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CONTEMPORARY IDEAS FOR BUSINESS MANAGEMENT

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The Tax Free Savings Account



In 2009, the federal government introduced the Tax Free Savings Account (TFSA) to give Canadians another means to save for their financial goals. The TFSA is similar to the Registered Retirement Savings Plan (RRSP) in some ways, but different in others.

TFSA Quick facts:

- Investments grow and compound on a completely tax-free basis within the TFSA.
- Contributions to the TFSA are not tax-deductible, but withdrawals are tax-free and can be made at any time.
- Unused contribution amounts accrue and can be used in future years.
- The current annual contribution limit is \$7,000 per person, increasing in \$500 increments based on inflation.
- Anyone who was 18 years of age in 2009 and resident in Canada during the period between 2009-2024 and has never contributed

to a TFSA has a contribution limit of \$95,000.

- Withdrawals from the TFSA do not impact Old Age Security (OAS) benefits.

Things to consider when deciding to use a TFSA:

- Consider how the TFSA fits within your overall financial plan –it may be better to maximize RRSPs, RESPs, or pay down personal debt first.
- The TFSA can complement other retirement savings and since withdrawals are tax-free, they could help you avoid potential Old Age Security (OAS) claw-back.
- Since contributions can be made at any age over 18, a TFSA can be a powerful estate planning tool in building a sizable tax-free asset for an estate or heirs – a benefit similar to using permanent life insurance. If a specific beneficiary is named in a TFSA, the estate administration tax (probate fees)

can be avoided on the value of the plan.

- Consider using existing personal non-registered savings to maximize TFSA contribution limits in order to shelter future investment income from tax.
- Investors owning a corporation may want to consider withdrawing additional dividends to fund a TFSA. Although the additional income from the corporation would be taxable, future investment earnings on those contributions would be tax-free.
- Both capital and growth can be withdrawn on a tax-free basis. The total amount withdrawn can then be re-contributed in the next calendar year, or any time afterwards, with no impact on annual contribution limits.

A DJB Wealth Management Advisor can help you make the right choice.

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Expense Claims that Pass the Audit Test



Often taxpayers are audited by the Canada Revenue Agency (CRA) and end up being surprised when some or all of their expenses are disallowed. Many times this could have been avoided with proper documentation. In this article, we will look at some common issues the CRA has with respect to claiming of expenses and the related documentation.

In general, expenses are deductible if they are incurred for the purpose of earning income from business or property, and are reasonable in the circumstances. Too often taxpayers attempt to deduct personal expenses from their business income.

Bank statements and credit card statements are not sufficient evidence for a CRA auditor. You need to keep invoices that detail what was purchased.

Meals and entertainment

Receipts are the major supporting documents because they provide information such as the date/time, location, and the amount paid. Since there can be a definite personal aspect to these expenditures, the CRA also expects an explanation on how those meals and entertainment expenses relate to your business income. Therefore, you should document the following information on each receipt:

- Who attended the event
- Their relationship to your business

- What client matter or income it relates to

If you do not have adequate supporting documents, the CRA could disallow the expense.

Automobile expenses

When you have self-employed income, the CRA allows you to take a deduction for costs associated with your vehicle. The deduction is based on the number of kilometres you travel in your vehicle for business-related activities.

To calculate your deduction properly, you will need to keep track of your trips throughout the year, and also hang on to any receipts for vehicle-related purchases, in the event of a CRA review. To claim this deduction, the CRA requires you to keep a full logbook that journals your travel activities. Your logbook should list the odometer reading on the first day of the tax year (or the odometer reading on the first day you decided to start using your vehicle for business), and the odometer reading for the last day of the tax year. Then for each trip, note the date, the Kilometers travelled, the address or destination of your travel and the business purpose for the trip. From your logbook, at the end of the year, you will be able to determine the total kilometers travelled and the number of kilometers travelled for business purposes, and thus the total percentage use for business use. To determine your tax deduction, you apply this percentage to your total

vehicle costs including:

- Fuel
- License and registration fees
- Insurance
- Lease expenses (CRA maximum lease cost may apply)
- Maintenance and repairs.
- The CRA prescribed capital cost allowance (depreciation)
- Interest costs

Home office expenses

Self-employed individuals often carry out at least a portion of their business activities at home. In order to claim home office expenses, you must meet one of the following requirements:

- Your home office must be the principal place of your business
- You use the space only to earn your business income, and you use it on a regular and ongoing basis to meet your clients, customers, or patients

If you are an employee, your employer must complete form T2200 indicating that you are required to use part of your home as an office to carry out your duties.

