



TOSI
(TAX ON SPLIT-INCOME)



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TOSI (TAX ON SPLIT-INCOME)

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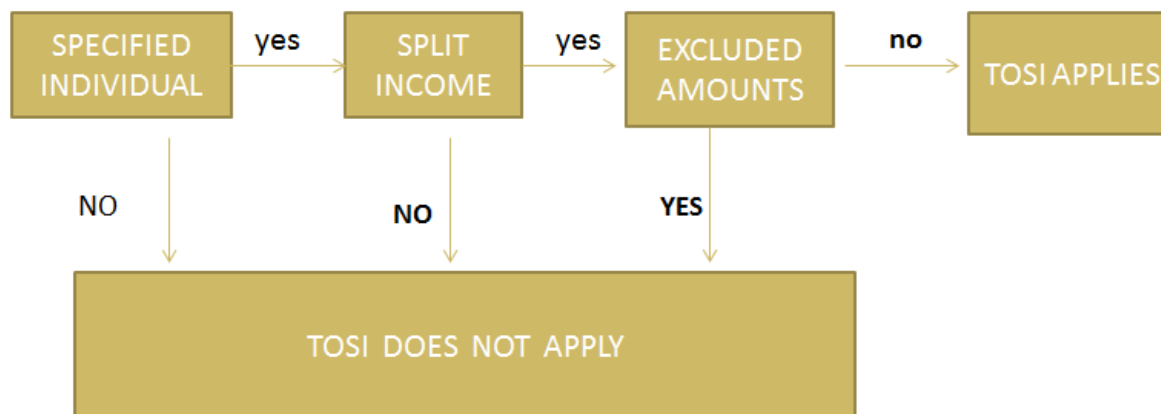
Montreal, Qc H3B2N2

DISCLAIMER:

This presentation is not legal advice: Each client situation is different and requires consultation with a professional; the law is evolving and government positions outlined herein may change and are not guaranteed

VERY BASIC DESCRIPTION OF HOW TOSI OPERATES

Reproduced with the permission of the Canadian Tax Foundation from Sean Grant-Young and Katie Rogers, "Income-Splitting Update," *Personal Tax Planning* feature (2019) 67:1 *Canadian Tax Journal* 209-34, at 221



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BRIEF DEFINITIONS

SPECIFIED INDIVIDUAL: individual who resides in Canada at the end of the year or immediately before his death

SOURCE INDIVIDUAL : individual who is related to the specified individual and who resides in Canada at any time in the year

RELATED : individuals connected by 1) blood relationship(one is the child or other descendant of the other or one is the brother or sister of the other, 2) by marriage (includes in-laws who are connected by blood to the person who is married to the individual) or by common law partnership (living together for 12 months) and 3) by adoption

RELATED BUSINESS IN RESPECT OF THE SPECIFIED INDIVIDUAL:

- a) a business carried on by a source individual in respect of the specified individual at any time in the year
- b) a business carried on by a partnership, corporation or trust if a source individual is actively engaged in the activities of the partnership, corporation or trust related to earning income from the business
- c) a business of a partnership if a source individual at any time in the year has an interest in the partnership (even if the source individual is not active in the partnership)
- d) a business of a corporation if the following conditions are met at any time in the year:
 - a source individual in respect of the specified individual owns:
 - A) shares directly in a corporation or
 - B) property that derives all or part of its value directly or indirectly from shares in the corporation and

the total value of the shares or the property owned by the source individual is $\geq 10\%$ of the total value of all the issued and outstanding shares of the corporation

BRIEF DEFINITIONS

SPLIT INCOME OF A SPECIFIED INDIVIDUAL (OTHER THAN EXCLUDED AMOUNTS) MEANS ALL OF THE FOLLOWING:

- taxable dividends or shareholder benefits received by the individual on shares of any company (other than shares listed on the stock exchange or mutual fund corporation)
- partnership income derived directly or indirectly from one or more related businesses in respect of the individual or from the rental of property by a particular partnership or trust if a person related to the specified individual is either active in the particular partnership or trust related to the rental of the property or has an interest in the particular partnership
- Income from a trust in respect of dividends or shareholder benefits received from a private company, income derived from a related business in respect of the specified individual or income derived from the rental of property by a particular partnership or trust if a person related to the individual is actively engaged in the activities of the partnership or trust related to the rental of property
- Interest income received in respect of debt obligations from private corporations
- Taxable capital gains from the disposition of property or included in income from a trust and attributable to a taxable capital gain but excluding gains attributable to shares listed on the stock exchange or shares of a mutual fund corporation)

EXCLUDED BUSINESS OF A SPECIFIED INDIVIDUAL MEANS: a business of a specified individual who is actively engaged on a regular, continuous and substantial basis in the activities of the business in the year or any of the previous 5 years (if work on the average ≥ 20 hours a week during the portion of the year the business operates); this 5 year previous work history includes subsequent reorganizations of the business (from sole proprietorship to a new corporation or an amalgamation of corporations) as long as there is a continuity of the original business by the new structure in place.

