TaxNewsFlash

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Owner-Managers — Year-End Tax Planning Tips for 2023

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As the owner-manager of your company, it's the perfect time to assess your tax situation as the end of 2023 approaches. A thorough 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. Among other important considerations, it's important to revisit your business succession plan in light of more restrictive proposed intergenerational business transfer rules and new proposed Employee Ownership Trust (EOT) rules expected to take effect in 2024.

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 Private 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 2023 tax situation and plan ahead for 2024. 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 2024

Your family

- ☑ Have you reviewed your business succession plan?
- ☑ Should you hire a family member?
- ☑ Are distributions from your company subject to TOSI?

Your compensation

- ☑ Do you have an effective dividend/salary mix?
- ☑ Should you accrue your salary or bonus?
- ☑ Should you pay dividends in 2023 or 2024?

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 tax considerations

- ☑ Have you made a charitable donation?
- ☑ Has your business paid its tax instalments?
- ☑ Have you considered other tax planning opportunities?
- ☑ Is your business affected by other new or proposed tax changes?

Your family

Have you reviewed your business succession plan?

If you are thinking about passing your business down to your children or grandchildren, you have a small window of opportunity to transfer your shares of your company to the next generation before more restrictive proposed rules are expected to apply in 2024. The revised intergenerational business transfer rules, among other changes, will soon require you to satisfy new transfer conditions to qualify for lower capital gains tax rates on transfers to the

next generation (instead of higher dividend tax rates). For more details, see *TaxNewsFlash-Canada* 2023-37 "Small Businesses — Consider Intergenerational Transfers Now".

On the other hand, if you are thinking of succession through your employees, you may want to wait until the new proposed EOT rules take effect, which is expected to be in 2024. An EOT is a trust that holds shares of a qualifying business exclusively for the benefit of employees. EOTs may be used to help employees purchase a business without paying directly to acquire shares of that business. EOTs must meet several conditions to qualify under the proposed rules, and the tax benefits for owners transferring shares of their business to these trusts may be limited. For more information, see *TaxNewsFlash-Canada* 2023-17 "2023 Federal Budget Highlights".

To understand how these rules may affect the transfer of your business, reach out to your KPMG Private Enterprise Tax Adviser for help with your business succession plan.

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 tax on split income (TOSI) rules do not apply to salaries paid to family members and a salary may allow them to contribute to their registered retirement savings plans (RRSPs), as discussed below. For adult family members that are still looking to buy their first home, earning salary may also allow them to deduct contributions to a First Home Savings Account (FHSA).

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.

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 2023, 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 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 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 $30,780 for 2023 and $31,560 for 2024. You will need about $176,000 in salary in 2023 to make the maximum RRSP contribution for 2024.

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 2023, and the related source deductions do not have to be remitted to the CRA until the salary or bonus is paid to you in 2024.

Should you pay dividends in 2023 or 2024?

When deciding whether you should pay dividends in 2023 or 2024, 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.

You should also remember that depending on the activities of your incorporated business, there may be an opportunity to make a non-taxable dividend payment to the extent your corporation has a positive capital dividend account balance. For assistance with the election process to make a capital dividend payment, contact your KPMG Private Enterprise Tax Adviser.

Keep in mind that there will be no tax savings from paying taxable 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% corporate dividend refund rate.

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.

In addition, you should consider documenting your corporation's annual dividend payment policy to assist in these matters.

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 2023 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 $50 million. The small business deduction is completely eliminated where the associated group of companies' taxable capital is $50 million or more. This reduction applies in all provinces and territories.

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 2023 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 2024.

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 2023 at half of the CCA rate otherwise allowable due to the "half-year" rule, or even an accelerated CCA rate in certain circumstances. Note that the accelerated CCA rate will be subject to a gradual phase-out for eligible property that becomes available for use after 2023 and before 2028.

In addition, you should consider how acquisitions may be affected by the rules on immediate expensing of eligible property, which allow a deduction of up to $1.5 million per taxation year. 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. Note that for CCPCs, the immediate expensing rules will no longer apply to property that is acquired and becomes available for use after 2023. For eligible sole proprietors and certain partnerships, the rules will apply to eligible property acquired and available for use before 2025.

Should you repay shareholder loans?

If you (or your family trust) borrow money from your corporation at low or no interest, you (or your family trust) 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 2023, the prescribed interest rate for this purpose has increased from 4% (for January 1, 2023 to March 31, 2023) to 5% (for April 1, 2023 to December 31, 2023) and is set to increase to 6% on January 1, 2024. For details, see *TaxNewsNow*, "CRA prescribed rates rise for Q1 2024").

