TAX NEWSLETTER

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What to Look for in a Financial Controller

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There comes a time when owner-managed businesses can grow beyond the point where all aspects of the business are effectively manageable by the owner.

The financial aspect of a business will always take a significant amount of time, which, in turn, can result in neglect of the operational side.

There is the point in the life of a growing business when hiring a competent financial controller starts to make sense.

The job comes with significant responsibilities. Financial controllers are expected to deliver accurate and timely information to the users of the information, such as owners, banks, and governments. In an ever-changing accounting and tax environment, this can present a huge challenge.

Financial information needs to be prepared precisely and communicated and presented clearly. Though he or she may work with a team, the financial controller will ultimately share in the accountability for all aspects of the financial management of the business.

Because the position bears such heavy accountability, a lot of thought should go into determining what characteristics and skills the successful candidate should possess. What traits should come to mind when you think about your ideal financial controller?

For starters, he or she should be:

- trustworthy,
- detail-oriented,
- a problem-solver,
- an effective communicator,
- technically strong with regards to accounting ability, and
- capable of meaningful financial analysis and reporting.

He or she should be able to explain the financial information in a way that is understandable, is useful to all decision-making processes, and allows the business owner to act on it quickly. As well, the financial controller should be able to effectively manage a group and demonstrate excellent interpersonal skills that will motivate a team.

So, how do you attract the best applicants? By ensuring the work is engaging; offering an attractive salary with incentives; and, depending on the size of the company, providing an opportunity for career progression.

How much power will the controller have? The very definition of 'control,' as defined by Merriam Webster, includes "the power to make decisions about how something is managed or done; the ability to direct the actions of someone or something." This is how a financial controller will want to operate, and will need to be given the authority to do so.

It is important to hire someone who will fit into the current organizational culture and bring out the best in their team. They will need to be aligned with the company's vision and values, and will have to work within the corporate norms and systems.

What is a Reasonable Return on Your Private Company Shares?

By John Connolly, BBA, CPA, CMA
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On July 18, 2017 and December 13, 2017, the Department of Finance introduced changes to the taxation of dividends that an individual receives from a private company. Many people who receive dividends from a private company could see that income taxed at the top personal tax rate without the benefit of the personal tax credits regardless of what other income they have. The new rules include a maze of exclusions that the Department of Finance says are intended to better target owners of private companies who attempt to "lower their personal income taxes by sprinkling their income to family members who do not contribute to the business."

Canada Revenue Agency published initial guidance on how they will apply the new rules with a number of examples. They expect that their interpretation and application of the rules could change as they gain experience in dealing with specific factual situations. The current guidance is found at:

https://www.canada.ca/en/revenue-agency/programs/about-canada-revenue-agency-cra/federal-government-budgets/income-sprinkling/guidance-split-income-rules-adults.html

Individuals older than 24 who are unable to meet the less subjective tests for exclusion from these rules will have to rely on a highly subjective exclusion for a "reasonable return" on their contributions to the business. The value of contributions to the business will be measured based on labour contributions, property contributions, risks assumed for the business, amounts received from the business in the past, and "such other factors as may be relevant". CRA's published guidance says that factors they will consider when determining what is a reasonable return may include the following.

LABOUR CONTRIBUTION

- The nature of the tasks performed;
- Hours required to complete the tasks;
- A competitive salary/wage for the tasks in relation to businesses of similar size and industry;
- Education, training and experience;
- Degree of activities and nature of activities in relation to those of a business of a comparable nature and size;
- Time spent on the activity in comparison to time spent in other activities or undertakings;
- Particular knowledge, skills or know-how that the individual possessed;
- Business acumen; and
- Past performance of functions.

