interest Expense Limitation Proposals".

Your compensation

Do you have an effective dividend/salary mix?

As the owner of an incorporated business, you can choose to receive corporate income as salary or dividends. To determine what's best for you in 2022, you should carefully analyze the ideal mix of dividends and salary for your particular situation. This depends on many factors, including:

- Your current and future cash flow needs
- Your desired income level
- The corporation's income level
- Whether the tax on split income (TOSI) rules affect you and your family

- Payroll taxes on salary.

You may want to consider paying yourself enough salary to allow the maximum possible contribution to your registered retirement savings plan (RRSP). The same goes for any family members you've employed. The maximum contribution amount is 18% of the previous year's earned income, up to a limit of $29,210 for 2022 and $30,780 for 2023. You will need about $171,000 in salary in 2022 to make the maximum RRSP contribution for 2023.

There are some other important considerations too. The TOSI rules, which subject individuals to the top marginal personal income tax rate, do not apply to salaries. However, salaries paid to family members must be reasonable in light of the services they perform for your company to receive a tax deduction. In addition, if you are in a volatile business that could easily suffer from an economic downturn, remember that paying out a large salary in a profitable year to reduce company income can take away your company's ability to carry back a later year's business loss to recover corporate taxes paid, if such a loss materializes.

Should you accrue your salary or bonus?

Once you decide on an appropriate salary or bonus for your company to pay you, consider accruing the salary or bonus in the business at year-end, but deferring your receipt of that amount until next year (i.e., up to 179 days after the company's year-end). Assuming a December 31 year-end, your company will get a deduction for the amount in 2022, and the related source deductions do not have to be remitted to the CRA until the salary or bonus is paid to you in 2023.

Should you pay dividends in 2022 or 2023?

When deciding whether you should pay dividends in 2022 or 2023, you typically need to consider relevant yearly tax rate changes as well as the acceleration or deferral of taxes. You will also need to factor in the possible impact of the TOSI rules. See the attached Appendix for the combined top marginal personal income tax rates on dividends for these years.

Keep in mind that there will be no tax savings from paying dividends to recover refundable dividend tax on hand where the combined top marginal personal income tax rate on dividends is higher than the 38.33% dividend refund rate.

Your family

Should you hire a family member?

If you have family members (e.g., a spouse or child) who provide services to your incorporated business, you may want to consider hiring them and paying them an appropriate salary. Your company will get a tax deduction for the salary paid, as long as the amounts are "reasonable". A salary is usually considered reasonable if the services are genuinely being provided and the salary is similar to a comparable market rate. If you are paying a salary to a family member, consider creating an employment contract or retaining documentation (e.g.,

time reports) to support their contributions to the business and the reasonableness of the salaries paid.

Note that the extra cost of any payroll taxes, including Canada Pension Plan (CPP) contributions and Employment Insurance (EI) premiums (where applicable), should be weighed against potential tax savings. On the other hand, the TOSI rules do not apply to salaries paid to family members and a salary may allow them to contribute to their RRSPs, as already noted.

Are distributions from your company subject to TOSI?

If you or a family member receive an amount from your company that is subject to TOSI, that person will be taxed at the top marginal personal income tax rate on that amount—even if you or that family member are not otherwise in that tax bracket. You and your family members may be subject to the TOSI rules when receiving amounts such as dividends or interest from your private company. The rules may also apply on certain capital gains from the disposition of shares or debts of your private company, or of an interest in a partnership or trust. Note that the only credits allowed against income subject to TOSI are the disability tax credit, the dividend tax credit and the foreign tax credit.

Determining whether TOSI applies to your particular situation requires a detailed analysis, as the rules are extremely complex and there are many potential exceptions. It's a good idea to consider professional advice on this matter.

Should you lock in an income splitting loan to a family member or family trust?

The CRA's current prescribed interest rate of 3% still offers an opportunity for you to lock in an income splitting loan arrangement with family members or a family trust on or before December 31, 2022. See *TaxNewsFlash-Canada* 22-52, "2022 Year-End Personal Tax Planning Tips" for details.

You should note that interest earned on income splitting loans between an individual (e.g., you or a family member) and your private company may be subject to the TOSI rules. Consider whether it makes sense to unwind such a loan, since the income earned from the loan may be taxed at the top marginal personal income tax rate (which would generally negate any tax benefits available from the loan).

Have you reviewed your business succession plan?

If you are thinking about passing your business down to your children or grandchildren, you may now qualify for a more favourable tax treatment. The government passed income tax relief intended to address the transfer of shares to corporations controlled by certain family members in June 2021. As the government is still consulting on potential further amendments to these new and complex rules, reach out to your KPMG Enterprise Tax Adviser to determine whether you may be eligible to benefit from them. For more details, see

TaxNewsFlash-Canada 22-24, "2022 Federal Budget Highlights" and *TaxNewsFlash-Canada* 21-41, "New Intergenerational Transfer Rules — More Changes Coming".

Your business

Have you calculated "safe income" before paying inter-corporate dividends?

