Tax on split income ('TOSI") rules – potentially liable for tax at top rate, in effective 2018 onwards

Draft legislation for tax on split income rules, commonly known as TOSI rules, was announced on December 13, 2017, which will be effective on January 1, 2018. This draft legislation was contained in the March, 2018 federal budget and became law in June 2018.

The split income subject to TOSI rules will be taxed at top tax rate. The potential cost for income subject TOSI rules was analyzed in the following chart

	Income amount	Top rate under TOSI rules	Graduated rates	**Tax difference**
Regular income	$100,000	$54,280	$25,452	**$36,224**
Eligible dividend	$100,000	$40,094	$9,508	**$30,586**
Ineligible dividend	$100,000	$47,589	$17,156	**$30,433**
Capital gain	$100,000	$27,365	$3,018	**$24,347**

Who will be affected by these rules?

Below are two typical examples of split income that would be caught by the TOSI rules.

Please refer to the earlier I&A's newsletter "Proposed new income splitting rules updates" (https://dev-ierfino-np.pantheonsite.io/wp-content/uploads/Proposed-New-Income-Spliting.pdf) for a detail discussion of the TOSI rules.

Example #1

Anna is 20 years old and is a full-time student. Her father Mr. Smith owns a corporation, Smithco. Mr. Smith gifted Anna $100,000 and Anna loaned the money to Smithco. In return, the company pays Anna interest at 6% annually. The interest income received by Anna is likely to be subject to TOSI rules and starting 2018, Anna will have to pay $2,141 (53.53% on $4,000 income subject to TOSI)*.

Example #2

Dr. Smith is a dentist and operates a professional corporation Smith Dentistry Professional Corp. Mrs. Smith is 40 years old and is a shareholder of the company. Mrs. Smith had never worked for the company and did not make any capital contribution to the company. Mrs. Smith is receiving a dividend in the amount of $30,000 from the company annually. The dividend income received by her is likely to be subject to TOSI rules, and she has to pay $14,052 additional tax (46.84% on $30,000 income subject to TOSI) on the split income starting 2018, compare to an nominal amount of tax if she has not other income prior to this TOSI rules.

Are there exceptions for these rules to apply?

For individuals above age of 18, "excluded business" is a common exception of the TOSI rules. To meet the criteria for excluded business, you will need to contribute labour to the business on a regular, continuous and substantial basis in the year or in any 5 previous years, i.e. average of 20 hours per week during the period of year the business operates. Detailed records should be maintained to outline the hours worked.

Another exclusion exists if your spouse or common-law partner is over age 64 who has made significant contributions to the business.

Other exceptions are available, as discussed in the earlier newsletter. However, the rules are not straightforward and require detailed analysis.

*Income subject to TOSI is reduced by interest income at prescribed rate of 2% annually