EXCLUDED SHARES OF A SPECIFIED INDIVIDUAL MEANS:

- 1) less than 90% of business income in previous year of the corporation is from provision of services
- 2) the corporation is not a professional corporation
- 3) shareholder has $\geq 10\%$ votes and value in the corporation
- 4) $\geq 90\%$ of income of the corporation in the previous year is not from one or more other related business (other than from the corporation)

BRIEF DEFINITIONS

REASONABLE RETURN IN RESPECT OF A SPECIFIED INDIVIDUAL FROM A RELATED BUSINESS

Relative contributions of the specified individual and each source individual in respect of:

- 1) work performed in support of the related business;
- 2) property contributed in support of the related business;
- 3) risks assumed in respect of the related business;
- 4) amounts paid/payable by any person in respect of the related business, etc

SAFE HARBOUR CAPITAL RETURN OF A SPECIFIED INDIVIDUAL:

The highest prescribed rate of interest (currently 2%) x the FMV of property contributed by the specified individual in support of a related business

ARM'S LENGTH CAPITAL OF A SPECIFIED INDIVIDUAL:

Property of the specified individual that was not borrowed by the individual, nor transferred to the individual from a related person (other than on death) nor acquired as income from or a taxable capital gain from the disposition of another property that was derived from a related business in respect of the individual

EXCLUDED AMOUNT IN RESPECT OF AN INDIVIDUAL FOR A TAXATION YEAR MEANS THE INCOME OR CAPITAL GAIN:

- 1) If individual has not attained 24 before the year (<25) and the amount is from property acquired from parent as an inheritance or from anyone else if individual is full-time student at a post-secondary school or has a tax credit for impairment
- 2) The amount is from property acquired as a result of a divorce or written separation agreement
- 3) The amount is from the deemed disposition on death under section 70(5) of the Income Tax Act
- 4) From the disposition of QSBC shares, or qualified farm or fishing property
- 5) If the individual attained the age of 17 before the year (≥ 18) and the amount is i) not from a related business in respect of the individual for the year or ii) is derived from an excluded business of the individual for the year
- 6) If individual has attained 17 before the year (he is ≥ 18) but has not attained 24 before the year the amount is i) a safe harbour capital return or ii) a reasonable return in respect of the individual having regard only to arm's length capital contributions
- 7) 1) If individual has attained 24 before the year (he is ≥ 25) the income is income from or a taxable gain from the disposition of excluded shares or ii) a reasonable return in respect of the individual

- NO RELATED BUSINESS

- Only X (OVER 17)
- (OVER 24)

X IS A "SPECIFIED INDIVIDUAL" CANADIAN RESIDENT OVER 17 YEARS/ OVER 24 YEARS

THERE IS, HOWEVER, NO OTHER PERSON WHO IS A "SOURCE INDIVIDUAL" AS THERE IS NO OTHER PERSON INVOLVED IN EITHER HOLDCO OR OPCO WHO IS "RELATED" TO X

THUS THERE IS NO "RELATED BUSINESS "

OPCO IS NOT CARRYING ON A SERVICE BUSINESS NOR IS IT A PROFESSIONAL CORPORATION

HOLDCO SHARES ARE "EXCLUDED SHARES" IF X IS OVER 24 EVEN THOUGH 100% OF HOLDCO INCOME IS FROM OPCO SINCE THE INCOME IS NOT FROM A "RELATED BUSINESS"

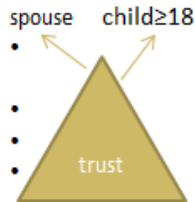
X IS CARRYING ON AN "EXCLUDED BUSINESS" IN OPCO AS HE/SHE ACTIVELY WORKS FULL-TIME IN OPCO ON A " REGULAR, CONTINUOUS AND SUBSTANTIAL BASIS" , MORE THAN 20 HOURS A WEEK

DIVIDENDS FROM HOLDCO ARE AN "EXCLUDED AMOUNT" FOR 3 POSSIBLE REASONS:

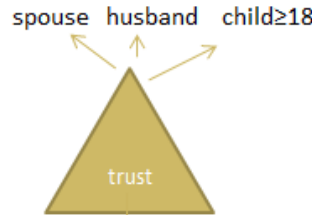
- 1) DIVIDEND INCOME NOT DERIVED FROM A RELATED BUSINESS
- 2) IF X OVER 24 THE HOLDCO SHARES ARE EXCLUDED SHARES
- 3) DIVIDEND IS DERIVED FROM EXCLUDED BUSINESS OF X



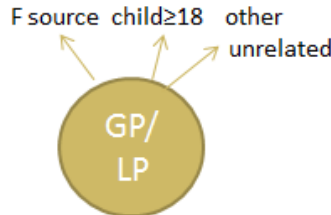
EXAMPLES OF “RELATED BUSINESS”



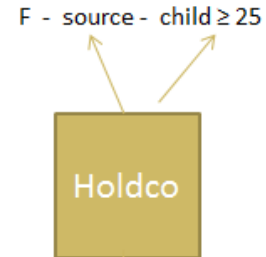
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- Father is source individual who is active in trust rental/service business; He is trustee of the trust
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if fmv of interest of each beneficiary in trust is greater than 10% of the fmv of Opco each is a source individual for each other what is the fmv of a discretionary interest in a trust ?



