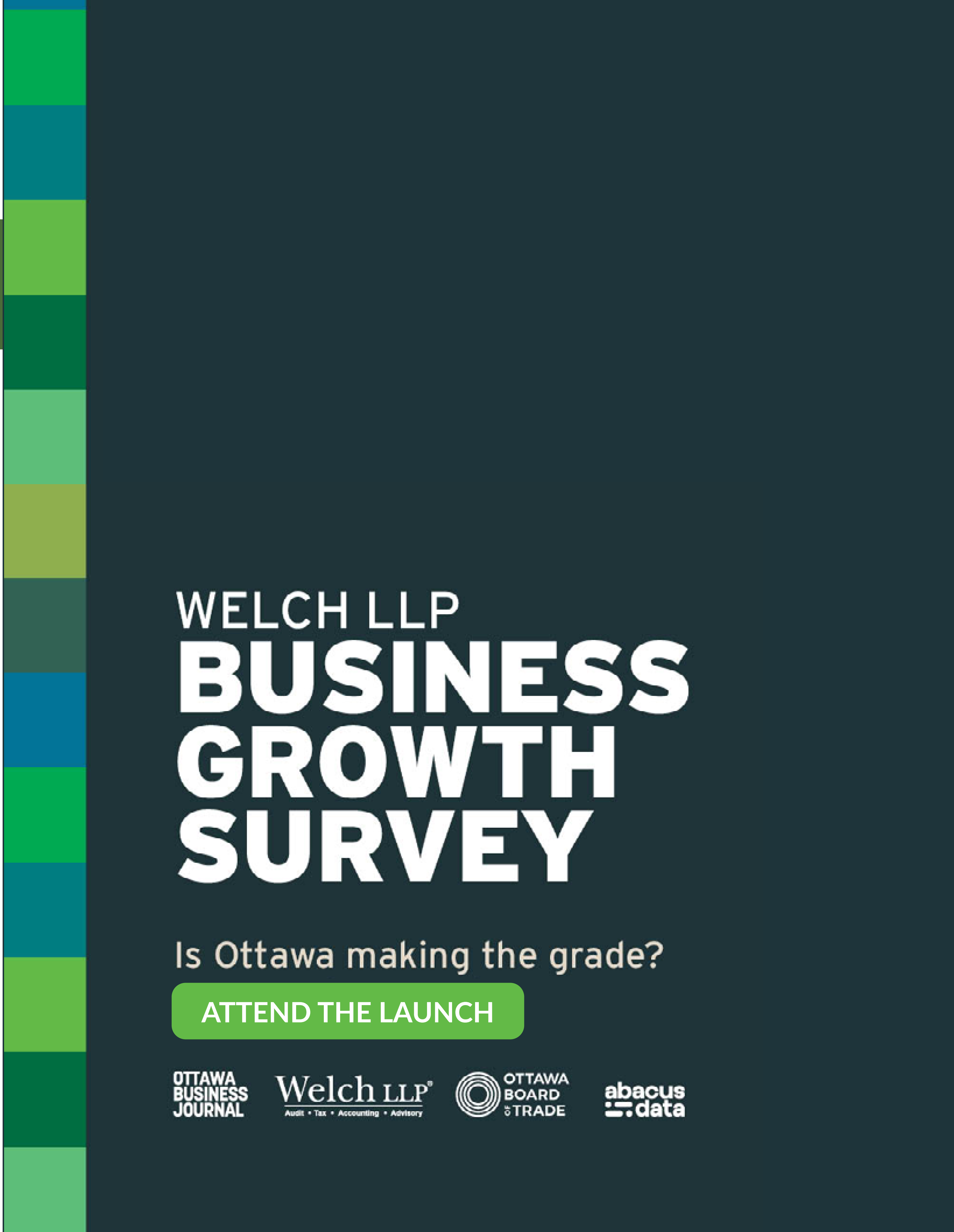
WELCH TIMES

SPRING 2024

CONTENTS


WELCH LLP
BUSINESS GROWTH SURVEY
Is Ottawa making the grade?
ATTEND THE LAUNCH
OTTAWA BUSINESS JOURNAL
Welch LLP
Audit • Tax • Accounting • Advisory
OTTAWA BOARD of TRADE
abacus data

MAXIMIZING THE BENEFITS OF R&D IN YOUR MEDICAL PROFESSIONAL CORPORATION

Do you perform research during your day-to-day activities? Are you looking to develop new procedures or new medical devices that will improve human lifestyles? If you answered yes to either of these, you may qualify for the very lucrative Scientific Research and Experimental Development ("SR&ED") tax credit.