If you pay inter-corporate dividends or redeem shares by distributing cash or assets through your corporate group (e.g., to provide cash flow for your holding company to pay you dividends), you should calculate "safe income" before paying such an inter-corporate dividend or redeeming shares. This is because certain tax-free inter-corporate dividends could be recharacterized as taxable capital gains under specific anti-avoidance tax rules. By calculating "safe income", you can determine if that dividend qualifies for the exception to the anti-avoidance rules for dividends paid out of a corporation's safe income.

Are you required to reduce your company's small business deduction?

Remember to review your corporate group's structure before claiming the small business deduction on your company's 2022 corporate income tax return, as there are complex rules that could limit your company's access to this deduction. Generally, your company's small business deduction is reduced by the greater of its taxable capital reduction and passive investment income reduction, which are determined as follows.

Under the taxable capital reduction, the small business deduction is reduced on a straight-line basis for companies within an associated group when the associated group's taxable capital employed in Canada in the preceding taxation year is between $10 million and $15 million. The small business deduction is completely eliminated where the associated group of companies' taxable capital is $15 million or more. This reduction applies in all provinces and territories. As previously noted, the upper end of the taxable capital range is proposed to increase to $50 million, for taxation years beginning on or after April 7, 2022.

Under the passive investment income reduction, the small business deduction is reduced on a straight-line basis for companies within an associated group when the associated group earns between $50,000 and $150,000 of passive investment income. The small business deduction is completely eliminated where the associated group of companies earns passive investment income of $150,000 or more. However, if your business is in Ontario or New Brunswick, these provinces have not harmonized with this federal measure, so the passive investment income reduction does not apply to reduce the Ontario or New Brunswick provincial small business deduction.

Your company's access to the small business deduction may also be restricted if its income is generated by providing property or services to another non-arm's length corporation.

Are you properly timing the purchase and sale of depreciable assets?

If you are thinking about selling a depreciable asset owned by your company that will be subject to recaptured depreciation, you may want to defer the sale until after your 2022

corporate year-end, as long as it makes sense for your business. That way, you'll be able to claim capital cost allowance (CCA) on the asset for one more year. You'll also defer any recapture arising from the sale until 2023.

On the other hand, if you're considering buying any depreciable assets, try to acquire them before your December 31 year-end. As long as you can actually put the asset to use in your business this year, acquiring the asset just before the company's year-end will accelerate the timing of your tax deduction—you'll be able to claim CCA on the asset for 2022 at half of the CCA rate otherwise allowable due to the “half-year” rule, or even an accelerated CCA rate in certain circumstances.

In addition, you should consider how acquisitions may be affected by the new rules on immediate expensing of eligible property for CCPCs. For example, you may want to take a closer look at the timing of acquiring eligible property given the annual limit under these rules, and identify which assets you want to depreciate under these rules in cases where you have a choice, among other considerations.

The new rules allow for the immediate expensing of certain properties acquired by a CCPC, up to a maximum of $1.5 million per taxation year. Eligible property includes any capital property subject to the CCA rules, except for property that would be included in Classes 1 to 6, 14.1, 17, 47, 49 and 51. Immediate expensing applies to eligible property acquired and available for use before 2024. For more details, see *TaxNewsFlash-Canada* 22-05, “Finance Issues Outstanding Interest Expense Rules & More” and *TaxNewsNow*, “2022 Federal Budget bill #1 now law”.

Should you repay shareholder loans?

If you borrow money from your corporation at low or no interest, you are generally considered to have received a taxable benefit from the corporation equal to the CRA's prescribed interest rate for the period the loan is outstanding, minus any interest you actually pay during the year or within 30 days after the end of the year. For 2022, the prescribed interest rate for this purpose has increased from 1% (for January 1, 2022 to June 30, 2022) to 2% (for July 1, 2022 to September 30, 2022) and to 3% (for October 1, 2022 to December 31, 2022). The prescribed interest rate is set to further increase to 4% on January 1, 2023. For details, see *TaxNewsNow*, “CRA prescribed rate continues to increase for Q1 2023”.

Unless the loan is for a limited number of qualified purposes, it will be included in your income for tax purposes in the year it was advanced, unless you repay it within one year after the end of the company’s taxation year in which the loan was made.

For example, if your company with a December 31 year-end loaned you funds on October 1, 2021, you must repay the loan by December 31, 2022. Otherwise, the loan will generally be considered income that is taxable in your 2021 personal income tax return (i.e., the year the funds were loaned to you).

Have you applied for apprentice and co-op tax credits?

If you claim federal or provincial tax credits for apprentices and co-op students you employ, you should review these credits to determine whether there have been any recent changes or enhancements. These credits, which can help boost your business' cash flow, vary by province, and can change from year to year. If you don't claim such credits, it's worth the time to check whether you qualify.

Don't forget to gather proper documentation to support your claim for these credits as soon as possible (e.g., apprenticeship training agreements) because it can be difficult to obtain them after apprentices leave your company. For assistance with these credits, contact the KPMG Tax Incentives group.

Has your company made CPP and EI overpayments?

