

TOSI, the unanswered questions, CRA's contradictory positions and what may be the correct answers

January 19, 2020

Sunny Jaggi, CPA, CA, MTax, CFF
Kakkar CPA Professional Corporation

Kenneth Keung, CA, CPA (CO, USA), TEP, CFP, MTax, LLB
Moody's Gartner Tax Law

Henry Shew, CPA, CA, TEP, CPA(WA), MAcc
Cadesky Tax

Agenda & Format

Discussion on various topics

Each topic will have 3-5 subtopics

Comments and discussions are open to the floor

Topics

- Topic #1 – Excluded share
- Topic #2 – Business carried on
- Topic #3 – Golden share
- Topic #4 – Reasonable return
- Topic #5 – Derived directly or indirectly
- Topic #6 – Excluded business
- Topic #7 – TOSI on grossed-up dividend basis
- Topic #8 – CRA enforcement and audit program
- Topic #9 – Trusts
- Topic #10 – Partnerships

Topic #1 – Excluded share

“excluded shares”, of a specified individual at any time, means shares of the capital stock of a corporation owned by the specified individual if

- (a) The following conditions are met:
 - (i) Less than 90% of the business income of the corporation for the last taxation year of the corporation that ends at or before the time (or, if no such taxation year exists, for the taxation year of the corporation that includes that time) was from the provision of services, and
 - (ii) The corporation is not a professional corporation,
- (b) immediately before that time, the specified individual owns shares of the capital stock of the corporation that
 - (i) Give the holders thereof 10% or more of the votes that could be cast at an annual meeting of the shareholders of the corporation, and
 - (ii) Have a fair market value of 10% or more of the fair market value of all of the issued and outstanding shares of the capital stock of the corporation, and
- (c) All or substantially all of the income of the corporation for the relevant taxation year in subparagraph (a)(i) is income that is not derived, directly or indirectly, from one or more related businesses in respect of the specified individual other than a business of the corporation.

Topic #1 – Excluded share

Subtopic #1 – what is “business income”? Does an investment company qualify?
Can you have no business income?

Subtopic #2 – Does the skip-a-year dividend strategy work? What about the straddling during-the-year and at-the-end-of-year strategy?

Subtopic #3 – CRA says cleaning supplies used/consumed in cleaning service is part of service income, but the materials used by a deck construction business is not part of service income. What is the rationale?

Topic #2 – Business carried on

“related business”, in respect of a specified individual for a taxation year, means

(a) A business carried on by

- (i) A source individual in respect of the specified individual at any time in the year, or
- (ii) A partnership, corporation or trust if a source individual in respect of the specified individual at any time in the year is actively engaged on a regular basis in the activities of the partnership, corporation or trust related to earning income from the business.

...

Topic #2 – Business carried on

120.4(1.1)(d)

for greater certainty, an amount derived directly or indirectly from a business includes

(i) an amount that

(A) is derived from the provision of property or services to, or in support of, the business, or

(B) arises in connection with the ownership or disposition of an interest in the person or partnership carrying on the business, and

(ii) an amount derived from an amount described in this paragraph; and

Topic #2 – Business carried on

Subtopic #1 – “business carried on” used in (a) of related business definition. “Business carried on” should have a higher threshold than “business” or “business income”

Subtopic #2 – Refer back to the investment company. What level of activity to fall under “business carried on”?

Subtopic #3 – “business carried on” not referred to in (b) and (c) of the “related business” definition. But Finance technical notes refers to business carried on when explaining (c). Furthermore, 120.4(1.1)(d)(B) only applies where a business is carried on. Can we assume the standard applies for (b) and (c)?

Topic #3 – Golden share – subsection 120.4(1.1)(b)

If an amount would – if this section were read without reference to this paragraph – be split income of a specified individual who has attained the age of 17 years before the year in respect of a property, and that property was acquired by, or for the benefit of, the specified individual as a consequence of the death of another person, then

- (i) For the purpose of applying paragraph (b) of the definition “reasonable return” in subsection (1), to the extent that the particular amount referred to in that paragraph is in respect of the property, then the factors referred to in that paragraph in respect of the other person are to be included for the purposes of determining a reasonable return in respect of the individual,
- (ii) For the purpose of this subparagraph and the definition “excluded business” in subsection (1), if the other person was actively engaged on a regular substantial and continuous basis in the activities of a business throughout five previous taxation years, then the individual is deemed to have been actively engaged on a regular, substantial and continuous basis in the business throughout those five years....