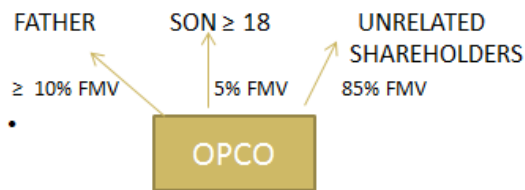
Partnership
F/C not active but have interest in partnership



If source F has shares ≥ 10% of fmv of Holdco and Holdco is carrying on a business through its holding of its interest in the partnership and neither F nor child active in partnership; do source individual and child have an indirect interest in the partnership ? If so then the partnership is a related business ; partnership income is imputed to Holdco; may be excluded shares if ≤90% of business income of Holdco is from services

EXAMPLE OF NON-RELATED OR RELATED BUSINESS

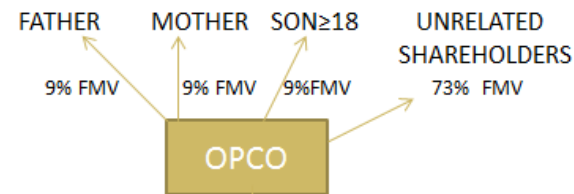
RELATED



BUSINESS (not service business nor professional corporation)

- Father and son not active in business at any time in the year
- FMV of FATHER'S SHARES \geq 10% OF TOTAL FMV OF OPCO AND THUS A RELATED BUSINESS IN RESPECT OF SON; DIVIDENDS RECEIVED BY SON WILL BE SUBJECT TO TOSI; LIKewise IF FATHER HAD LESS THAN 10% FMV BUT WAS ACTIVELY ENGAGED IN THE BUSINESS OF OPCO ON A REGULAR BASIS AT ANY TIME IN THE YEAR
- If son were actively engaged in the business then the business would be a related business in respect of his father but dividends to father would not be subject to TOSI as F has EXCLUDED SHARES unless father's shares were $<$ 10% FMV of OPCO.

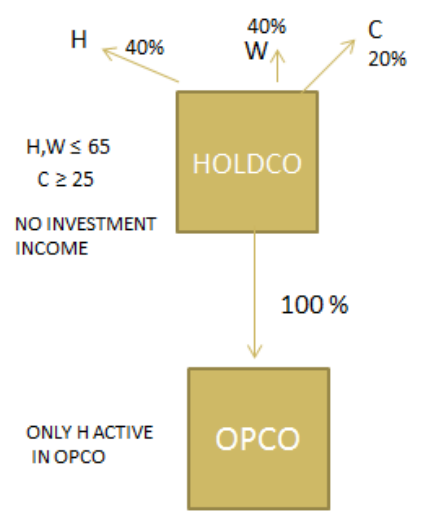
NON-RELATED



BUSINESS

Father, Mother and son not active in business at any time in the year; As there is no 'related business' in respect of any 'specified individual' who is related to a 'source individual' (eg father vis à vis mother and son and vice versa) there should be no TOSI on dividends paid out by OPCO to F, M or Son

EXAMPLES OF RELATED BUSINESS

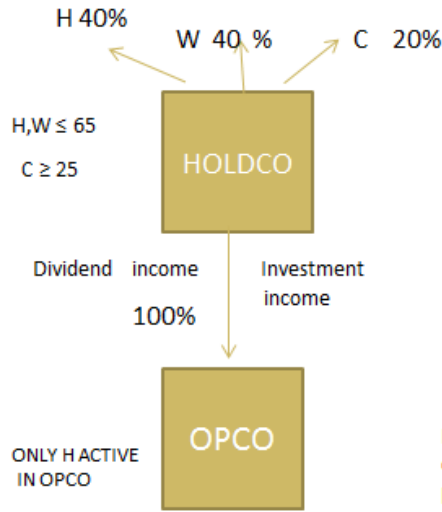


A RELATED BUSINESS FOR H, W & C

EXCLUDED BUSINESS FOR H

NOT EXCLUDED SHARES AS ≥90% OF HOLDCO INCOME IS FROM OPCO

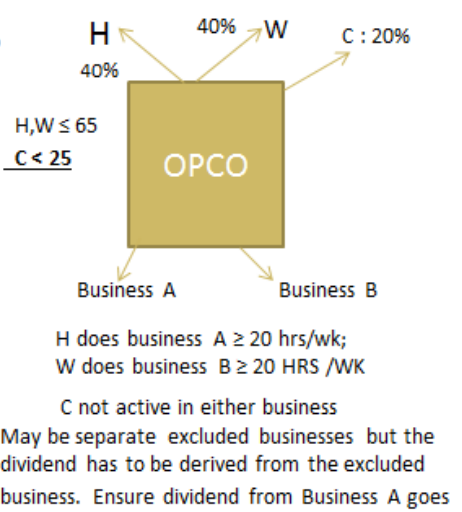
IF W/C HELD ≥ 10% VOTES & VALUE DIRECTLY IN OPCO- EXCLUDED SHARES FOR W /C



Is ≥ 90% of Holdco income from OPCO?; if so, not excluded shares ; may be > 90% in year 1 and < than 90% in year 2

Is dividend income for H/W/C derived from investment income of HOLDCO or dividend income from OPCO ?;

Is investment income business income? If not business income then dividend from HOLDCO investment income would be an excluded amount as not being from a related **business**; BEST TO SEGREGATE DIFFERENT SOURCES OF INCOME



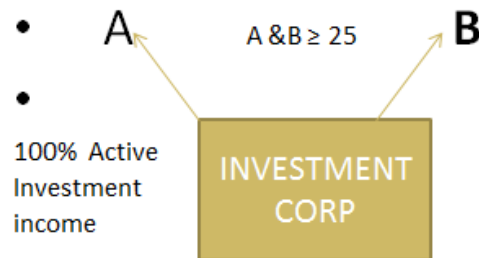
May be separate excluded businesses but the dividend has to be derived from the excluded business. Ensure dividend from Business A goes to H ; ensure dividend from Business B goes to W; otherwise income may be sourced to related businesses; segregate income from different businesses if not excluded shares

Will be excluded shares for H & W (unless service business or professional corporation) and hold more than 10% votes and value C has no excluded business & his excluded shares do not qualify as an excluded amount ; any dividends paid to him will be subject to TOSI unless he can show a reasonable arm's length contribution

