PARSONS & CUMMINGS LIMITED

MANAGEMENT CONSULTANTS

245 Yorkland Blvd., Suite 100 Willowdale, Ontario M2J 4W9

Tel: (416) 490-8810 Fax: (416) 490-8275

Internet: www.parsons.on.ca

TAX LETTER

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NEW TAX BENEFITS FOR FAMILIES WITH CHILDREN

On October 30, 2014, Prime Minister Harper and Finance Minister Joe Oliver announced three new tax benefits for families with children. The Conservatives had promised these changes in their April 2011 election platform, but indicated that they would only happen once the federal budget had been balanced. This has now happened, and so these changes will take effect in time for the federal election expected in fall 2015:

(1) Family Tax Cut —
sort of income splitting

This change, announced publicly as "income splitting", is not actually income splitting, though it will have the same economic effect to the family unit.

Under our progressive tax system, a family's income is taxed at a higher rate if one spouse earns, say, $100,000 and the other spouse earns nothing, as opposed to each one earning $50,000.

The new "Family Tax Cut" is designed to reduce or eliminate this difference. It is available only to couples (including common-law partners) with children under 18. It takes effect in the 2014 taxation year.

<u>The new rule does not actually permit income splitting.</u> The spouse earning $100,000 cannot transfer $50,000 of that income to his or her spouse for tax purposes (as can be

done with pension income since 2007). Instead, a calculation is done ***as if*** **up to $50,000 of the income was earned by the lower-income spouse**, and either spouse can claim a **credit**, reducing federal tax by **up to $2,000** (typically, the higher-income spouse would claim the credit, but either spouse can).

(2) Increased and expanded Universal Child Care Benefit

The Universal Child Care Benefit (UCCB) is a $100 monthly payment to parents of children under 6. It is taxable to the lower-income spouse, or for a single parent, in the child's hands (so that no tax is normally payable). The UCCB theoretically allows parents to pay for child care, but there are no strings or conditions attached to it, and taxpayers can spend it on whatever they like. The UCCB is being **increased from $100 to $160 for children up to age 6**, and will be introduced as a **$60 monthly payment for children age 6-17**. Again, there are no conditions or restrictions on how these funds are used.

These increases of $60 per month for every child aged 0-17 will take effect January 2015, but will not start being paid until July. One effect of this postponement is that the higher UCCB will not affect the federal government's budget for the year ending March 31, 2015. More important politically is that parents will receive a cheque for $420 per child (accumulating 7 months of payments) in July 2015, conveniently just around when a federal election is called. A family with three children under 18, for example, will get an extra $1,260 in July, and $180 each month after that, in addition to what they were already receiving.

As a result of the enhanced UCCB, the regular child tax credit will be repealed, effective for 2015. However, the "family caregiver credit" that applies to infirm minor children will continue to apply.

(3) Increased child care expense limits

Child care expenses can generally be deducted by the lower-income spouse, up to a limit of 2/3 of "earned income" and subject to certain dollar limits. These dollar limits have not increased since 1998 (since 2001 for disabled children):

- $10,000 per severely disabled child ($250 per week)
- $7,000 per other child under 7 ($175 per week)
- $4,000 per other child age 7-16 (and infirm dependent children over 16) ($100 per week)

(The expenses do not have to be incurred for the child in question. For example, if the family has two children age 12 and 3, then the dollar limit is $11,000 even if all the child-care costs are paid to care for the 3-year-old.)

The new announcement makes small increases in these amounts:

- $11,000 per severely disabled child ($275 per week)
- $8,000 per other child under 7 ($200 per week)
- $5,000 per other child age 7-16 (and infirm dependent children over 16) ($125 per week)

These changes will automatically result in increases to the "periodic" child care expense limits, which apply to boarding school or camp or where the higher-income spouse can claim the expenses because the lower-income spouse is in school, prison or hospital. Those limits are 1/40th of the annual limit per week.

HST QUIZ — IS YOUR BUSINESS CHARGING IT PROPERLY?

