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CONTEMPORARY IDEAS FOR BUSINESS MANAGEMENT FALL/WINTER 2020

GST/HST Reporting Period: How Frequently Do I Need to File?

GST/HST registrants are required to file GST/HST returns on a monthly, quarterly, or annual basis. The reporting period a registrant has determines how often GST/HST returns are required to be prepared during the GST/HST year. When registering for a GST/HST account and in cases where a reporting period is not specified, Canada Revenue Agency (CRA) will assign an annual reporting period; however, the determination of the minimum filing frequency requirement is determined based on the registrant's "threshold amount".

Should I be Reporting Monthly or Annually?

Where a registrant (not a listed financial institution) is making taxable supplies (adjusted for some items in the threshold amount calculation) that exceed $6,000,000, GST/HST is required to be filed on a monthly basis. Where annual taxable supplies are between $1,500,000 and $6,000,000, GST/HST is required to be filed quarterly and where taxable supplies are $1,500,000 or less, an annual reporting period would be permitted.

It should be noted that for purposes of determining the threshold amount and the GST/HST reporting period, the annual taxable supplies considered exclude zero-rated exports and supplies made outside Canada.

Can I Pick my Reporting Frequency?

There are minimum filing frequency requirements for filing GST/HST returns but a registrant can voluntarily elect to expedite the frequency of filings. For instance, a registrant with an annual filing requirement can elect to file on a quarterly or monthly basis and a registrant with a quarterly filing requirement can elect to file monthly. This election can be made by filing the GST20 Election for GST/HST Reporting Period and may also be used to change reporting periods across an associated group where a prior threshold amount or group threshold amount has changed.

A registrant may prefer to accelerate their GST/HST reporting period for a variety of reasons, including to expedite GST/HST refunds where a large refund is expected or a filer is in a refund position regularly.

Threshold Amount	Reporting Period Options Available
$1,500,000 or less	Annual, quarterly or monthly
More than $1,500,000 but not more than $6,000,000	Quarterly or monthly
More than $6,000,000	Monthly

Things to Remember When Determining your Reporting Frequency

It should be noted that the reporting period of a GST/HST registrant is not static. The calculation of the threshold amount should be performed when there would have been changes to total revenue in the prior fiscal period. This will clarify the options available for filing by determining if there has been a change to the minimum GST/HST reporting period requirements. When performing the calculation, some revenues are excluded from the threshold amount.

When determining the minimum filing frequency requirements, an area that is often overlooked is the total revenues and threshold amount for ALL ASSOCIATES. In an associated group, each associate is not looked at on a stand-alone basis to determine their individual reporting period requirements for GST/HST. In contrast, the total revenue and threshold amount for ALL ASSOCIATES in totality should be considered when preparing the threshold calculation and determining the minimum reporting requirements. For example, if one operating company in an associated group has total revenues (and a threshold amount in excess of $6,000,000), all associated entities for GST/HST purposes will be required to be filing monthly even if an associates individual threshold amount does not exceed $1,500,000.

For assistance with determining your GST/HST Reporting Period, please contact one of our DJB Commodity Tax professionals.

Article written by: **Arber Dick,** CPA, CA

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Income Splitting - Prescribed Rate Loans

A common question that gets asked is, "Are there any ways of splitting income with my spouse?" This is especially popular when two spouses have significantly different levels of income, meaning that they are taxed at vastly different marginal tax rates. In the ideal scenario, the higher-income spouse would be able to shift some of their investment income to their spouse's tax return in order to utilize the marginal rate tax system in Ontario and pay lower taxes overall. In Ontario, the lowest combined tax bracket is 20.05% which is the tax rate that an individual would pay on most income sources up to about $45,000 of taxable income. In Ontario, an individual starts to pay a 53.53% combined income tax rate on most sources of income when their taxable income exceeds $220,000. As shown, there are varying tax rates that are levied in Ontario which makes it desirable to income-split with your spouse, given the right circumstances.