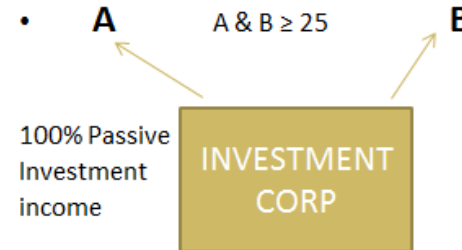
If C ≥ 25 his shares will be excluded shares even though he does not work in OPCO and the dividend is derived from related businesses

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IS INVESTMENT INCOME A BUSINESS

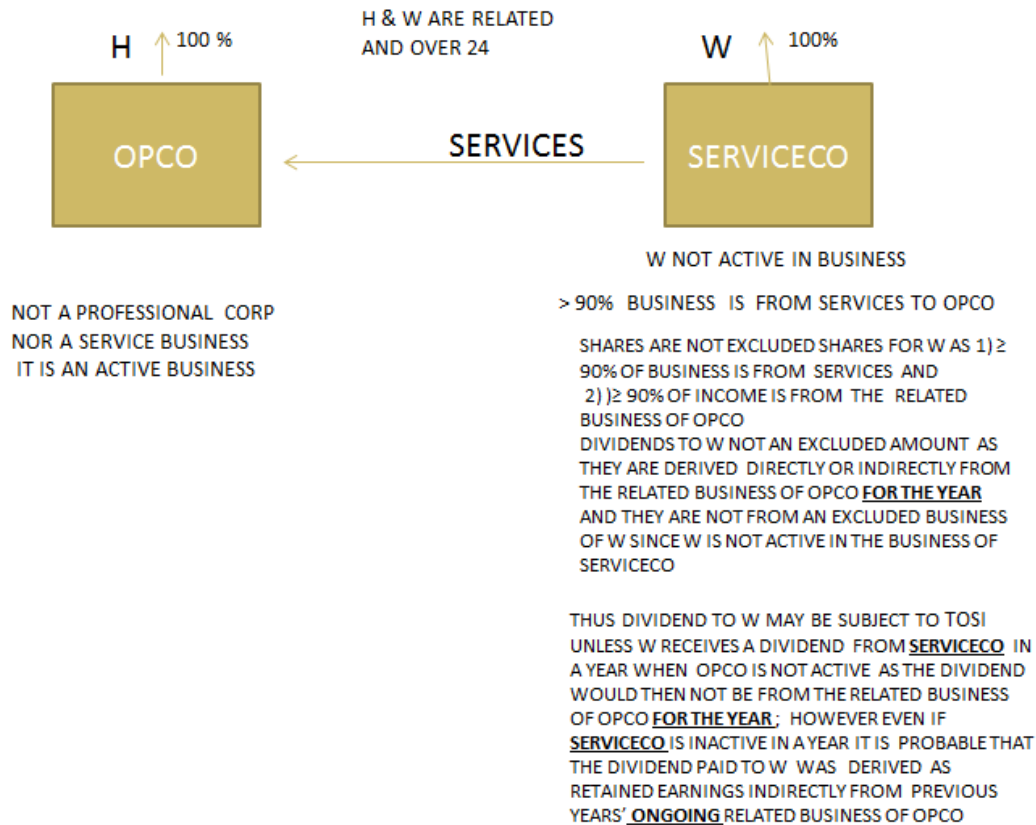


- If investment activity is considered a **business** then A & B have excluded shares
- assume corp is not a service business nor a professional corporation



If investment activity is not considered a **business** then dividends are an excluded amount because no dividends are derived from any related **business** even though shares are not excluded shares because there is no business income

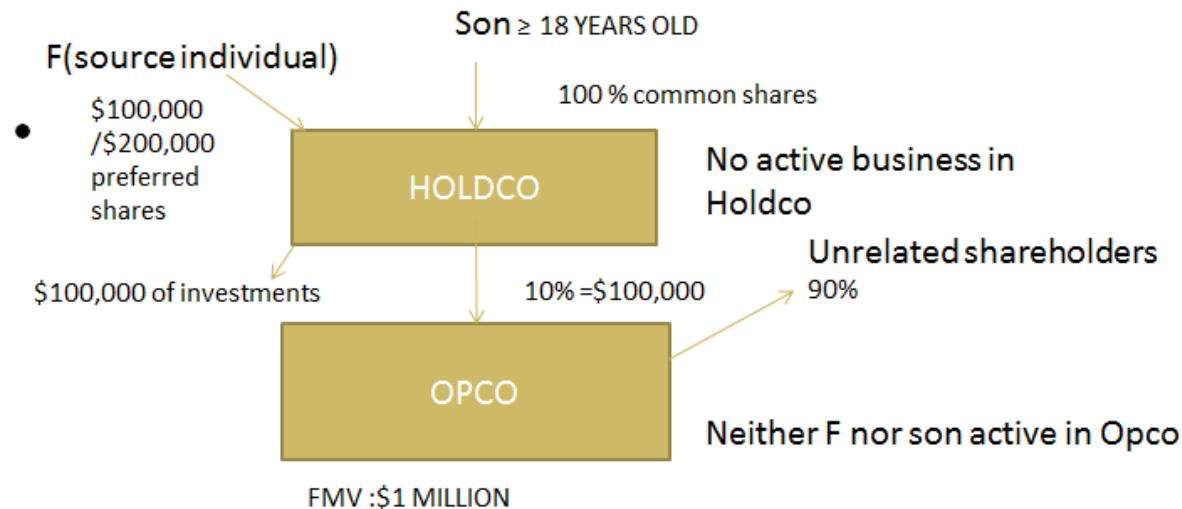
IS THERE A RELATED BUSINESS?