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, 2022, you must repay the loan by December 31, 2023. Otherwise, the loan will generally be considered income that is taxable in your 2022 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, 2023 to file a refund application for CPP contributions overpaid in 2019, or for EI premiums overpaid in 2020 (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 2023. See *TaxNewsFlash-Canada* 23-45, "2023 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 2023 trades, try to complete all trades on or before December 20, 2023 (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.

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 tax considerations

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* 23-43, “Make the Most of Your 2023 Charitable Donations”.

Has your business paid its tax instalments?

Ensuring your company’s tax instalments are up-to-date, and that any balance owing above that amount is paid on time by the company’s balance-due day (generally two months, or, in the case of certain CCPCs, three months, after the end of the taxation year) is especially important this year given the high interest rates on underpaid taxes in 2023 and the first quarter of 2024. Interest on underpaid taxes to the CRA is 8% for January 1, 2023 to March 31, 2023 and increases to 9% for April 1, 2023 to December 31, 2023. The interest rate is set to rise to 10% on January 1, 2024. This is 4% higher than the interest rate the CRA will pay

your company in the case of overpaid taxes. For details, see *TaxNewsNow*, "CRA prescribed rates rise for Q1 2024".

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 intergenerational business 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.

Is your business affected by other new or proposed tax changes?

You may want to also consider the impact on your business of other recently enacted or proposed tax measures, such as:

- New mandatory disclosure rules which may require disclosure to the CRA within 90 days of entering into certain transactions as well as new disclosures for certain corporate taxpayers of uncertain tax treatments reflected in their audited financial statements for taxation years beginning on or after January 1, 2023, see *TaxNewsFlash-Canada* 23-41, "Mandatory Reporting — CRA Posts Notifiable Transactions", *TaxNewsFlash-Canada* 23-27, "Mandatory Reporting Rules — CRA Clarifies New Obligations" and *TaxNewsFlash-Canada* 23-32, "Get Ready for New Mandatory Reporting Obligations"
- New underused housing tax rules that may require owners to file a separate return for each reportable residential property owned as of December 31, 2022 and December 31, 2023 (and potentially pay a 1% tax) no later than April 30, 2024, see *TaxNewsFlash-Canada* 23-39, "UHT — CRA Extends Penalty & Interest Relief to 2024"
- New trust reporting requirements, effective for taxation years ending after December 30, 2023, that will require more trusts (including bare trusts) to file a T3 return and also report certain information on all beneficiaries, trustees, settlors and persons who have the ability to exert control over trustee decisions regarding the appointment of income or capital of the trust (e.g., protectors), generally by April 2, 2024, see *TaxNewsNow,* "Federal budget bill #2 now law" and *TaxNewsFlash* 22-51, "New Reporting Rules — Review Your Trust Structure Now"

- Proposed excessive interest and financing expenses limitation (EIFEL) rules to limit the amount of net interest and financing expenses that may be deducted by corporations and trusts, subject to certain exceptions (these rules are not yet enacted, but are proposed to apply to taxation years beginning on or after October 1, 2023), see *TaxNewsFlash-Canada* 23-30, "EIFEL Rules — Finance Further Revises Proposals"
- Proposed rules to align the taxation of investment income earned and distributed by "substantive CCPCs" with the rules that currently apply to CCPCs (these rules are not yet enacted, but are proposed to apply to taxation years ending on or after April 7, 2022), see *TaxNewsFlash-Canada* 22-24, "2022 Federal Budget Highlights"
- Proposed rules to eliminate the tax deferral advantage available to CCPCs and their shareholders earning investment income through controlled foreign affiliates (these rules are not yet enacted, but are proposed to apply to taxation years beginning on or after April 7, 2022), see *TaxNewsFlash-Canada* 22-24, "2022 Federal Budget Highlights".

We can help

Most businesses find year-round tax planning to be crucial for making the most of their financial resources. Your KPMG Private 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 Private Enterprise Tax Adviser.

Appendix

Combined Top Marginal Personal Income Tax Rates							
	Non-Eligible Dividends				Eligible Dividends		
	2024	2023	Increase / (Decrease)		2024	2023	Increase
British Columbia	48.9%	48.9%	-		36.5%	36.5%	-
Alberta	42.3%	42.3%	-		34.3%	34.3%	-
Saskatchewan	40.9%	41.8%	-0.9%		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%	46.8%	-		32.4%	32.4%	-
Nova Scotia	48.3%	48.3%	-		41.6%	41.6%	-
Prince Edward Island	47.6%	47.0%	0.6%		36.2%	34.2%	2.0%
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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