To determine how much you can deduct for your home office expenses, calculate the size of your office as a percentage of your home's total size.

The rules for claiming home office expenses depend heavily on your type of employment: Both self-employed individuals and eligible employees

may both claim expenses for heat, electricity, water, maintenance, and rent (if applicable). Commission employees and the self-employed may also claim property taxes and insurance. Only self-employed taxpayers may claim mortgage interest as a home office expense.

If you have maintenance costs that are related exclusively to your home office, you can deduct the entire portion of those expenses. Make sure that you keep all of your invoices to support your claim.

In some cases, you may not be able to claim the entire amount of your home office expenses in a single tax year. Both employees and self-employed

individuals cannot create a loss from claiming home office expenses. The excess expenses can be carried forward and in most cases can be applied to future years.

Oral audit evidence

If you do not have all of your documentation in place when the auditor calls, they may accept your oral testimony as support for the tax deductions that you've claimed. However, in most cases you will lose at least a portion of your expense claim. The better way and to reduce your stress, is to develop a habit of making sure that you have the right documentation in place from the start.

If you have any questions, or need assistance with claiming expenses, please contact one of our DJB tax professionals.

Article written by: Don Knechtel, CPA, CA

Minority Shareholdings

Does a Minority Discount Apply?

Who are minority shareholders?

A minority shareholder is any shareholder who does not own a controlling interest in a public or privately-held company.

What is a minority discount?

In a notional valuation context, a minority discount is when the pro rata value of a particular minority shareholding is reduced to reflect the disadvantages of owning a minority interest of an asset or security as a whole. Typically, a minority shareholding realizes a discount for:

- The inherent lack of marketability or illiquidity, which refers to assets

or securities that cannot be sold and converted to cash without a loss in value. Minority shareholdings are generally viewed as less marketable or liquid than a controlling interest, therefore attracting fewer potential buyers resulting in a discount. Sometimes referred to as Discount for Lack of Marketability or DLOM; and

- The lack of control over the company's operations and the ability to influence the future direction of the company and the distribution of profits/dividends. Sometimes referred to as Discount for Lack of Control or DLOC.

The level of minority discount can

range significantly depending on the facts of the particular situation and ownership interest held.

Minority shareholders in a publicly traded company vs. a privately-held company

Minority shares in a publicly traded company, where shares are widely held and large volumes of share are frequently traded, usually has a minimal illiquidity discount. While minority shareholders have no control over the direction of the public company, they can choose whether to sell or hold the company's shares. As a result, there is often no significant discount for illiquidity or lack of control.

In contrast, a privately-held company's en bloc value may already reflect a general illiquidity discount as there is no ready market available to buy or sell shares in a privately-held company. A further discount for illiquidity may apply specifically to a minority shareholder, compared to a controlling shareholder of the same privately-held company.

Factors influencing discount

While the specific methods and possible empirical evidence are outside of the scope of this article, the quantum of the discount for lack of control and lack of marketability, which are sometimes combined into one discount, is dependent on several factors, including the following factors:

- Shareholder's level of involvement in the business.
- A shareholder who is on the board of directors or involved in the daily operations of the business would generally have a lower quantum of discount than a shareholder who has no involvement in the business operations or governance.
- Relationship and size of the shareholding relative to the other shareholdings.
- In scenarios where there are no controlling shareholder, the relationship and combination of the size of the subject shareholding with other minority shareholders must be considered to determine if the subject shareholder can influence decisions.
- Additionally, the applicable minority discount may be less or a potential premium may be available, if the other minority shareholders want to purchase the subject's shares in order to become a majority shareholder.

Shareholders' agreements

- Clauses that influence liquidity or control will have influence on the quantum of a discount, such as restrictions on share transfer, rights of first refusal, or tag-along/drag-along provisions.

Nuisance value

- Shareholders who hold just enough shareholdings to prevent or delay the plans of a controlling shareholder are considered to have "nuisance value" and may have a lower quantum of discount.
- It is difficult to determine the discount for nuisance value in a notional valuation.

Family or group control

- Shareholders who act in concert and in aggregate owns over 50% of the shares, may not have an applicable minority discount. However, a third party who enters into a shareholder agreement may have a significant minority discount applied to the value of their shares.

Dividends

- A history of dividend distribution is an indication of return on investment and may indicate less of a minority discount.

Prior sales of minority shareholdings

- Prior transactions provide insight regarding the quantum of any minority discount.