Whether or not you're in a Harmonized Sales Tax province, if you carry on business you need to know the rules for when to charge HST. You might be surprised!

The GST/HST rates are:

- 13% HST in Ontario, New Brunswick and Newfoundland & Labrador
- 14% HST in Prince Edward Island
- 15% HST in Nova Scotia
- 5% GST in all other provinces and the territories. (There is a also a provincial retail sales tax in British Columbia, Saskatchewan and Manitoba, and a GST-like Quebec Sales Tax in Quebec. Alberta and the territories have only the 5% GST.)

Try this quiz and see how you do. Answers are on page 6.

1. You're in Calgary and you sell widgets. A customer in Halifax orders a widget and you ship it to her in Halifax. What rate of tax do you charge?

2. You're in Calgary and you sell widgets. A customer in Halifax orders a widget and you "deliver" it at your warehouse in Calgary. In order to get the widget to her, you also arrange (as your customer's agent) for a courier company to deliver the widget to her. What rate of tax do you charge?

3. You're in Calgary and you sell widgets. A customer in Halifax orders a widget and you deliver it at your warehouse in Calgary. In order to get the widget, your customer calls a courier company to have the widget picked up at your warehouse. What rate of tax do you charge?

4. You're an engineer based in Charlottetown. A client in Winnipeg thinks he's invented a new device, and wants you to review his design plans to tell him if they will work. You stay at your office in Charlottetown, review the plans, write a report and bill the client. What rate of tax do you charge?

5. You're an engineer based in Charlottetown. A client in Winnipeg thinks he's invented a new device, and wants you to review his design plans to tell him if they will work. You travel to Winnipeg, review the plans, write a report and bill the client. What rate of tax do you charge?

6. You're an engineer based in Charlottetown. A client in Winnipeg thinks he's invented a new device, but is being sued by a competitor in Ontario who says your client stole the plans. They're in litigation in the Ontario courts. You stay at your office in Charlottetown, review the plans, write an expert report for your client to use in the litigation and bill the client. What rate of tax do you charge?

7. Following #6, you travel to Toronto to testify as an expert witness in the trial, on behalf of your Winnipeg client. What rate of tax do you charge?

8. You're a hair stylist in Edmonton. You style the hair of a client from Toronto who is visiting Edmonton. What rate of tax do you charge?

9. You’re a plastic surgeon in Edmonton doing facelifts (which are taxable when done solely for cosmetic reasons). You do a facelift for a patient from Toronto who is visiting Edmonton. What rate of tax do you charge?

10. You’re a computer expert based in New Brunswick. A customer from a nearby town in Quebec sends you a computer to repair. You repair it and return it. What rate of tax do you charge?

(See page 6 for the answers.)

RRSP DEDUCTION LIMITS

If you haven’t yet made your RRSP contribution for 2014 and are under 71, you can make it any time up to and including March 1, 2015 (60 days after year-end).

The maximum contribution for 2014 is **$24,270**, or 18% of your 2013 “earned income” if that “earned income” was less than $134,833. Added to this amount is your unused contribution room from previous years. "Earned income" is generally your income from:

- employment
- carrying on business (but not through a corporation unless the corporation pays you a salary; dividends or shareholder benefits are not “earned income”)
- net rental income (after expenses) from real estate
- CPP disability pension
- research grants
- taxable spousal support payments
- contributions to an “amateur athlete trust” on your behalf (starting 2014 only).

Your RRSP contribution room is reduced by your 2013 “pension adjustment” if you are a member of a registered pension plan. (This figure represents the value of employer pension benefits accrued to you during 2013.) The pension adjustment figure appears on the T4 for 2013 that you received from your employer in February 2014.

FOREIGN TAX CREDIT — MAKE SURE THE FOREIGN TAX IS MANDATORY

As you may know, Canada provides a **“foreign tax credit”** (FTC) to Canadian residents, to reduce double taxation on foreign-source income.

