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COMMENT

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UNDERSTANDING WHEN CORPORATIONS MAY BE ASSOCIATED

The concept of control is used throughout the *Income Tax Act* and is an essential test that is used to determine if one corporation is associated with another. In very general terms, corporations are associated if one corporation controls another "directly or indirectly in any manner whatever" or there is common control of the corporations. Certain tax rules and restrictions apply to corporations that are associated.

The notion of control can be complex, particularly with recent jurisprudence where the courts have provided new interpretations in grey areas. Discussions with business owners often highlight that the fundamentals of control and association are not well-understood, but the implications are significant. Associated corporations must share one small business deduction, which means that only $500,000 of active business income across the entire group of associated corporations is subject to the low tax rate.

This article discusses the fundamental concepts of control and association.

There are two ways that control can exist - *de facto* control and *de jure* control. *De jure* control means control in law – holding sufficient shares to elect the majority of the directors of the corporation (i.e., more than 50 percent of the shares). *De facto* control means direct or indirect influence that, if exercised, would result in control of the corporation. In general terms, case law has confirmed *de facto* control may exist even when there is no share ownership. Where circumstances exist for influence to occur, even if it is not actually exercised, this could be sufficient to result in *de facto* control.

De jure control can occur through a single person or a group of persons, where the term "person" includes individuals, corporations and trusts. If the same person or group of persons controls two companies, the two companies will be considered associated. The group of persons does not have to be related – the two groups must simply be made up of the same members. For instance, two companies each have three equal shareholders; if two shareholders are the same in both groups, then both companies are controlled by the same group of shareholders and would therefore be associated.

The *Income Tax Act* contains a set of rules with respect to who is "deemed to own" shares of a corporation; these rules are important to consider in the analysis of *de jure* control.

- Shares held in a discretionary trust are deemed to be held by each beneficiary of that trust. This creates duplication when analyzing shares held by a discretionary trust; the same share could be counted multiple times in analyzing votes. Consider the situation of a discretionary family trust that holds all of the shares of the family corporation (Opco A). One of the beneficiaries (Maggie) is also a sole shareholder of another corporation that operates a veterinarian clinic (Opco B). Opco A and Opco B are deemed to be associated because Maggie is deemed to control Opco A and she actually controls Opco B.

  When looking at a non-discretionary trust, there is no application of this deeming rule. Instead, shares held in a non-discretionary trust are deemed to be held by the beneficiary with entitlement to the shares.

- Shares held by minors are deemed to be held by the parents. This can be a surprise to some families and can become even more problematic with second marriages and common-law relationships because of the new relationships that are created.

  An exception is available when it can be "reasonably" demonstrated that the

child, in fact, manages the business affairs through the corporation without significant influence from the parent. Application of this exception is generally quite rare.

- The above two deeming rules can be combined such that if a minor is deemed to own all the shares held by the discretionary trust, then the parent is deemed to own all of the shares that were deemed owned by the child. This can become a significant issue in estate freezes that use discretionary trusts where multiple businesses are owned across generations.

In terms of *de facto* control, consider the example of a family business that is financed by a large loan from a relative. The relative could be considered to have control of the corporation, if the loan is callable on demand. Many other types of "influence" also exist. In situations where a passive shareholder (Mr. A) concedes control of the business operations of Opco to another individual (Ms. B, a non-shareholder), there may well be *de facto* control of Opco by Ms. B as she is effectively controlling the business. If Ms. B is a controlling shareholder of other corporations, Opco may be considered associated with these other corporations.

There is even a provision that can deem two corporations to be associated through a third corporation. If, for example, Corporations A and B are associated and Corporations A and C are associated, then because Corporations B and C are each associated with Corporation A, they too are "deemed" to be associated. This situation can arise in family business structures where family members each own independent corporations but the entire family owns a common (for example, real estate) corporation.

Control is an important concept in tax planning and can arise in situations where it is not readily apparent. An awareness of the concept of control and how it plays into the issue of association will help to minimize the element of surprise.

NEW RULES FOR RRIFS

New rules for Registered Retirement Income Funds (RRIFs), introduced in the 2015 Federal Budget, passed into law on June 23, 2015. The primary focus of these changes is to lower the minimum amount RRIF holders are required to withdraw from their plans on an annual basis. An extended period of low interest rates in recent years and increased life expectancy meant that individuals were depleting their RRIF accounts more quickly than anticipated when minimum withdrawal limits were last established.

A new set of RRIF factors has been introduced for the 2015 calendar year and will reduce the required minimum amount for RRIF holders who are over age 70. Since the change was only passed into law mid-year, a further measure was introduced that allows RRIF holders to recontribute any portion of their RRIF income in excess of the "new" minimum back into a RRIF account. A RRIF holder may make this re-deposit during the 2015 calendar year and during the first 60 days of 2016.

In order to provide taxpayers and their advisors with information about how the new rules will apply during 2015, a transition year, the Canada Revenue Agency provided a series of questions and answers on the topic. Below is an excerpt from the CRA's publication, with some edits, to help individuals with their planning.

Q: *What is the withholding tax requirement when a RRIF holder takes the minimum RRIF amount based on the 'old' rules?*

A: The RRIF carrier should base tax withholding on the 'old' RRIF minimum amounts.