THE BENEFIT OF SR&ED

Beyond the obvious benefits of your R&D work (improved pharmaceuticals, faster and safer medical procedures, increased longevity), your R&D work could qualify for SR&ED. If this is true and you perform the R&D through your Medical Professional Corporations (MPC) or another Corporation (which you should consider and is discussed below), your corporation could qualify for up to 65% in tax credits on qualifying salaries and wages paid for SR&ED purposes in Ontario. If you are outside of Ontario, you can qualify for these credits as well, but the rates will vary. In addition to qualifying for these credits, a portion of those available (approximately 60% in Ontario) may be refundable to the corporation in a year where the corporation has no tax balance owing.

As you may expect, there are very specific rules with respect to qualifying activities for SR&ED given the lucrative nature of the tax credit and potential refund available. The key to qualifying SR&ED is the advancement of knowledge in the field of science or technology. If you are operating an MPC, this is likely in the field of medical science (devices) or medical research (new compounds, materials, procedures or pharmaceuticals).

Now that you know the benefits of SR&ED, you must consider whether you are currently or want to start pursuing SR&ED in your MPC, or through a separate corporation. A couple of common areas where physicians perform SR&ED are:

DEVELOPING A NEW MEDICAL DEVICE

As a physician at the face of medical services, you may recognize the need for an improvement in a medical device including the equipment to perform your duties (scalpels, sutures), measurement devices (EKG, portable ultrasound devices) or systems (computer guided surgical systems).

DEVELOPING A NEW TREATMENT

Consider targeted cancer treatments versus the traditional non-targeted chemotherapy or the new EKG-based headsets and gamification.

PHARMACEUTICALS

New chemical compounds are created everyday. The formulation, development and testing of these compounds may be SR&ED.

THE BENEFITS OF A SEPARATE CORPORATION

While you can perform SR&ED within your MPC, you may find it beneficial to incorporate a separate company for this development. The benefits include access to additional funding, limiting potential risk and sharing the benefits of ownership with family members.

ADDITIONAL FUNDING

As a physician at the face of medical services, you may recognize the need for an improvement in a medical device including the equipment to perform your duties (scalpels, sutures), measurement devices (EKG, portable ultrasound devices) or systems (computer guided surgical systems).

LIMITING POTENTIAL RISK

Consider targeted cancer treatments versus the traditional non-targeted chemotherapy or the new EKG-based headsets and gamification.

SHARING IN THE BENEFITS

New chemical compounds are created everyday. The formulation, development and testing of these compounds may be SR&ED.

As you can see, performing R&D within your corporation or another corporation can be very beneficial to you, your family and others. If you are performing R&D in your MPC currently, you should consider a separate corporation to take advantage of the benefits discussed above. If you have any questions about SR&ED, MPCs or the benefits of using a separate corporation, please reach out to your Welch advisor for guidance.

Author: Joshua Smith, CPA, CA, Partner

Federal Budget 2024

COMMENTARY AND INSIGHTS

On April 16, 2024, the Deputy Prime Minister and Finance Minister, the Honourable Chrystia Freeland, presented Budget 2024 – Fairness for Every Generation, to the House of Commons.

No changes were made to personal or corporate tax rates.

Some highlights include the following:

PERSONAL MEASURES

- An increase to the capital gains inclusion rate to 2/3, however individuals will retain the 1/2 inclusion rate on the first $250,000 of capital gains annually.
- An increase to the lifetime maximum capital gains exemption, and two new incentives on specific types of business sales.
- Modifications to the proposed amendments to focus the alternative minimum tax regime on high-income individuals.