One potential income-splitting strategy is to provide your spouse (or a family trust) with a prescribed rate loan. It is important to highlight the difference between "a gift" to a spouse (or a family trust) and a "prescribed rate loan" to a spouse (or a family trust). If funds are gifted to a spouse, then the income generated from that gift are subject to the attribution rules of the Income Tax Act and the income is reported on the gifting individual's tax return resulting in no income-splitting benefit. This prescribed rate spousal loan strategy also avoids any negative implications of the Tax on Split Income (TOSI) rules. In order to avoid the attribution rules, the following criteria must be met:

1. Interest must be charged on a loan at a rate equal to or greater than the prescribed rate that was in effect at the time the loan was made; and
2. The amount of interest that was payable in respect of each year the loan is outstanding is paid no later than January 30 of the following year.

The current prescribed rate (as of July 1, 2020) is 1%, meaning that this strategy is as desirable as ever since the recipient of the loan only has to pay interest at 1% in order for this strategy to be effective. In addition, this strategy is only effective if the loaned funds are generating income at a rate that is higher than the prescribed rate, which is now more easily attainable since the prescribed rate is down to only 1% (previously 2%).

Please see table below for an comparative example of the tax savings calculation by effectively utilizing the prescribed rate spousal loan.

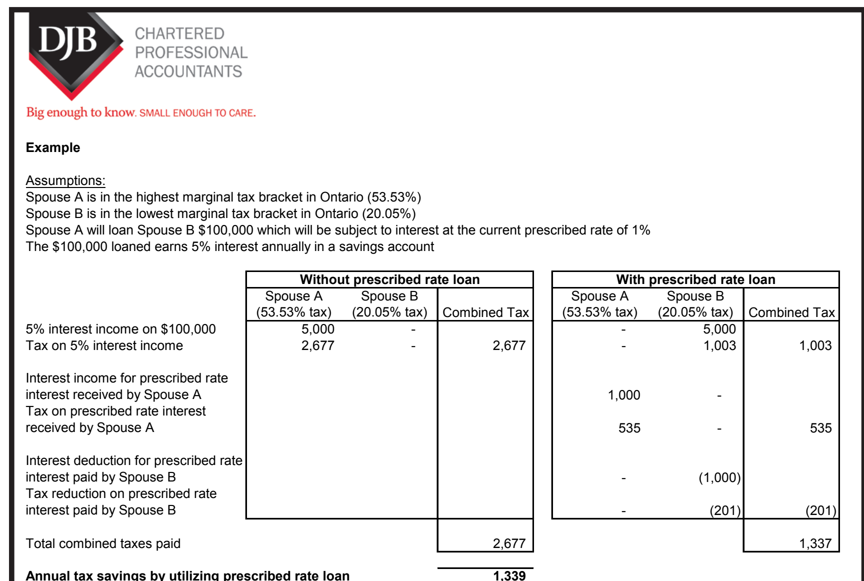
There are some additional steps that need to be undertaken in order to formalize the spousal loan and to be in accordance to Canada Revenue Agency's (CRA) protocols:

1. A promissory note should be drafted and signed by both parties to formalize the terms of the loan.
2. The interest on the loan needs to be paid, preferably from an account solely in the payer's name to an account solely in the recipient's name, before January 30 annually. Documentation such as cancelled cheques or proof of transfer should be retained for CRA audit purposes.

Further considerations need to be explored if any US persons (US resident, US citizen, or green card holder) are involved in this type of arrangement. These issues are beyond the scope of this article.

In closing, the prescribed rate spousal loan strategy can be an effective way to income-split with your spouse in the right circumstances. It is also important to ensure you are following all of Income Tax Act's rules to ensure you are onside should CRA ever review the details of the loan arrangement. Contact one of our Taxation Professionals if you feel you may benefit from a prescribed rate spousal loan arrangement.