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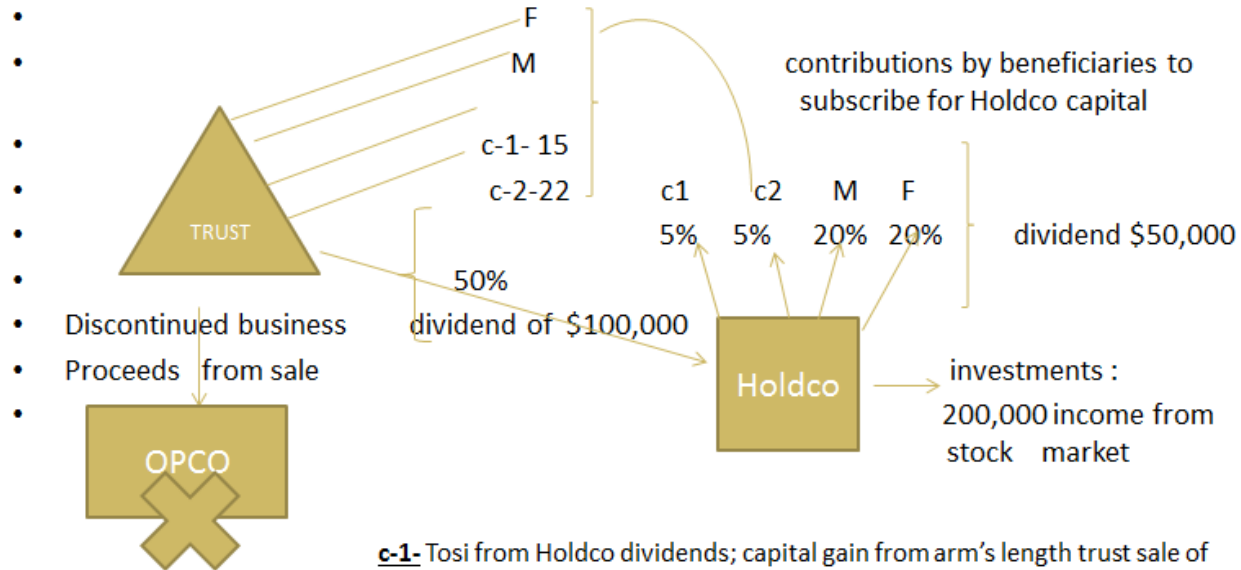
“Property that derives all or part of its FMV, directly or indirectly, from shares of a Corporation”



Do the F preferred shares derive their \$100,000 fmv from the \$100,000 of investments of Holdco or from the 10% shareholding that Holdco has in Opco? If from the 10% Opco investment then Opco is a related business for the son and dividends from Opco to Holdco and then to the son may be subject to TOSI; if the F preferred shares derive their value from the \$100,000 of investments then Opco is not a related business; dividends to the son will not be derived directly or indirectly from a related business and will not be subject to TOSI; If the preferred shares were worth \$200,000 then \$100,000 of their value would be derived from the Opco investment making Opco a related business and dividends from Opco to Holdco and then to the son would be subject to TOSI unless they could be sourced to any investment income of Holdco. Son is a source individual vis a vis his father and Opco may thus be a related business of F if value of common shares held by son in Holdco > 10% fmv of Opco; thus dividends to F may be subject to TOSI unless an exemption applies, eg excluded shares for F and S.

ILLUSTRATION OF APPLICATION OF RULES

Proceeds from sale of Opco shares by trust distributed to trust beneficiaries

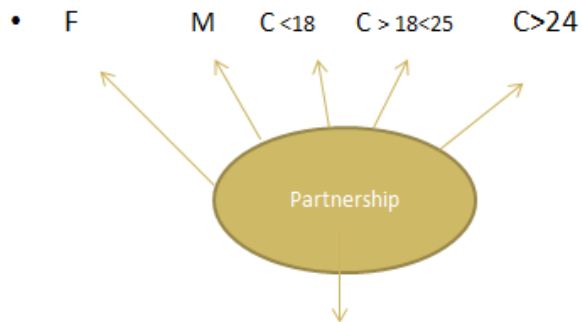


c-1- Tosi from Holdco dividends; capital gain from arm's length trust sale of Opco shares may qualify for CGE & not Tosi if Opco was a QSBC; any dividends paid from Holdco to trust to c-1 will be Tosi
 If no business in Holdco dividends are excluded amounts whether directly or through trust
 If business in Holdco excluded shares for F & M but not for c2; only a safe harbour capital return for c2; not arm's length capital for c2 as capital was derived indirectly from the related business of Opco

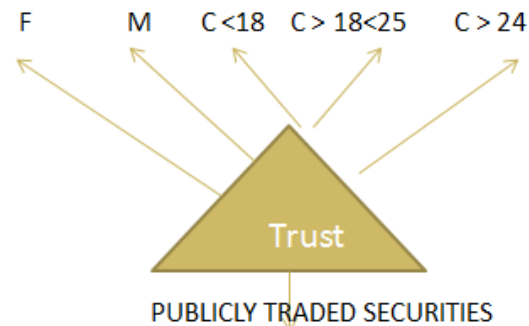
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EXCEPTION: PUBLICLY TRADED SECURITIES