BUSINESS MEASURES

- A Canada carbon rebate for small businesses that will begin by delivering payments to eligible CCPCs for five years of carbon tax.
- Accelerated capital cost allowance on purpose-built residential rental properties.
- Immediate expensing of certain productivity-enhancing assets, including computer hardware, acquired on or after April 16, 2024.

INTERNATIONAL MEASURES

- A crypto-asset reporting framework that will require annual reporting by crypto-asset service providers on their clients' activities using these assets.

SALES AND EXCISE MEASURES

- Extension of the GST exemption for new purpose-built rental housing projects to not-for-profit universities, public colleges and school authorities.

OTHER MEASURES

- Details on the Canada disability benefit intended to commence in July 2025.

PREVIOUSLY ANNOUNCED MEASURES

- Intention to proceed with previously announced measures, including the denial of expenses for non-compliant short-term rental activities; the exemption of certain services of psychotherapists and counselling therapists from GST/HST; proposals related to the underused housing tax; temporarily pausing the fuel charge on heating oil; various clean energy tax credits; and other initiatives related to the clean economy.

Author: Zoran Vranjkovic, CPA, CA, CFP, TEP, Director, Partner

HOLDING COMPANIES

AND THE COST OF FOREIGN DIVIDENDS

Our tax system is based on the concept of "tax integration", whereby taxpayers should be indifferent as to whether they earn income personally or through a corporation. In theory, after a corporation has paid personal tax on its income and distributed the after-tax profits as dividends to its shareholders, who in turn pay personal tax on the dividend, the end result should be the same as if the individual had earned the income personally in the first instance and simply paid personal tax. Given the number of tax jurisdictions within Canada (federal, ten provinces and three territories) and that each may have its own fiscal issues and policies, this can be difficult to achieve. For the most part though, our tax system is fairly close to perfect tax integration in most cases.

In the case of business income, when considering an Ontario-resident individual who is in the highest personal tax bracket, there is a very slight cost to earning business income through a corporation and then distributing dividends to the individual. However, there is a significant deferral of personal tax in these cases, such that the benefits of being able to invest/reinvest this deferred tax will typically easily exceed the tax cost of incorporating the business activity. This tax deferral and ability to accumulate investment capital at a faster pace is one of the key tax advantages of incorporating a business activity.

In the case of investment income earned through a corporation, there is a tax cost once the corporation pays its after-tax income out to shareholders as dividends, as follows:

- dividends from Canadian corporations – no cost;
- capital gains – cost of 2.2%;
- interest income – cost of 4.4%;
- rental income – cost of 4.4%; and
- dividends from foreign corporations – 10.4%.

Despite the added tax burden associated with earning investment income through a corporation, there are many reasons why one may be willing to bear this cost, including:

- allows for the implementation of an estate freeze, which may defer tax that would otherwise arise on death;
- provides more certainty as to one's eventual tax liability upon death;
- allows for planning to avoid probate fees on the underlying investments;
- provides the ability to better manage one's personal income level; and
- if the capital that has been invested originated from an operating company, a significant tax deferral is maintained so long as the investments remain in a corporation.

Using a corporation to hold investments is a common tax and estate planning tool, but people are often surprised at the cost associated with earning foreign dividend income through a corporation. While the "tax tail" should not necessarily wag the "investment dog", having an understanding of the tax impact may help in planning how to optimally hold different types of investments. Speak to your Welch LLP advisor to discuss how this may impact your situation.

Author: Zoran Vranjkovic, CPA, CA, CFP, TEP, Director, Partner



Capital Gains Inclusion Rate

How Does It Impact Me?

The federal Budget was presented on April 16, 2024 and among a number of proposed tax changes, included an increase in the capital gains inclusion rate from 1/2 to 2/3 for corporations, as well as for individuals in respect of any capital gains in excess of $250,000 in a given year. This change is to apply for capital gains realized after June 24, 2024 and will effectively increase the tax rate applicable to capital gains realized by corporations to 33.45% (from the current 25.1%) and to 35.69% for affected individuals (from the current 26.77%). However, in addition to directly increasing the tax rate, this change will have many other indirect implications for taxpayers.

This change will have many other indirect implications for taxpayers.