The FTC rules are complex. In general terms, Canada allows a credit to a Canadian resident for **foreign income tax paid on foreign-source income**, up to a limit of the Canadian tax payable on that income.

The effect is that you pay total tax equal to the higher of the two rates of tax (Canadian and foreign) on the foreign-source income.

Thus, for example, suppose you earn $1,000 in dividends on a U.S. stock, and the U.S. company withholds $150 as withholding tax. (We’ll ignore exchange rate issues for this example; assume all amounts are in Canadian dollars.) Assume you are in a 40% tax bracket, so you pay $400 of Canadian tax on the same $1,000 of dividend income.

In this example, Canada will grant you a foreign tax credit of $150 on your Canadian tax return, so that you only pay $250 of Canadian tax on the dividends. The total tax burden ($150 to the U.S. and $250 to Canada) will thus equal the $400 of Canadian tax you would have paid if there had not been any foreign tax. (Most developed countries have similar rules.)

The FTC has many complexities and traps. One trap you should be aware of is that the **foreign tax must be mandatory**. If you could have avoided paying the foreign tax, or recovered it from the foreign government, then you cannot claim it as a foreign tax credit.

Thus, for example, suppose your U.S.-source income is interest rather than dividends, and the interest is exempt from U.S. tax under the Canada-U.S. tax treaty. If the U.S. payor withheld U.S. tax, and you can recover that tax from the U.S. government by claiming relief under the treaty, then the U.S. tax you paid is not eligible for the foreign tax credit, because **Canada will consider it to be a "voluntary" payment** to the U.S. rather than a foreign tax.

Note also that the foreign tax credit applies only to an "income or profits tax". It is not available for social security taxes other than paid to the U.S.; see CRA's *Income Tax Technical News* No. 31R2 (available at cra.gc.ca). Most U.S. "FICA" (Federal Insurance Contributions Act) payments do qualify, due to a specific provision in the Canada-U.S. tax treaty.

BUYING PROPERTY FROM A NON-RESIDENT

If you are buying real estate — such as a house or condominium — from a non-resident of Canada, you need to know about your **obligation to withhold tax** unless the vendor provides you with a "section 116 certificate" from the CRA.

Non-residents generally are subject to Canadian income tax only on certain Canadian-source income. One such source is capital gains on "taxable Canadian property", which generally includes Canadian real property, shares of corporations whose value is primarily attributable to Canadian real property, and certain other items.

Of course, a non-resident who sells Canadian property might not have any other property in Canada, and so the CRA might not be able to enforce collection of the tax that is payable. To solve this problem, section 116 of the Income Tax Act makes the *purchaser* potentially liable for the vendor's capital gains tax.

If you buy taxable Canadian property from a non-resident, then you are required to **withhold 25% of the purchase price** and remit it to the CRA. If you do not, you can be assessed for this amount. (The 25% reflects the typical maximum tax rate of about 50% on taxable capital gains, which are one-half of actual capital gains.)

To avoid having you withhold this 25%, the non-resident can apply to the CRA for a "section 116 certificate", which relieves the purchaser from the withholding obligation. The non-resident must calculate the amount of tax payable on the gain, and pay that amount to the CRA, in order to get the certificate.

Normally your real estate lawyer will be very aware of this issue and will ensure that if the vendor is non-resident, a section 116 certificate is provided before your purchase price is paid over to the vendor.

Note however that this rule can apply to the **sale of a purchaser's right under an**

Agreement of Purchase and Sale, which is a "right" to acquire real property and thus falls into the definition of taxable Canadian property.

For example, suppose you are looking to buy a condominium that is not yet finished but has been under construction for some time. A non-resident signed up to buy the condo from the builder three years ago when the cost was $200,000, and put down a $20,000 deposit. With increases in local real estate prices, the condo will be worth $300,000 on completion. The non-resident agrees to "sell" you her rights under the purchase agreement, with the builder's consent, for $120,000 (i.e., the increase in the condo's value, plus the $20,000 deposit that will stand to your credit on closing).