Topic #3 – Golden share

Subtopic #1 – If one passes away, do all future generations exempt from TOSI, and does an inherited share have halo effect on heir's other shares? Is there a difference between the answers from the 2019 STEP roundtable and the 2019 CTF roundtable?

Subtopic #2 – What if there is a new business that is starting after inheriting the share?

Subtopic #3 – How broadly can “acquired ... as a consequence of the death of another person” be interpreted?

Topic #4 – Reasonable return – subsection 120.4(1)

“reasonable return”, in respect of a specified individual for a taxation year, means a particular amount derived directly or indirectly from a related business in respect of the specified individual that

(a) would, if the subsection were read without reference to subparagraph (f)(ii) or (g)(ii) of the definition “excluded amount”, be an amount described in the definition “split income” in respect of the specified individual for the year; and

(b) is reasonable having regard to the following factors relating to the relative contributions of the specified individual, and each source individual in respect of the specified individual, in respect of the related business:

- (i) the work they performed in support of the related business,
- (ii) the property they contributed, directly or indirectly, in support of the related business,
- (iii) the risks they assumed in respect of the related business,
- (iv) the total of all amounts that were paid or that became payable, directly or indirectly, by any person or partnership to, or for the benefit of, them in respect of the related business, and
- (v) such other factors as may be relevant.

Topic #4 – Reasonable return

Subtopic #1 – What does “relative contribution” mean?

Subtopic #2 – How broadly can “... in support of the ... business”, and “such other factors as may be relevant” be interpreted?

Subtopic #3 – CRA says a guarantee provide by a non-working spouse provides reasonable return, but is that different in principal than house chores to allow the working spouse to do work?

Subtopic #4 – Can we rely on CRA’s comment in 2018-0771851E5 that a startup loan that is already repaid can still be a good factor?

Topic #5 – Derived directly or indirectly

Relevant term for many instances:

- 1) “excluded amount” – (e) from a related business or from an excluded business
- 2) “excluded share” – (c) from a related business
- 3) “related business” – (c)(i)(B) – convertible property
- 4) “split income” – (b)(ii) – partnership income and (c)(ii)(C) – trust income

120.4(1.1)(d) clarifies “derived directly or indirectly”

Topic #5 – Derived directly or indirectly

120.4(1.1)(d)

for greater certainty, an amount derived directly or indirectly from a business includes

(i) an amount that

(A) is derived from the provision of property or services to, or in support of, the business, or

(B) arises in connection with the ownership or disposition of an interest in the person or partnership carrying on the business, and

(ii) an amount derived from an amount described in this paragraph; and

Topic #5 – Derived directly or indirectly

Subtopic #1 – How far do you trace? CRA provides some guidance in 2018-0768801C6, 2018-0778661C6, 2018-0779981C6, 2019-0792011E5, 2018-0771861E5, 2018-0768821C6

Subtopic #2 – Does the word “for the year” carry any significance in determining “derived directly or indirectly”?

Subtopic #3 – How is the phrase “arises in connection with” different from “derived” in 120.4(1.1)(d)(A)/(B)?

Subtopic #4 – What is intended to be included in 120.4(1.1)(d)(ii)? Is it an amount that is derived from an amount that itself is derived from a related business? Would this interpretation capture second generation income?

Subtopic #5 – Does it matter whether the business has been sold? What about selling the business to an unrelated corporation?

Topic #6 – Excluded business – subsection 120.4(1)

“excluded business”, of a specified individual for a taxation year, means a business if the specified individual is actively engaged on a regular, continuous and substantial basis in the activities of the business in either portion

- (a) the taxation year, except in respect of an amount described in paragraph (e) of the definition “split income”, or
- (b) any five prior taxation years of the specified individual

Topic #6 – Excluded business

Subtopic #1 – What happens if you have multiple businesses? Collectively you work at least 20 hours a week across all businesses (so not more than 20 hours for each business). Does CRA's answer on 2018-0761601E5 make sense?