TRIGGERING CAPITAL GAINS

While triggering capital gains before this increase may result in less tax, consider whether you would be better off paying a lower tax rate now, but have less value invested over a period of time. Factors to consider would include when the assets might otherwise have been sold, and what the expected rate of return might have been over that period.

COST OF EARNING INVESTMENT INCOME IN A CORPORATION

There has always been a tax cost to earning investment income through a corporation. These costs are 4.4% for interest and rental income, 10.4% for foreign dividends and until recently, 2.2% for capital gains. In the case of individuals that would have less than $250,000 of capital gains personally, the cost of earning capital gains through a corporation will now increase to 11.86%. There will continue to be reasons for using corporations to earn investment income, including to achieve a significant tax deferral where the invested capital is generated from an active business, and for estate planning reasons. However, this increased tax cost for capital gains will have to be considered, along with whether certain types of income should be earned outside of the corporation if possible.

TERMINAL TAX LIABILITY

An "estate freeze" is a common estate planning strategy where assets are held in a corporation and the individual owns fixed-value Preferred shares of the corporation, thereby limiting the tax arising on death based on the value of the Preferred shares owned. By capping one's max tax liability, this strategy provides some certainty over the amount of tax that may be payable on death and facilitates plans to fund this tax liability. However, the increase in the capital gains inclusion rate effectively increases the maximum terminal tax liability by 1/3. Consideration should now be given to how one's estate will fund this additional unexpected liability, particularly in the case of illiquid estates that own significant real estate or private company shares. Life insurance may be one option for funding this amount.

SMALL BUSINESS DEDUCTION

An associated group of Canadian-controlled private corporations is entitled to a lower corporate tax rate (12.2% in Ontario) on the first $500,000 of active business income (compared to 26.5% otherwise). Where the group's aggregate investment income in a year exceeds $50,000, its entitlement to this lower tax rate will be clawed back in the following tax year. Where aggregate investment income exceeds $150,000, the group will not be entitled to this lower tax rate in the following year. The increased capital gains inclusion rate will increase corporate groups' taxable capital gains, thereby increasing investment income and reducing the group's entitlement to this lower tax rate.

STOCK OPTIONS

Many employees find stock option compensation attractive because the benefit may be reduced by half, mirroring the tax result of a capital gain. In order to maintain this parity with capital gains treatment, the Budget proposes to reduce this employee stock option deduction from 1/2 to 1/3 for any portion of the stock option benefit exceeding $250,000 in the year (note that the individual's capital gains for the year would also be taken into account in this $250,000 threshold). This change will make stock option compensation less attractive for some employees.

CAPITAL GAINS EXEMPTION

The lifetime capital gains exemption currently allows individuals to realize tax-free capital gains from the disposal of qualified small business corporation shares and qualified farm or fishing property during their lifetimes. The exemption will increase to $1,250,000 (from the current $1,016,836) beginning on June 25, 2024. Between the increase in the capital gain exemption threshold and the increased capital gains inclusion rate, the lifetime capital gains exemption will provide significantly more tax savings – up to $446,000 per exemption, compared to $272,000 currently. To the extent the corporate structure allows family members to participate in ownership, these savings can be significant. Business owners will want to ensure that their corporate structures are optimal for purposes of accessing the maximum benefits from the lifetime capital gains exemption.

As you can see, the adjustment of the capital gains inclusion rate on its own has many direct and indirect implications for all taxpayers, particularly for business owners. Contact your Welch LLP advisor to discuss how these changes impact your situation.

Author: Zoran Vranjkovic, CPA, CA, CFP, TEP, Director, Partner

our CLIENTS IN THE NEWS

CRYPTO4A

LANDS $3.7M IN FEDERAL FUNDING TO SCAL UP QUANTUM-SAFE CYBERSECURITY HARDWARE

M&H

FIND SUCCESS WITH TENTEGRATED MOB NEAR OTTAWA

GROWCER

IS #9 ON THE POWER LIST

Welch LLP®

Welch Risk Advisory LLP

ELEVATE
BY WELCH LLP

Welch Capital Partners

FAMILY WEALTH ADVISORY
BY WELCH LLP

welchllp.com