PROPERTY CONTRIBUTION

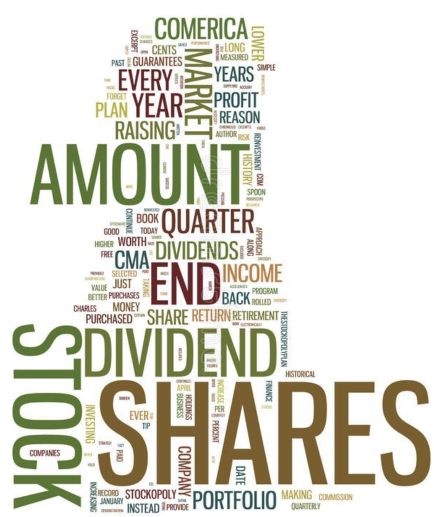
- The amount of capital contributed to the business;
- The amount of loans to the business;
- The fair market value of property (both tangible and intangible property) transferred to the business, including technical knowledge, experience, skill, or know-how;
- Whether the individual has provided property as collateral for loans or other undertakings;
- Whether other sources of capital or loans are readily available;
- Whether comparable property is readily available;
- Whether property is unique or personal to the individual;
- Opportunity costs; and
- Past property contributions.

RISK ASSUMPTION

- Whether the individual is exposed to the financial liabilities of the business, whether through guarantees of mortgages, loans or lines of credit or otherwise;
- Whether the individual is exposed to statutory liabilities related to the business;
- Extent of the risk that contributions made by the individual to the business may be lost, whether in whole or part;
- Whether any risk is indemnified or otherwise limited in the circumstances, whether by agreement or otherwise;
- Whether the individual's reputation or personal goodwill is at risk; and
- Past or ongoing risk assumption.

TOTAL AMOUNTS PAID

In determining whether a payment received by the individual exceeds a reasonable amount, account should be taken of other amounts previously paid to the individual. This should generally include any payment of any kind (including salary or other remuneration or compensation, dividends, interest, proceeds, and fees), benefits, and deemed payments (as may be reasonably required in the circumstances).



Selling Shares of a Private Corporation

By Kamille Stead, CPA
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As a shareholder of a private corporation, it is important to be aware of your options and any tax planning opportunities should you ever be in a position to sell your shares. Planning for the structure of the sale now can result in considerable tax savings when you eventually sell your shares. Generally, the departing shareholder will either have their shares repurchased by the corporation or will sell them to either the existing shareholders or a third party. A summary of the tax consequences of each option follows:

The Share Repurchase

If the corporation were to repurchase your shares, this will result in a taxable dividend to the extent the proceeds received exceeds the paid-up capital of the shares which is generally the amount shown on the financial statements for the shares. Depending on whether the company is able to make an eligible dividend designation or a capital dividend election, the dividend will be taxed as an eligible dividend at 2018 tax rates of 30-40% (based on the top personal tax bracket), as an ineligible dividend at rates 8-10% higher, as a tax-free capital dividend or some combination of the three. The specific tax rates depend on the province where you reside.

It is possible that you may be able to restructure your affairs prior to the share repurchase by transferring your shares on a tax-deferred basis to a new company in order to defer some or all of the tax that would otherwise result. When the repurchase of shares occurs, a portion of the deemed dividend will generally be received by the new corporation on a tax-free basis; the proportion received tax-free will vary based on the tax attributes of the corporation sold. If you plan to subsequently start your own business, the cash now held in your corporation could assist in funding your new business operations. If you do not plan to start any new business activities, the funds could be held in your corporation until a time when your personal tax rates are lower, at which time the funds may be taken personally. This option will require additional professional fees to set up and will involve ongoing compliance costs so this will need to be factored in to the overall decision.

Sale to Existing Shareholders/Third Party Purchaser

A sale of your shares to the existing shareholders or a third party purchaser normally carries a more favorable tax treatment. The proceeds received less the amount paid for the shares gives rise to a capital gain*. The top personal tax rates on capital gains are between 23% and 27% in most provinces for 2018 as opposed to the dividend rates mentioned previously. Furthermore, if the shares meet certain criteria making them "qualified small business corporation shares," and you have lifetime capital gains exemption available (maximum available of $848,252 in 2018), you may be able to claim a capital gains deduction to offset a portion of the taxable capital gain and reduce your taxable income to end up with an even lower effective tax rate. Note that only individuals are eligible to claim a capital gains deduction; corporations cannot.

*There are exceptions to this for certain non-arms length sales but these exceptions are outside the scope of this article.

Review Your Unanimous Shareholder Agreement

To ensure that both of these options are available to you when you choose to sell your shares, you should review your Unanimous Shareholder Agreement. Ensure the appropriate clauses are included which allow you to either sell your shares to existing shareholders or have the company repurchase your shares.

