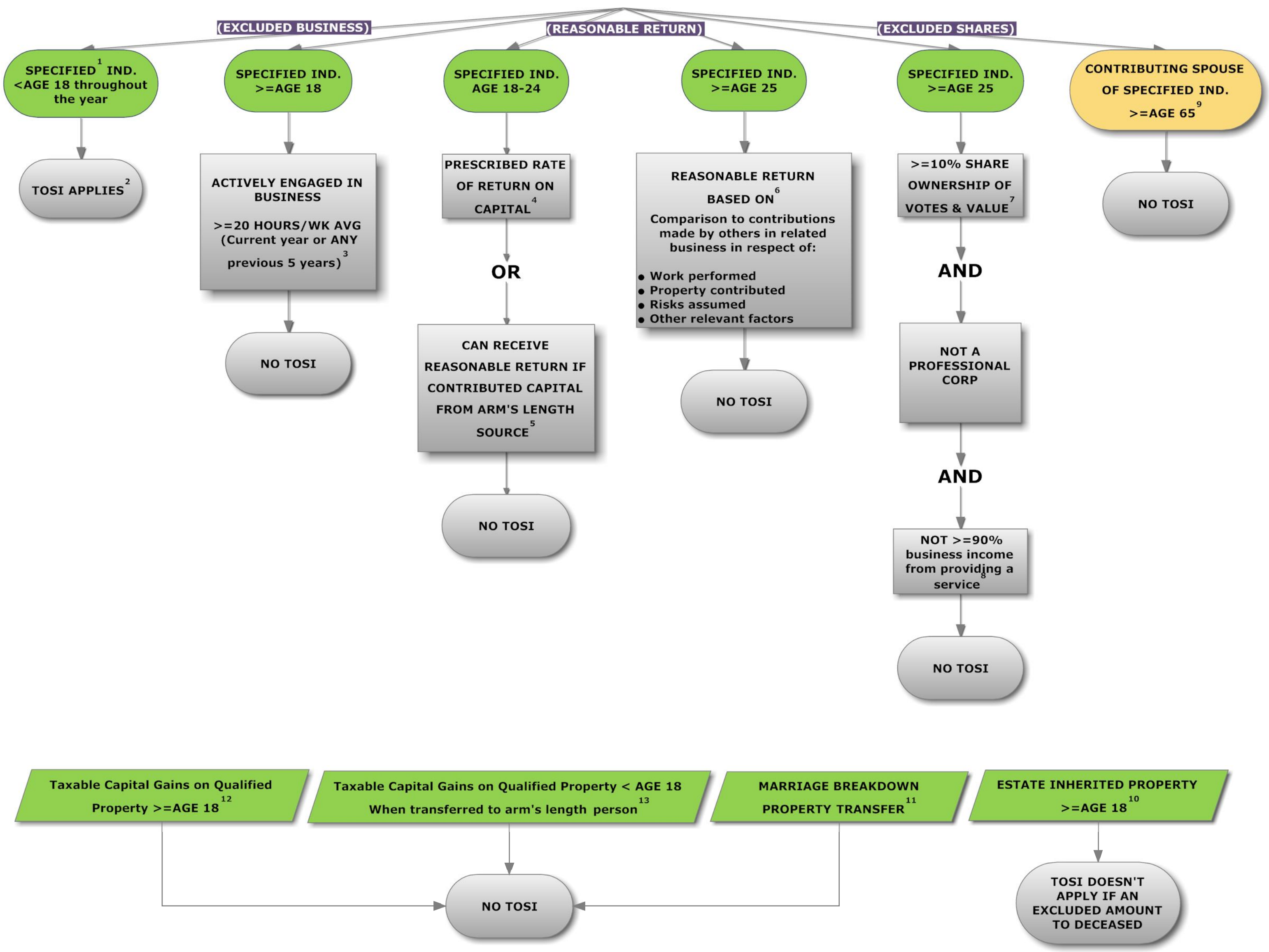
TAX ON SPLIT INCOME
("TOSI")

SIMPLIFIED GUIDELINES - SPEAK TO YOUR ACCOUNTANT REGARDING YOUR SPECIFIC SITUATION

The accompanying explanatory notes are an integral part of this flow chart please see reference numbers

NON-SALARY INCOME



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TAX ON SPLIT INCOME ("TOSI")

Explanatory Note 1: Specified individual: Minor or Adult, resident in Canada, related to a person who is either actively engaged in carrying on a business in Canada or owns a significant portion of the equity of that related business.

Explanatory Note 1A: Specified individual < Age 18 throughout the year. Under the previous TOSI rules, an individual (other than a spouse) would not have been a specified individual if they had attained the age of 17 in the prior year. This allowed for persons who were 17 at the time of payment to not be subject to the old TOSI rules if they were 18 by the end of the calendar year.