Article written by: **Derek Smith**, CPA, CA



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Example

Assumptions:
Spouse A is in the highest marginal tax bracket in Ontario (53.53%)
Spouse B is in the lowest marginal tax bracket in Ontario (20.05%)
Spouse A will loan Spouse B $100,000 which will be subject to interest at the current prescribed rate of 1%
The $100,000 loaned earns 5% interest annually in a savings account

	Without prescribed rate loan			With prescribed rate loan		
	Spouse A (53.53% tax)	Spouse B (20.05% tax)	Combined Tax	Spouse A (53.53% tax)	Spouse B (20.05% tax)	Combined Tax
5% interest income on $100,000	5,000	-		-	5,000	
Tax on 5% interest income	2,677	-	2,677	-	1,003	1,003
Interest income for prescribed rate interest received by Spouse A				1,000	-	
Tax on prescribed rate interest received by Spouse A				535	-	535
Interest deduction for prescribed rate interest paid by Spouse B				-	(1,000)	
Tax reduction on prescribed rate interest paid by Spouse B				-	(201)	(201)
Total combined taxes paid			2,677			1,337
Annual tax savings by utilizing prescribed rate loan			**1,339**			

5 Strategies to Consider for Generating Tax Relief During COVID-19

Whether markets are up or down, there is always room for tax planning. With the markets being down as a result of COVID-19, there are some tax plans that you may consider.

In addition to the Federal Government's response, there are at least 5 strategies that can be executed under existing tax legislation to use COVID-19 to generate tax relief.

Estate Freeze

An estate freeze fixes the value at a point in time, and as a result, the capital gains tax payable on death. In simplistic terms, an individual exchanges his investment for fixed value preferred or special shares. In today's economic conditions, the value of most portfolio investments will have decreased significantly. Similarly, given the outlook of the economy, the value of active businesses will also likely be reduced.

If we can assume that the value of these investments will bounce back in the future, implementing an estate freeze now could potentially reduce estate taxes, resulting in greater wealth being transferred to the next generation. There are various ways in which to implement an estate freeze depending on your situation. I would be happy discuss these with you.

Refreeze

For those who have previously undertaken an estate freeze, the preferred or special shares issued previously may be worth considerably less than their original value. Under a refreeze they are revalued at today's lower fair market value. Taxpayers who may have previously executed a freeze transaction at higher values aren't penalized and can still take advantage of the current economic situation. A careful review of corporation's share structure is required.

Generate Losses

With reduced values, there is an opportunity to realize losses and reduce or recover taxes. This strategy can be particularly useful where tax has been previously paid on gains. Losses generated today can be carried back up to three prior tax years or carried forward to future tax years.

Gift Assets to Adult Children/Grandchildren

As part of typical estate planning for taxpayers, assets are often gifted to children and grandchildren. Most times gifts are made on death through the person's will. One disadvantage to gifting assets on death is that there is likely to be an increased capital gain on the assets being gifted at the time of death. Since the date of death is unknown, so to is the associated tax liability that will arise. By gifting assets today at a lower fair market value, the tax payable can be reduced or even eliminated in some cases. An added advantage is seeing loved ones enjoying the gift. One item of caution is that there are tax issues associated with gifting assets to minor children. Therefore, a tax professional should be consulted before such planning is undertaken.

Low Interest Rate Loans

A common strategy is to lend money to family members who are in lower tax brackets. The person borrowing the money uses it to invest and pays income tax at their lower marginal tax rate. Currently, the prescribed rate that must be paid on the promissory note is 2%, which will likely decrease in the next quarter as a result of the bank of Canada lowering its prime lending rate.

This strategy could also be carried out by lending funds to a trust. Income splitting is achieved where the trust allocates its investment income (in excess of the 2% interest cost) to lower income beneficiaries. Transferring income from a taxpayer in a tax bracket over 50% to a taxpayer in the 20% bracket can result in significant tax savings. In order for this strategy to be effective, it is crucial that the interest be paid by January 30th of the following year.

For help determining if any of these strategies are right for you, please contact Don Knechtel, CPA, CA.