The Unanimous Shareholder Agreement should also include how the value of the shares will be determined on such a sale to avoid disagreements on the value or potentially costly professional fees. Failing to ensure these items are in your Unanimous Shareholder Agreement today can restrict your tax planning opportunities when you decide to sell your shares in the future.

As a current shareholder there is a lot to consider with respect to the sale of your shares and this is only a brief overview. A detailed review of your and your corporation's specific circumstances is essential to achieving the best possible tax results.

Consult your nearest DFK tax professional for further advice and planning.

Good News and Bad News in the U.S. Tax Changes

By John Connolly, BBA, CPA, CMA
MRSB Group, Charlottetown, PEI

U.S. President Trump signed the Tax Cuts and Jobs Act into law on December 22, 2017. While the title promises tax cuts, the legislation includes a number of measures that could result in tax increases for U.S. citizens living in Canada. Here is a brief overview of some of the changes.

Personal tax rates will go down by 0% to 4% depending on what tax bracket you are in. For single filers, the threshold for the top tax bracket is increased to income over $500,000, and the standard deduction almost doubles to $12,000. The child tax credit is doubled to $2,000 per child, and the income threshold for the elimination of the credit increases to $200,000.

There are also positive changes for individuals with business income. For example, bonus depreciation rules will allow 100% current deduction for qualifying property and are extended to 2022. There is a new deduction for 20% of Qualifying Business Income" if your business is unincorporated and is not a "specified service" business. "Specified service" businesses include health, accounting, legal, and consulting businesses among others.

There are also some unfavourable changes. The $4,050 personal exemption is eliminated. If you claimed itemized deductions, the deduction for state and local taxes is now capped at $10,000, and foreign property taxes are no longer deductible. Mortgage interest was previously deductible on up to $1,000,000 of purchase debt. That cap is reduced to $750,000. Interest on up to $100,000 of home equity debt was previously deductible. That deduction is eliminated. Many

of the miscellaneous itemized deductions are eliminated; including unreimbursed employee expenses, investment fees, home office deductions, and tax preparation fees. The deduction for moving expenses is eliminated, and moving expense reimbursements must now be included in income.

Starting in 2018, U.S. corporations that receive dividends from a foreign (non-U.S.) subsidiary may be eligible for an exemption from tax on those dividends. A number of tests related to the percentage of shares owned and the amount of time the shares were owned must be met to qualify for the exemption. The fallout from this exemption is a new one-time transitional tax that the U.S. **shareholders** must pay on the undistributed "earnings & profits" of the foreign subsidiary. This transitional tax applies to U.S. shareholders, including U.S. citizens living abroad, who own at least 10% of the votes or value of a foreign company that is controlled by U.S. shareholders. There are deemed ownership rules that complicate and expand who this transitional tax will apply to. This transitional tax is not a separate tax. The U.S. shareholder's pro-rata share of the undistributed "earnings & profits" of the foreign company is run through a complicated formula to determine an amount that is added to the U.S. shareholder's other taxable income. The U.S. shareholder's income is then taxed at the applicable regular income tax rate for that shareholder. For a U.S. citizen living in Canada, the effective rate of the transitional tax is expected to range between 2% and 18% of their pro-rata share of the undistributed "earnings & profits". The effective rate will depend on the tax bracket the U.S. shareholder is in, and what sort of assets make up the undistributed "earnings & profits". The tax applies based on the foreign corporation's last taxation year that begins before 2018. That means the tax applies to 2017 for many taxpayers and must be dealt with during the current personal tax season. There is an election to pay this tax over 8 years.

There is another new addition to the taxable income of U.S. shareholders of foreign companies. Again, there are complicated rules based on share ownership to determine whether or not this income addition applies to you. The new income inclusion is called "Global Intangible Low-Taxed Income" or GILTI. If your foreign company earns a return in excess of 10% of the cost for U.S. tax purposes of its tangible depreciable assets, then the excess may have to be added to your taxable income.

The Tax Cuts and Jobs Act is over 500 pages long. U.S. tax law was always complicated. Now it's more complicated. This is a limited overview of a few of the changes. You should not make any tax planning decisions without contacting a U.S. tax specialist.