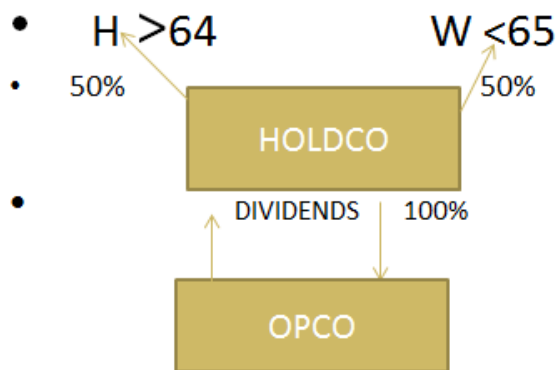


- PUBLICLY TRADED SECURITIES
 SPLIT INCOME EXCLUDES INCOME FROM PUBLICLY TRADED SECURITIES
 NO TOSI : SECTION 96 DEEMS SOURCE OF INCOME OF PARTNERSHIP TO BE SAME SOURCE OF INCOME FOR THE PARTNER
 SPOUSE AND MINOR CHILD MAY BE SUBJECT TO ATTRIBUTION RULES; ALSO ANY INTEREST-FREE OR LOW INTEREST LOANS MAY BE SUBJECT TO ATTRIBUTION UNDER SECTION 56(4.1)



- PUBLICLY TRADED SECURITIES
 SPLIT INCOME EXCLUDES INCOME FROM PUBLICLY TRADE SECURITIES; THUS NO TOSI.
 SECTION 104(19) DESIGNATION BY TRUST OF TAXABLE DIVIDENDS TO THE BENEFICIARIES;
 SPOUSE AND MINOR CHILDREN MAY BE SUBJECT TO ATTRIBUTION RULES; ALSO ANY INTEREST-FREE OR LOW INTEREST LOANS MAY BE SUBJECT TO ATTRIBUTION UNDER SECTION 56(4.1)

EXCEPTION: Shareholder >64 and spouse of shareholder who is <65 receives a dividend



H is active in OPCO business in current year or in any of previous 5 years; W not active in OPCO; Thus not an “excluded business” for W

- 90% OF Holdco income is from OPCO; Thus not “excluded shares” for W
- Deemed an “excluded amount” for W and thus dividends to wife not subject to TOSI; Likewise if any capital gain to W on a sale of shares would have been an “excluded amount” (e.g. sale of QSBC shares) if sold by H it will be an “excluded amount” for W

EXCEPTION :DEATH

H ACTIVE IN BUSINESS >5 PREVIOUS YEARS, H DIES; H &W >24 ; WIFE & CHILDREN NOT ACTIVE IN BUSINESS; THUS NOT AN EXCLUDED BUSINESS FOR THEM; CHILD 1<24; CHILD 2 >24; OPCO IS A PROFESSIONAL CORPORATION; SHARES ARE THEREFORE NOT EXCLUDED SHARES

H OWNS 100 % OF SHARES AT DATE OF DEATH



H's capital gain on death (if shares go to children) is an excluded amount; not subject to TOSI but regular capital gains and possibly the capital gains exemption if it is qualified

IF W inherits directly or indirectly shares of OPCO any future dividends and capital gains will be an excluded amount if it would be an excluded amount for H if h had received that amount in the year he died

If CHILD 1 inherits directly or through a trust the shares of OPCO the shares will be an excluded amount until the year after he turns 24; after that year he may qualify under other rules(see below)

If CHILD 2 inherits the shares of OPCO directly or through a trust if the father 's contributions to the business of OPCO constituted a reasonable return for father in respect of OPCO child 2 will be considered to have made a reasonable contribution so as to constitute a reasonable return for child 2

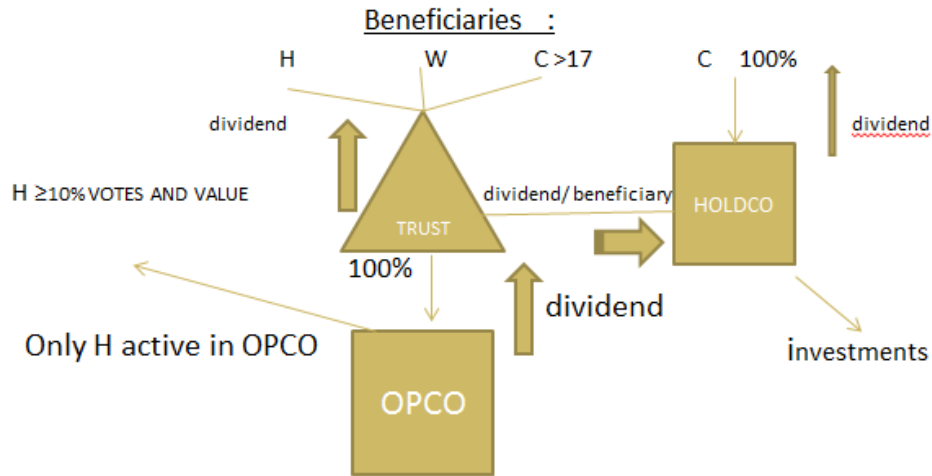
As father was actively engaged in the business before he died for more than 5 years Child 2 will be considered to also have been actively engaged in the business throughout those past 5 years for purposes of meeting the excluded business exemption to constitute an excluded amount

If Child 2 was >17 he will be considered to be >24 for purposes of the excluded share definition(not relevant in this case as shares in a professional corporation do not qualify for excluded shares.)