This sale is a sale of taxable Canadian property, and your lawyer should be advising you to withhold 25% of the $120,000, so that the CRA does not assess you for this amount. (There may be some cases where Canada's tax treaty with the non-resident's country of residence relieves you of this obligation, but even in such cases the relief applies only if you notify the CRA of the purchase within 30 days after closing.) To prevent this withholding, the non-resident will need to get a section 116 certificate from the CRA.

Many lawyers are not aware of the requirement to obtain a section 116 certificate on the transfer of rights under a purchase agreement.

HST QUIZ — THE ANSWERS

Here are the answers to the quiz on page 3.

1. You charge 15%, the rate for Nova Scotia. Goods sold and shipped anywhere in Canada bear GST or HST based on the rate of tax in the destination province.

2. You still charge 15%, the rate for Nova Scotia. As long as you're arranging the shipping, even as the customer's agent, the same rule applies as in #1: the GST or HST applies at the rate in the destination province to which you've shipped the goods.

3. You charge only 5% GST, the rate for Alberta. You've completed delivery at your Calgary warehouse, and the customer has made her own arrangements to pick up the goods.

4. You charge only 5% GST. Services are normally taxed based on the customer's address (subject to some exceptions).

5. Again you charge only 5% GST. It doesn't matter where you perform the work. Services are normally taxed based on the customer's address (subject to some exceptions).

6. You charge 13% HST, the rate for Ontario. A service "rendered in connection with litigation" in a province's courts is taxed at the rate for that province. The litigation is in an Ontario court. This rule is often thought to apply only to lawyers' services, but is actually much broader!

7. Again you charge 13% HST, the rate for Ontario, because this is a service in connection with litigation in an Ontario court. It doesn't matter where you perform the service.

8. You charge only 5% GST, the rate for Alberta. Even though services are normally taxed based on the customer's address,

there is an exception for "personal services" performed in the presence of the individual to whom the services are rendered. Such services are taxed based on where they are performed. Since you perform the service in Ontario, the Ontario rate applies.

9. You charge 13% HST, the rate for Ontario. The exception for "personal services" in #8 above doesn't apply to an "advisory, professional or consulting service". Instead, such a service is subject to the normal rule for services, based on the customer's address. (A physician's service is a "professional" service.)

10. You charge only 5% GST, the rate for Quebec. There is a special rule for goods that are sent for repair, alteration, cleaning or a similar physical service. The tax applies based on the address to which the goods are returned after being repaired, altered, cleaned, etc. (If you had an office in Quebec, you would have to charge Quebec Sales Tax as well.)

If you didn't score too well on the quiz, don't be surprised. The rules are complex and confusing. What's important is that you ensure that your business applies the rules correctly. Otherwise you could be in for a very costly assessment when a CRA auditor shows up to audit your business for GST and HST.

AROUND THE COURTS

Company in business of buying and selling real estate could still have capital gain

A taxpayer that buys properties with the intention of selling them is considered to be in business, and the gain on such sales is fully taxed as business income rather than only half-taxed as a capital gain.

Once the CRA concludes that such a person is buying properties as inventory for resale, the CRA will almost never allow some of such properties to be considered capital property.

However, in the recent case of *Belcourt Properties Inc.*, a company succeeded in challenging the CRA's view.

The company in question was in the business of building and selling residential condominiums for profit. However, it also had a business of owning rental properties, from which it earned rental income. It unexpectedly received unsolicited offers to buy two of these properties. When it sold them, it treated the profit on each one as being capital gain, only half-taxed. The CRA reassessed the company on the basis that the properties were inventory, and the company appealed.

The Tax Court of Canada allowed the company's appeal. The properties were bought as rental properties. The CRA might possibly have succeeded on the basis that the company had a "secondary intention" to sell the properties when it bought them, but the CRA auditor had not made such an assumption when reassessing the company, and it was too late for the CRA to raise this issue in the appeal.

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