Explanatory Note 2: Split income includes the following types of income: Taxable dividends and shareholder benefits from private corporations; trust income allocations derived from private corporation dividends or benefits, or a rental where a related person is involved; income earned from debt owing from a private corporation, partnership or trust; partnership income generated from a related business (generally defined as a business sufficiently connected to a related individual), or a rental where a related person is involved. Income or gains resulting from the disposition of property noted above. Excluded amounts will not be considered to be split income and as such not subject to the TOSI.

Explanatory note 3: An individual will be deemed to be actively engaged in the business on a regular, continuous, and substantial basis, if they work at least an average of 20 hours per week in the related business. For seasonal businesses, this test will apply only to the months during which the business operates.

Explanatory note 4: The "safe habour capital return" is a formula based on multiplying the fair market value ("FMV") of property contributed in support of a related business by the prescribed rate of interest. Income subject to TOSI is reduced by the safe harbour capital return.

Explanatory note 5: A reasonable return is based on the criteria available for individuals 25 years and older. In order for these rules to be in effect, the capital must come from an arm's length source and must not be borrowed nor received directly or indirectly from a related person. For example, if the 18 year old has income from a non-related source and uses that income to contribute capital to the related business, then a reasonable return can be received without being subject to TOSI rather than being limited to a prescribed rate of return on the capital contributed.

Explanatory note 6: When determining if an amount is reasonable, the individual's contributions must be compared to the contributions made by others in the related business. Contributions may include work performed in the business, property contributed to the business and risks assumed in respect of the business. The contributions should be compared to those of the "source individual(s)" of the related business (i.e. the person(s) carrying on the related business), not to the contributions of other specified individuals.

Explanatory note 7: The specified individual must, before the payment is received, hold shares which gives them 10% or more of the votes that can be cast and must represent a FMV of 10% or more of the FMV of all of the issued and outstanding shares of the related corporation. For 2018 only, an individual has until the end of 2018 in order to obtain the required ownership percentage in order to have access to this exception.

Explanatory note 8: The excluded share exception does not apply to professional corporations nor to corporations who have 90% or more of their business income derived from providing services. A related corporation cannot be used to move income from an service business to a non-service business in order to try to have this exception apply.

Explanatory note 9: TOSI will not apply to income received by an individual from a related business when their spouse has made contributions (current or previous) to that business and is 65 years of age or older. For this exclusion to apply, the amount would have had to be an excluded amount to the contributing spouse had the contributing spouse received it directly because of one of the three exceptions (excluded business, excluded shares, or reasonable return). When those conditions are met, such receipts will be deemed to be an excluded amount to the specified individual. There is no requirement for the spouse receiving the income to be 65 years of age or older.

Explanatory note 10: The amount will be an excluded amount for a specified person (age 18 or older) who has inherited the property if the income from the inherited property, had it been earned by the deceased, would have been an excluded amount to the deceased due to one of the three exceptions (excluded business, excluded shares, or reasonable return). For the purposes of this provision, individuals age 18-24 will be deemed to be 25 or older if the deceased was 25 or older so they can have access to the same exceptions as the deceased would have had access to.

Explanatory Note 11: Property received by an individual as a result of a separation agreement or judgement due to breakdown of marriage or a common-law partnership will not be subject to the TOSI.

Explanatory Note 12: Taxable Capital Gains resulting from the disposition of qualified farm or fishing property and/or qualified small business corporation shares are excluded from the TOSI.

Explanatory Note 13: Taxable Capital Gains resulting from the disposition of qualified farm or fishing property and/or qualified small business corporation shares are excluded from the TOSI when transferred to arm's length persons. Non-arm's length dispositions by persons under the age of 18 remain subject to the TOSI.

Taxation Update 2017

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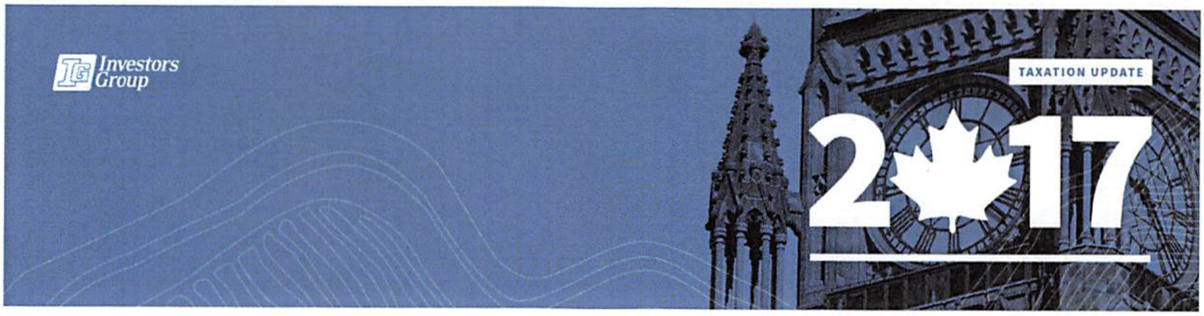

PROPOSALS IMPACTING PRIVATE CORPORATIONS

On December 13, 2017, William Morneau, the Federal Minister of Finance, released revised measures designed to clarify the income sprinkling proposals that were announced this past July. The revised measures are narrower in application than the original proposals and will have the greatest impact on professionals and other service businesses. While these new measures do provide clarity, they are complex in their application. This summary contains highlights of these new proposals, which are not yet law. Clients should contact their Investors Group Consultant for information on how these proposals may affect their financial plans.