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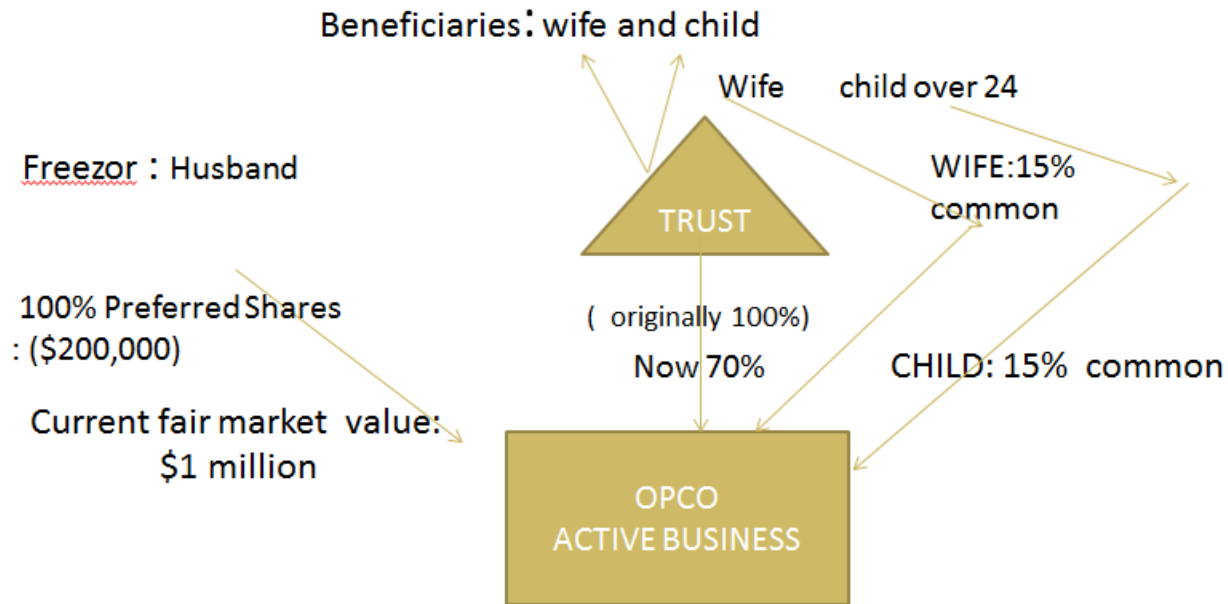
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ILLUSTRATION OF TOSI APPLICATION



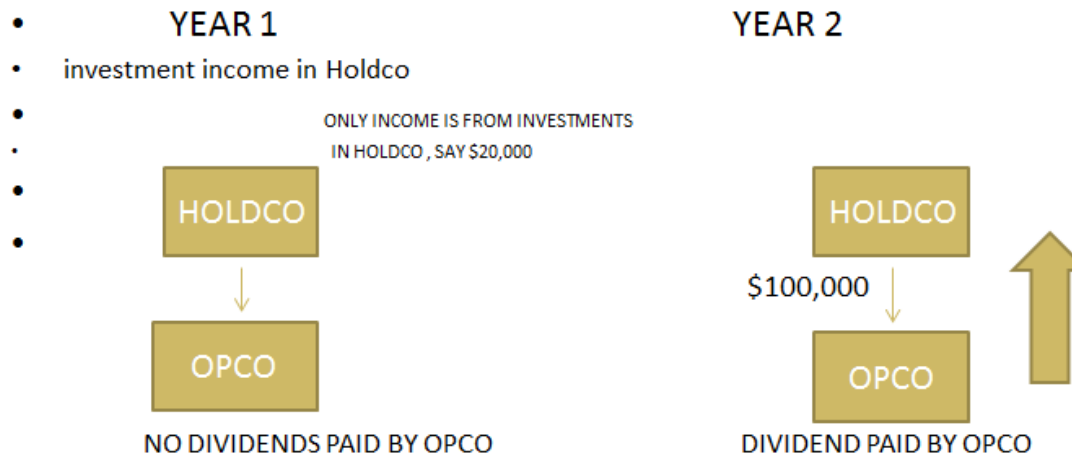
- 1) Dividend from OPCO to TRUST to HOLDCO to C is split income unless another exception applies; C may hold excluded shares unless $\geq 90\%$ income of HOLDCO is indirectly from OPCO via the trust
- 2) If dividend to C from HOLDCO is from investments of HOLDCO it is an excluded amount as the dividend would not be from a related business but from the business of HOLDCO directly; good to segregate income of HOLDCO from trust and investments
- 3) If HOLDCO not carrying on a business is its passive income from dividends received in the year from the TRUST or from investments of HOLDCO? If income of HOLDCO not segregated then the income of HOLDCO paid out as a dividend may be considered to be derived indirectly from the related business of OPCO and thus subject to TOSI; to avoid this problem best not for trust to pay a dividend in the year to HOLDCO
- 4) Dividends from OPCO to TRUST to individual beneficiaries H, W and C: H is not subject to TOSI as he is active in OPCO and owns $\geq 10\%$ of OPCO; W & C subject to TOSI since: 1) dividend is from a related business in respect to W & C; 2) H has an interest in the TRUST which may have a FMV $\geq 10\%$ of FMV of OPCO ; 3) income from TRUST is derived from dividends from OPCO which is a related business in respect to W & C

ESTATE FREEZE/TOSI AVOIDANCE: Several years after freeze by Husband trust distributes 30% of its common shares in OPCO to wife and child