To apply a minority discount or not?

To determine whether a minority discount applies, consider the following two factors: the purpose of the valuation and the valuator's professional judgment. If the valuation were to determine the value of the minority's interest for the purpose of a sale to a non-related party, a minority discount would apply. The quantum of the discount that applies to the sale requires a valuator's professional

judgment and analysis.

In shareholder disputes involving oppression, one of the remedies is to have the corporation purchase the oppressed minority shareholder's interest at fair value. In this case, a minority discount would not apply.

If you have any questions or require assistance with determining if a minority discount is applicable and the quantum of the discount, please contact a member of our Financial Services Advisory Team (FSAT) team.

Article written by: Rachel Mak

Have you Considered the Scientific Research and Experimental Development Tax Credit?



Is your corporation involved in such activities as agricultural and food processing, information and/ or communication technology, life sciences, advanced manufacturing, or independent research to name a few. If so, you may be eligible to claim a Scientific Research and Experimental Development Tax Credit (SRED). When we think of scientific research, we often think of the scientist in the lab wearing a white coat. This isn't always the case as many claims are a result of development or improvements to a product or process on the shop floor.

In order to qualify, the work must be conducted for the advancement of scientific knowledge or for the purpose of achieving a technological advancement. It is important to note that you do not have to achieve your goal in order to gain new knowledge. For example, if your work allowed you to understand that the idea you tested is not a solution for your situation, this can be considered new knowledge. What's important is that the knowledge gained advances the understanding of science or technology, not how the work advanced your corporation or business practices.

The work must be a systematic investigation or search that is carried out in a field of science or technology by means of experiment or analysis. A systematic investigation or search refers to how SRED work is carried out. It is more than just having a systematic approach to your work

or using established techniques or protocols. A systematic investigation or search must include the following steps:

- Defining a problem.
- Advancing a hypothesis towards resolving that problem.
- Planning and testing the hypothesis by experiment or analysis.
- Developing logical conclusions based on the results.

The federal government will allow corporations to claim an Investment Tax Credit (ITC) of 15% on eligible expenditures. This ITC can be applied against the current year's income tax or in some cases carried back to a previous tax year or forward to a future tax year. However, some small business corporations may earn an ITC of 35% on eligible expenditures which may be fully refundable in the year.

Eligible expenditures include:

- Canadian wages and salaries.
- An overhead calculation.
- Canadian R&D-related contracts.
- Materials.
- Payments made to eligible research institutions.

The province of Ontario also provides additional incentives to corporations carrying out SRED activities in the province. Certain small business corporations can earn a refundable

Ontario Innovation Tax Credit (OITC) of 8% on eligible expenditures. In addition, the Ontario Research and Development Tax Credit (ORDTC) is available. It is a 3.5% non-refundable tax credit based on eligible expenditures incurred by a corporation in a tax year.

It is important to note that the deadline to file a SRED claim on your tax return is eighteen months after your taxation year.

So if you haven't considered SRED, it may be worthwhile to do so.

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Association and HST

In the tax world, association can have a significant impact on your income taxes, but it can also impact your GST/HST as well. When it comes to having to register for GST/HST, the small supplier threshold of \$30,000 (or \$50,000 for public service bodies) applies to a company and its associates. Association is defined in section 127 of the Excise Tax Act (ETA) and subsections 256 (1) to (6) of the Income Tax Act (ITA). The rules of association for ITA purposes can be found at: <http://laws-lois.justice.gc.ca/eng/acts/l-3.3/section-256.html>

When it comes to association and GST/HST, a common error is not factoring in all of the taxable sales of all associated parties when looking at the small supplier test. Unlike the ITA definition of association, which applies to corporations only, the ETA extends this definition to apply to other persons (such as individuals). It is common for an individual who controls a corporation to charge management fees or commercial rent to their corporation. Assuming the corporation they control is not a small supplier, due to the association rules, these fees would be taxable for GST/HST. Having the individual registered and charging for these services is often overlooked on the incorrect assumption they are not taxable if

under \$30,000 of taxable supplies. Please note the appropriateness and income tax consequences of such management fees are beyond the scope of this article.

It should also be noted that, as a trust and a partnership is a person for GST/HST purposes, they should also be factored into association with any corporations with common ownership.

If you have a corporate group with transactions amongst all of the entities and shareholders, it would be prudent to have a GST/HST review done to ensure that all taxes are being charged appropriately.

For assistance or advice, please contact DJB's Commodity Tax specialist.

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