Q: *Does the RRIF holder have to re-contribute the excess amount to the same financial institution?*

A: No, but from a practical standpoint, the holder will most likely re-contribute back into their existing RRIF.

Q: *Who determines the eligible RRIF withdrawal amount, the RRIF holder or the RRIF carrier?*

A: The CRA expects that the RRIF carrier will provide the RRIF holder with the required information.

Q: *Where will the RRIF holder report the RRIF re-contribution amount on his or her income tax return?*

A: The deduction will be reported on line 232 of the 2015 personal income tax return. The receipt received from the financial institution will show the amount re-contributed to the qualifying registered plan along with the name of the administrator or carrier of the plan, the signature of an authorized official, the contract number, the RRIF annuitant's name and social insurance number, and the date the re-contributed amount was received.

Q: *What income attribution rules apply where the new factors create a taxable excess and the RRIF is a spousal or common-law partner plan?*

A: The spousal attribution rules applicable in respect of RRIF withdrawals made in 2015 will be based on the "old" RRIF minimum amount.

Q: *How will RRIF carriers calculate and report excess amounts?*

A: The excess amount reported in box 24 of the T4RIF slip should continue to be based on the 'old' minimum amount for 2015. A RRIF carrier will provide additional information to a RRIF annuitant with respect to the "new" RRIF minimum amount and "new" excess amount for 2015.

Q: *When a RRIF holder transfers an account from one financial institution to another, the transferring institution is required to pay the minimum amount before transferring the RRIF. What minimum amount is required to be paid, the "old" or the "new" minimum amount?*

A: Before Bill C-59 received royal assent (June 23, 2015), the transferring RRIF carrier should use the "old" RRIF minimum amount. After Bill C-59 received royal assent, the transferring RRIF carrier must use the "new" RRIF minimum amount. Where the RRIF carrier calculated the minimum amount using the "old" prescribed factors, the annuitant has the option of re-contributing the difference.

Q: *For the purpose of calculating the eligible designated benefit for a RRIF being distributed in 2015 due to the death of the plan holder, should this calculation be based on the 'old' or the 'new' minimum amount?*

A: The RRIF carrier should be calculating the eligible amount based on the pre and post Bill C-59 receiving royal assent.

The RRIF changes were welcome news. While the administration during 2015 will be somewhat complex, the administrative process will return to normal in 2016 but with new lower minimum withdrawal amounts.

TAXPAYER BILL OF RIGHTS

The Canada Revenue Agency has published the Taxpayer Bill of Rights as a set of 16 rights of the taxpayer in their dealings with the CRA. The purpose of publishing these rights is to create obligations on the CRA with respect to service standards and protection of confidentiality.

The following is an excerpt from the Taxpayer Bill of Rights, as published by the CRA, where the term "you" refers to the taxpayer. The official document uses the term "we" when referring to the CRA; in the text below, "we" has been replaced with the term "CRA."

1) You have the right to receive tax entitlements and to pay no more and no less tax than what is required by law.

2) You have the right to service in both official languages. The *Official Languages Act* gives you the right to communicate with, and receive services from, the federal government in English or French at designated bilingual offices.

3) You have the right to privacy and confidentiality. Under this right, you can expect the CRA to protect and manage the confidentiality of your personal and financial information in accordance with the laws that the CRA administers.

4) You have the right to a formal review and a subsequent appeal.

5) You have the right to be treated professionally, courteously, and fairly.

6) You have the right to complete, accurate, clear, and timely information. You can expect the CRA to provide you with complete, accurate, and timely information in plain language that explains the laws and policies that apply to your situation.

7) You have the right, unless otherwise provided by law, not to pay income tax amounts in dispute before you have had an impartial review. However it should be noted that interest will be charged during this period.

8) You have the right to have the law applied consistently so everyone gets their entitlements and pays the right amount of tax.

9) You have the right to lodge a service complaint and to be provided with an explanation of the CRA's findings. You can expect that if you make a service-related complaint, you will be listened to and given the opportunity to explain your situation.

10) You have the right to have the costs of compliance taken into account when administering tax legislation.

11) You have the right to expect the CRA to be accountable. When the CRA makes a decision about your tax or benefit affairs, you can expect an explanation about that decision and information about your rights and obligations.

12) You have the right to relief from penalties and interest under tax legislation because of extraordinary circumstances. This right means that the CRA will consider your request to waive or cancel all or part of any penalty and interest charges, if you were prevented from complying with your tax obligations because of circumstances beyond your control.

13) You have the right to expect the CRA to publish their service standards and report annually.

14) You have the right to expect the CRA to warn you about questionable tax schemes in a timely manner.

15) You have the right to be represented by a person of your choice. You can choose another person to represent you and give advice about your tax and benefit affairs.

16) You have the right to lodge a service complaint or request a formal review without fear of reprisal.

The Taxpayer Bill of Rights is an important component of dealing with the CRA in tax matters. The full text is available on the CRA website at http://www.cra-arc.gc.ca/E/pub/tg/rc17/rc17-e.html. The CRA's role is to administer tax and related benefits as outlined in the laws passed by parliament. A taxpayer can expect courteous service but is still expected to meet his or her tax obligation.

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