As an employer, your company has until December 31, 2022 to file a refund application for CPP contributions overpaid in 2018, or for EI premiums overpaid in 2019 (i.e., no later than four years from the end of the year in which the CPP overpayment was made, and no later than three years from the end of the year in which the EI overpayment was made).

Can you reduce the taxable benefit for your company car?

If you drive a car that is owned or leased by your company, you might be able to reduce the taxable benefit for your use of the car in 2022. See *TaxNewsFlash-Canada* 22-52, "2022 Year-End Personal Tax Planning Tips" for details.

Should you sell investments with unrealized capital losses/gains?

If your company owns investments with unrealized capital losses, consider selling them before your company's year-end (but only after your company's capital dividend account has been paid out). This way, your company can realize the loss and apply it against any net capital gains your company realized during the taxation year, or in the past three taxation years. When selling these investments, remember that it's important to comply with special tax rules designed to stop the artificial creation of tax losses (e.g., the suspended loss rules). If you intend to do any last-minute 2022 trades, try to complete all trades on or before December 20, 2022 (assuming a calendar year-end for the company) and confirm the settlement date with your broker.

If your company has unused capital losses, consider whether it may be beneficial for your company to sell investments with unrealized capital gains now to use these losses and improve your cash flows. On the other hand, if your company is planning to sell investments with unrealized capital gains but has no capital losses to offset the capital gains, consider whether it may be beneficial for your company to sell those investments after your corporate year-end, so that your company will be taxed on the gains in a later taxation year instead of this year.

In each case, tax considerations should not override your investment decisions.

Do you operate a professional practice that has work in progress?

Designated professionals (i.e., accountants, dentists, lawyers, doctors, veterinarians or chiropractors) must include certain “in progress” amounts in their year-end business income. This amount is the lesser of either the cost of their work in progress or the fair market value of their to-be-completed work, subject to a five-year transitional relief period for tax years beginning after March 21, 2017.

Your KPMG Enterprise Tax Adviser can help you calculate the cost of work in progress, as it can be challenging to understand the five-year transitional relief mechanism.

Your estate

Have you reviewed your will?

If your family situation has changed (e.g., if there has been a marriage, divorce, birth, or disability) or if your estate plan includes a plan to create a trust to pass on your family business to family members, it’s a good time to review your will. You should make sure that your will planning is tax effective and achieves your intended probate fee objectives.

A review of your will can also help you determine whether the private company shares you leave to children (or other persons) will cause them to be caught under the TOSI rules.

Other planning opportunities

Have you made a charitable donation?

If your private corporation donates securities or other capital property, your corporation’s capital dividend account will be increased by the non-taxable portion of the capital gains. This amount can be paid out to you and other shareholders tax-free. For more about tax savings that are available to you when you donate to charities, see *TaxNewsFlash-Canada* 22-49, “Make the Most of Your 2022 Charitable Gifts”.

Have you considered other tax planning opportunities?

As an owner-manager you may also want to take stock of other opportunities to:

- Use realized non-capital losses to improve your cash flows
- Determine whether a family trust in your corporate structure could facilitate estate planning and achieve other tax and non-tax objectives
- Ensure your company is maintaining its status as a “qualified small business corporation”, especially in light of the TOSI and new intergenerational transfer rules
- Use your lifetime capital gains exemption
- Maximize capital dividend payments—keeping your capital dividend account balance up to date is a good practice
- Make a tax-free repayment of capital (this repayment must be carefully structured to ensure it will be tax-free)

- Determine whether to segregate investment assets from your operating company for asset protection purposes.

We can help

Most businesses find year-round tax planning to be crucial for making the most of their financial resources. Recent changes to tax rules affecting private companies make planning this year even more important. Your KPMG Enterprise Tax Adviser can help you review your personal and business tax situation and determine which steps you and your business can take before the end of the year.

For details, contact your KPMG Enterprise Tax Adviser.

Appendix

Combined Top Marginal Personal Income Tax Rates							
	Non-Eligible Dividends				Eligible Dividends		
	2023	2022	Decrease		2023	2022	Decrease
British Columbia	48.9%	48.9%	-		36.5%	36.5%	-
Alberta	42.3%	42.3%	-		34.3%	34.3%	-
Saskatchewan	41.8%	42.3%	-0.5%		29.6%	29.6%	-
Manitoba	46.7%	46.7%	-		37.8%	37.8%	-
Ontario	47.7%	47.7%	-		39.3%	39.3%	-
Quebec	48.7%	48.7%	-		40.1%	40.1%	-
New Brunswick	46.8%	47.8%	-1.0%		32.4%	33.5%	-1.1%
Nova Scotia	48.3%	48.3%	-		41.6%	41.6%	-
Prince Edward Island	47.0%	47.0%	-		34.2%	34.2%	-
Newfoundland and Labrador	49.0%	49.0%	-		46.2%	46.2%	-
Yukon	44.1%	44.1%	-		28.9%	28.9%	-
Northwest Territories	36.8%	36.8%	-		28.3%	28.3%	-
Nunavut	37.8%	37.8%	-		33.1%	33.1%	-

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