Subtopic #2 – Assume husband and wife worked 20+ hours for 5 years and assets of a business are sold. The proceeds are invested in marketable securities. Can you still rely on excluded business (assume excluded share is not available) despite the business is ceased to exist?

Subtopic #3 – Does meeting the “excluded business” exception give you unlimited amounts for income splitting?

Topic #7 – TOSI on grossed-up dividend basis

“split income”, of a specified individual for a taxation year, means the total of all amounts (other than excluded amounts) each of which is

- (a) An amount required to be included in computing the individual’s income for the year
 - (i) In respect of taxable dividends received by the individual in respect of shares of the capital stock of a corporation (other than shares of a class listed on a designated stock exchange or shares of the capital stock of a mutual fund corporation), or
 - (ii) Because of the application of section 15 in respect of the ownership by any person of shares of the capital stock of a corporation (other than shares of a class listed on a designated stock exchange)

Topic #7 – TOSI on grossed-up dividend basis

Subtopic #1 – When reporting TOSI dividend, the foregone conclusion seems to be that dividend – 82(1)(b) – are subject to TOSI. Is that correct? Is 82(1)(b) really “an amount required to be included in ... income for the year in respect of taxable dividends...”?

Topic #8 – CRA enforcement and audit program

Subtopic #1 – What will CRA enforcement and audit program for TOSI look like?

Topic #9 – Trusts – definition (c) in split income

a portion of an amount included because of the application of subsection 104(13) or 105(2) in respect of a trust (other than a mutual fund trust or a trust that is deemed to be in existence by subsection 143(1)) in computing the individual's income for the year, to the extent that the portion

(i) is not included in an amount described in paragraph (a), and

(ii) can reasonably be considered

(A) to be in respect of taxable dividends received in respect of shares of the capital stock of a corporation (other than shares of a class listed on a designated stock exchange or shares of the capital stock of a mutual fund corporation),

(B) to arise because of the application of section 15 in respect of the ownership by any person of shares of the capital stock of a corporation (other than shares of a class listed on a designated stock exchange),

(C) to be income derived directly or indirectly from one or more related businesses in respect of the individual for the year, or

(D) to be income derived from the rental of property by a particular partnership or trust, if a person who is related to the individual at any time in the year is actively engaged on a regular basis in the activities of the particular partnership or trust related to the rental of property,

Topic #9 – Trusts

Subtopic #1 – Will there be TOSI if the trust earns rental income? Is there a risk to rely on 2018-0765811C6?

Subtopic #2 – Is there any tax planning opportunity using preferred beneficiary election and rely on STEP 2019 Q13 and Q14 answers?

Subtopic #3 – Will there be TOSI if a trust earns income from portfolio? Is there a risk in relying on 2018-0765801C6?

Topic #10 – Partnerships – definition (b) in split income

a portion of an amount included because of the application of paragraph 96(1)(f) in computing the individual's income for the year, to the extent that the portion

- (i) is not included in an amount described in paragraph (a), and
- (ii) can reasonably be considered to be income derived directly or indirectly from
 - (A) one or more related businesses in respect of the individual for the year, or
 - (B) the rental of property by a particular partnership or trust, if a person who is related to the individual at any time in the year
 - (I) is actively engaged on a regular basis in the activities of the particular partnership or trust related to the rental of property, or
 - (II) in the case of a particular partnership, has an interest in the particular partnership directly or indirectly through one or more other partnerships

Topic #10 – Partnerships

Subtopic #1 – Will there be TOSI if a partnership earns income from a portfolio? Is there a risk in relying on 2018-0768831C6?

Subtopic #2 – Who carries on a business – partnership or corporate partners? Can 2019-0813021E5 give us guidance?

TOSI, the unanswered questions, CRA's contradictory positions and what may be the correct answers

January 19, 2020

Questions?