Article written by: **Don Knechtel**, CPA, CA

Changes to Compilation Standards

The Auditing and Assurance Standards Board (AASB) has released a new compilation standard that is effective for periods ending on or after December 14, 2021, with early application permitted. These are what have been informally referred to as "Notice to Reader" or "NTR" statements. The new section 4200, Compilation Engagements will replace section 9200, which the AASB recognized as outdated.

The AASB advised that the new standards were designed to respond to stakeholder input and public interest, and listed the following as some of the key features:

- A scope that sets out which services are compilation engagements. Today, practitioners find it difficult to distinguish a bookkeeping service from a compilation engagement. The new standard clarifies that a bookkeeping service may result in system-generated financial information. Such information is excluded from the scope of the standard if no communication is included or attached to it.
- Specific engagement acceptance considerations that apply when the compiled financial information is intended to be used by a third party. Currently, practitioners are unclear about whether it is appropriate to accept or continue a compilation engagement when there is a third-party user.
- Specific required work effort and documentation. The lack of explicit guidance in this area could be a reason for the existing variability in practice.
- A requirement that compiled financial information includes a note describing the basis of accounting that was applied. Today, users generally lack an understanding of how the compiled financial information was prepared.
- A new compilation engagement report that is more informative and insightful than the current Notice to Reader. Users are unclear as to the extent of work performed by the practitioner and have asked for greater transparency about those responsibilities.

How does this affect your business?

As mentioned in our article **here**, Notice to Reader financial statements were generally when there was no intention for the financial statements to be used by external parties. These changes allow for a compilation engagement to be issued with the intention of being used by an external party such as a bank.

In comparison to what is mentioned in our article of minimal work being done by the external accountant, there is now specific work effort and documentation required. This means that there will be additional requests for information, as well as additional discussions on your business and operations, accounting systems, and accounting records. There will also be a discussion about significant judgments that you have been assisted with in the preparation of the financial statements.

A basis of accounting must also be chosen and this will be described in your new compilation engagement report. The report page of your financial statements will also look different, however as noted above this is designed to be more informative and insightful than the current Notice to Reader. There will also be new engagement and representation letters to be signed.

Further information on this can be obtained from CPA Canada at this **link**.

How does this affect external parties?

As noted above a compilation engagement can now be used with the intention of being provided to an external party. Consistent with the previous standards, however, the reporting practitioner does not provide any assurance on the financial statements and information prepared by management.

The disclosure of a basis of accounting will also improve understandability for external parties. Some of examples of what this could be are:

- a cash basis of accounting
- a cash basis of accounting with selected accruals and accounting estimates
- a basis of accounting prescribed by a contract or other form of agreement established by a creditor or a regulator, which could be one area of discussion that external parties have with management

It is important for external parties' understanding of the how financial information is compiled for their review of the financial statements to determine whether it is appropriate for their use.

More information on this can be found **here**.

What to do now

Although this standard is not required until years ending on or after December 14, 2021, it could be prudent to adopt this early (e.g. for December 31, 2020, year end). This could be the case, for example, if your lender felt it necessary.

Please reach out to your DJB representative to discuss whether an early change is right for you.

Article written by: **Matt Miedus**, CPA, CA

RRSP vs Debt Repayment - A Case Study

Angela is a 45-year-old advertising executive, with a mortgage, car loan, and comfortable lifestyle. Angela's company has agreed to start paying her an annual bonus of $20,000. After paying her mortgage and car loan, Angela is comfortable with the lifestyle provided by her base salary and wants to know what to do with her bonus to give her the best financial advantage. She wants to know if she should use her bonus to pay down her mortgage, pay down her car loan, or if she should save her bonus in her RRSP. Angela's father says she should do what he did and pay down her mortgage as soon as possible, to save the interest. Her best friend, Suzie, is suggesting she pay off her car loan since it's her smallest debt, then apply the amount she was paying on her car loan to her mortgage. Angela's investment advisor is recommending that she put her bonus into her RRSP to reduce her income tax and save for her retirement. Her dilemma is that she trusts all three people giving her advice and each makes a good argument for their suggestion.