Measures to address income sprinkling

Effective January 1, 2018, the new income sprinkling measures, referred to as the amended tax on split income ("TOSI") rules, will apply top personal rates of tax to dividends and other (non-salary) income, as well as some capital gains, received by specified individuals from a related business. A specified individual can either be a minor or an adult who is related to a person who either is actively engaged in carrying on a business in Canada or who owns a significant portion of the equity in that business (i.e. a related business). However for adults, the TOSI will not apply when (non-salary) income, capital gains or profit received meets the definition of an excluded amount. Excluded amounts can be received from an excluded business, as a result of owning excluded shares, or are amounts considered to be a reasonable return.

Excluded business

Amounts received by an adult, **age 18 or over**, from an excluded business will not be subject to the new TOSI. An excluded business is:

- A related business, in which the individual was actively engaged on a regular, continuous and substantial basis in the activities of the business either in the current taxation year or **in any five** prior taxation years of the individual;

- For certainty, an individual will be actively engaged if they work in the business at least an average of 20 hours per week. For seasonal businesses, the average will apply only to the months during which the business operates;

- If the average of 20 hours per week test is not met in the current year, but the individual meets that requirement for any five prior years (these years do not have to be consecutive), the amount will be an excluded amount.

Excluded shares

Amounts received by individuals, **age 25 or over,** from excluded shares will not be subject to the new TOSI. Shares will be excluded shares when:

- The shares owned represent 10% or more of the votes **and** value of the corporation. The ownership must be held directly (i.e. not through a family trust). Taxpayers have until the end of 2018 to obtain the required 10% ownership in the corporation in order to rely on this exclusion;

- Less than 90% of the corporation's business income was from providing services;

- The corporation was not a professional corporation (i.e. doctor, lawyer, accountant, dentist); **and**

- 90% or more of the income of the corporation is not from another related business of the individual, meaning a corporation cannot be used to move income from a service business or professional corporation in order to meet the excluded share test.

Reasonable return

Amounts received, other than from an excluded business or from excluded shares, will be subject to the TOSI to the extent that they are unreasonable. For individuals, age 25 or over, reasonable amounts will be based on the comparison of contributions made by others in the related business with respect to the following factors:

- Work performed in support of the business;

- Property contributed in support of the business;

- Risks assumed in respect of the business;

- Total amounts paid for the benefit of the individual in respect of the business; and

- Other relevant factors.

For individuals, age 18 to 24, an excluded amount is a return not exceeding a prescribed rate return. Individuals, age 18 to 24, can receive a reasonable return, rather than a prescribed rate return, on contributed capital obtained from arm's length sources.

Retirement and inherited property

In order to provide similar benefits as the existing pension income splitting provisions, the TOSI rules will not apply when income is received by an individual from a related business when that individual's spouse has made current or previous contributions to the business and that spouse is 65 years or older. If the amount would have been considered an excluded amount to the spouse had they received it, the amount will be an excluded amount to the specified individual.

There are also new rules with respect to inherited property. When the property has been inherited by an individual, 18 years or older, the income from that property will not be subject to the TOSI if it was not subject to the TOSI for the deceased.

Qualified property eligible for the Lifetime Capital Gains Exemption (LCGE)

The TOSI will not apply to taxable capital gains resulting from the disposition of property which can qualify for the LCGE (qualified small business corporation shares and qualified farm and fishing property). The exemption applies regardless of whether the specified individual actually claims their LCGE in respect of the resulting taxable capital gain. Gains realized by a minor resulting from a non-arm's length disposition will continue to be subject to the TOSI.

Other changes to the July 2017 proposals

- The government will no longer proceed with proposals to apply the TOSI to compound income.
- Related persons, for the purpose of the TOSI rules, will not be extended to include aunts, uncles, nieces, and nephews.
- When property is acquired as a result of the breakdown of marriage or common-law partnership, income earned from that property will not be subject to the TOSI.

Next steps

The Government will continue to move forward with measures designed to limit tax deferral opportunities related to passive investments, details of which will be included in Budget 2018. When introduced, the passive investment measures will apply on a go-forward basis.

For more information on the July 18, 2017, proposals go to www.investorsgroup.com and click on More.