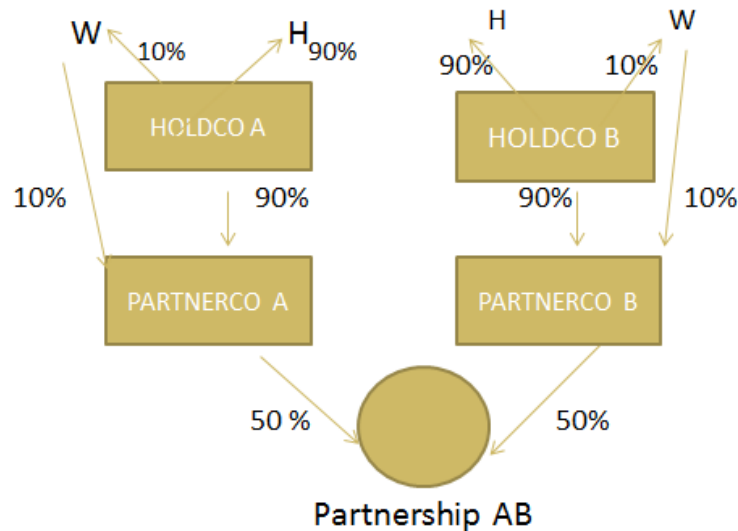
Make sure that wife and child common shares have at least 10% FMV in OPCO

HOW TO ENSURE 'EXCLUDED SHARE' STATUS: SUBJECT TO GAAR



Assume Holdco qualifies for excluded shares: its investment income is business income; $\leq 90\%$ of business income of Holdco for previous year(Year 1) is from services, it is not a professional corporation; shareholders hold $\geq 10\%$ votes and value; $\geq 90\%$ of income for previous year is not derived from a related business(Opco) other than the business of Holdco;
Result: NO TOSI in year 2 from dividend income from Opco

USE OF PARTNERSHIP TO AVOID 'RELATED BUSINESS': SUBJECT TO GAAR



Active Partnership AB business income is $\leq 90\%$ from services ;not a professional partnership; despite partnership constituting a “related business” for each of W and H in each Partnerco(as they are each considered vis à vis their respective spouses to have an indirect interest in the partnership) , the shares in each Partnerco co are still considered to be excluded shares since the “related” business carried on by the partnership AB constitutes the business of each Partnerco and the partnership income is thus not derived from other related businesses other than the business of each Partnerco ; If partnership AB were a corporation the corporation would be a related business of each Partnerco and the income of the corporation flowing to each Partnerco would make the shares of each Partnerco not an excluded share

Implication of Tosi rules:

DEDUCTION OF TOSI INCOME UNDER PARAGRAPH 20(1)(ww) of the Income Tax Act

To avoid double taxation Tosi income is deductible in computing regular income from a business or property as Tosi is already taxed with Tosi tax credits limited to the dividend tax credit, the foreign tax credit and the disability tax credit; it is not clear, however, how this deduction will operate when there is a capital gain subject to Tosi: the deduction in paragraph 20(1)(ww) is in the section dealing with income from a business or property and not from a capital gain; will the deduction still be allowed or will it be denied resulting in both regular tax and Tosi tax on the capital gain ?

This deduction is ignored for purposes of :

- personal tax credits under section 118(1)
- the age credit
- the GST/HST credit
- the Canada child benefit
- the working income tax benefit
- the tax on Old age security benefits

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Joint and several liability

If a specified individual has not attained the age of 18 in the year the parent of the specified individual is solidarily responsible with the minor child to pay the Tosi tax.

If the specified individual is 18 or over but less than 25 and there is a “particular person” who is related as source person in respect of the specified individual, if the amount of the Tosi tax imposed on the specified individual was derived directly or indirectly from a “related business” in respect of the specified individual and the particular person meets any one of the conditions in paragraphs (a) to (c) in the definition “related business” – (ie the particular person is carrying on a business directly or indirectly through a partnership, corporation or trust or has a direct interest in a partnership or has a $\geq 10\%$ interest, directly or indirectly, in a corporation) then the particular person will be solidarily responsible with the specified individual for the Tosi tax

Tosi and the income attribution rules

If Tosi applies generally the income attribution rules will not apply; this is the case for indirect payments, transfers of rights to income, certain interest-free or low-interest loans, income (excluding capital gains) arising from a transfer of property to a spouse, a minor child or to a trust for the benefit of a spouse or minor and income arising from a transfer to a reversionary trust.

However the attribution rules relating to capital gains on transfers to a spouse or to a trust for the benefit of a spouse and the corporate attribution rules relating to transfers or loans to corporations for the purpose of paying dividends out to lower-income family members still apply notwithstanding that Tosi may also apply.

It should be noted that even if the Tosi rules do not apply the income attribution rules may still apply.

Notwithstanding Tosi a section 82(3) election still applies to shift all dividend income received by 1 spouse to the other spouse to allow the other spouse to claim the marriage credit under section 118(1)(a) : beware that Tosi may also apply

Conclusion

- This statement from The Joint Committee on Taxation of The Canadian Bar Association and Chartered Professional Accountants of Canada in its March 8, 2018 submission to the Department of Finance regarding the TOSI rule is the best way to end this presentation :
- ***“There is a time and place for complexity. Rules likely to apply primarily to multinational corporations, who can be expected to have access to sophisticated advisors can reasonably be complex and involved where necessary for their purpose. The TOSI rules apply in a context that could not be more different. Every single individual resident in Canada who receives or realizes an amount derived from a private corporation, partnership or trust will need to understand these rules in order to comply with the law.”***