One of the best ways to determine which option provides Angela with the best financial advantage is to create three financial planning scenarios and see which one improves her net worth the most. Of course there is more to financial planning than just numbers, but knowing the numbers is a good place to start when making an important decision such as this. Let's look at the facts:

Income Assumptions:

- Salary $120,000 indexed to inflation at assumed rate of 3%
- Bonus $20,000/year
- Marginal Tax Rate 43.41%

Mortgage Facts:

- Balance owing $547,000
- Interest rate 2.69%
- Monthly Payments $2287.42
- Renewal December 01, 2022
- Prepayment options: Any amount without penalty

Car Loan Facts:

- Balance owing $32,000
- Interest rate 5.65%
- Monthly Payment $688.08
- Prepayment options: Any amount without penalty

RRSP Facts:

- Balanced Growth portfolio
- Expected rate of return 5%
- Contribution Limit $158,000

Dad's advice: "Pay down your mortgage to save the interest."

Angela's dad has not had a mortgage for many years and when he did the interest rates were much higher than they are now, so it might have made sense to pay down his mortgage at that time, but is this good advice for Angela now? Let's work out the financial benefit of taking this advice. One thing she needs to consider is that if she takes her bonus in cash, she will have to pay tax on it, which means she would only receive $11,318 after tax. In this scenario, Angela would apply the after-tax bonus amount of $11,318 to her mortgage and would increase her mortgage payment by an additional $8,257 per year once her car loan is paid off. In this scenario, we will also assume that once Angela has paid off her mortgage, the entire payment that she had been making each year will be invested in her RRSP savings. In this scenario Angela would have an after-tax net worth of $1,394,897 at age 65.

Best friend advice: "Pay down your car loan first."

The strategy of paying off your smallest debt first is known as the debt-snowball method, whereby you make minimum payments on your largest debts and concentrate on paying off your debts with the lowest balances first. Once the lowest balance debt is paid off, you add the amount you were paying against it to the next lowest balance, creating a snowball effect as your payment amount continues to increase for each debt as the previous debt is eliminated. This option often makes people feel better since they feel like they are accomplishing something by eliminating debt balances. Once again, Angela will only have $11,318 after-tax from her bonus to pay down her car loan. In this scenario we assume that Angela applies her bonus to her car loan and once the car loan is paid off the bonus gets added to her mortgage and once her mortgage is eliminated, she invests the ballooned mortgage payment into her RRSP. If Angela were to follow her friend's advice, she would have an after-tax net worth of $1,395,631 at age 65.

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Advisor advice: "Put your bonus into your RRSP."

If Angela follows this advice she will be able to deposit her full bonus of $20,000 to her RRSP. This will result in an immediate tax savings of $8,682 since she will not have to pay tax on her bonus when it's earned and can invest the entire amount. In this scenario, Angela will continue to make her regular car payments until her car loan is paid off at which time she will apply her car loan payments to her RRSP investments. Using this approach, Angela's after-tax net worth would be $1,594,463 at age 65.

Summary

After reviewing all three options it's clear that Angela would have the greatest financial advantage by investing her bonus in her RRSP. By implementing this strategy each year Angela would have an increased net worth of almost $200,000 over the other two options by age 65, however there are other factors to consider that could have an impact on her decision. What if mortgage rates go up in the future? What if her RRSP investment earns less than the 5% she is anticipating? What if she needs money in the future for another car, renovations, emergencies or even opportunities? Does having debt cause her stress? These are all good questions for Angela to consider before making her decision. In Angela's situation, the best choice for her may be to take a balanced approach and save some of her bonus to her RRSP and use the balance to pay down her car loan or mortgage. Whatever decision Angela makes about her bonus this year, she will need to review her situation again when the next bonus becomes available to determine the best course of action at that time considering any variables that may have changed.

The key to effective financial planning is understanding that your plan is unique to you and needs to be updated on a regular basis to account for any changes in your circumstances, goals, and objectives and any variations from the assumptions used. Good financial planning will provide you with the information needed to make informed financial decisions that will help you achieve your goals.

Article written by: **Brad Giroux,** CFP®, CLU, CHS

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