Tax and Tax Planning

Tax and Tax Planning

ELAINE THOMPSON

FANSHAWE COLLEGE PRESSBOOKS
LONDON ONTARIO

Contents

Chapter 2: Residency, filing rules, appeals etc.

Additional Resources

Acknowledgements

This resource was collated by Elaine Thompson in partnership with the OER Design Studio and the Library Learning Commons at Fanshawe College in London, Ontario. This work is part of the FanshaweOpen learning initiative and is made available through a Creative Commons Attribution-NonCommercial-ShareAlike 4.0 International License unless otherwise noted.

We want to acknowledge and thank the accounting students in ACCT 2235 and ACCT 3335 and the faculty at Kwantlen Polytechnic University who wrote the content and shared it openly through the following two open resources which were used to compile this version:

- Introductory Canadian Tax Copyright © 2021 by Sam Newton and Wahaj Awan is licensed under a Creative Commons Attribution-NonCommercial-ShareAlike 4.0 International License, except where otherwise noted.
- Intermediate Canadian Tax Copyright © 2021 by Sam Newton and Wahaj Awan is licensed under a Creative Commons Attribution-NonCommercial-ShareAlike 4.0 International License, except where otherwise noted.

Student authors at Kwantlen Polytechnic University are listed in the sections they developed as well as listed below.

Addan Ayaz
Aelyssa Bhatti
Amanda Luies
Amaneet Dhudwal
Amer Bassi
Amra Bayasgalan
Amrick Sidhu
Anita Kartawidjaja
Arshdeep Kaur
Arshpreet Kular
Arvind Harry
Ashpreet Kaur
Azhar Jaffari
Basil Edavilayil
Bhanvi Ghai
Bhavish Toor
Bobinpreet Singh
Chandhar Arvind
Chanpreet Kang
Cynara Almendarez
Daljinder Nijjar
David Ren
Deepali
Dilpreet Grewal
Diplesh Puria
Eva Viernes
Falak Sharma
Gurleen Kaur
Gurmehar S. Grewal
Gurprem Dhaliwal
Gurtaj Pannu
Gurveer Brar
Gurvir Sahota
Gurwant Singh
H. Khosa
Harman Hayer
Hoang Phuc
Jasmine Dhesi
Jasmine Leblanc
Jasmine Marahar
Jason Gill
Jatin Gupta
Jaydeep Shergill
Jeewanpreet Kaur
Jerred Flynn
Jessica Thao
Karen Rana
Karn Josan
Karnvir Bhoonpaul
Kaur Rajdeep
Kayleigh Budlong
Kevin Lee
Langsha Tao
Leonor Lanon
Lovellen Cheema
Manisha Soorah
Manpreet Kaur
Mariah Cawkell
Md Ancher
Mingyao Geng
Morgan Campbell
Natasha Dutt
Navjot Lalli
Paul Jhajj
Pavin Hundal
Pooja Devi
Pooja Sehgal
Prabpreet Badyal
Puneet Bering
Raminder Sidhu
Ramneek Kaur
Ritesh Dhall
Rumabel Mateo
Sean Co
Sharon Basi
Shelvin Chand
Shubhneet Kaur Grewal
Simran Gill
Sukhman Bhathal
Susan Gill
Taylor Chow
Vianna Tran

Changes made to this version include:

- Images with tables were converted to HTML tables.
- Image descriptions were added to the images.
- Some images were converted to bullet lists or box charts, and textboxes were added to the interactive content and examples.
- Additionally, links to references were added.

Cover image by Victor Ballesteros, Unsplash License.

Collaborators

- Stephany Ceron Salas, *Instructional Design Student*
- Jason Benoit, *Quality Assurance*
- Shauna Roch, *Project Lead*
- Wilson Poulter, *Copyright Officer*

Book Navigation

Recommended Format: Online Webbook

You can access this resource online using a desktop computer or mobile device or download it for free on the main landing page of this resource. Look for the "Download this book" drop-down menu directly below the webbook cover. This resource is available for download in the following formats:

- **PDF.** You can download this book as a PDF to read on a computer (Digital PDF) or print it out (Print PDF). The digital PDF preserves hyperlinks and provides default navigation within the document. In addition, the PDF allows the user to highlight, annotate, and zoom the text.
- **Mobile.** If you want to read this textbook on your phone or tablet, use the EPUB (eReader) or MOBI (Kindle) files. Please refer to your device's features for additional support when navigating this resource.

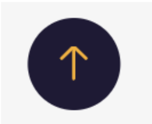
Navigating this Webbook

To move to the next page, click on the "Next" button at the bottom right of your screen.

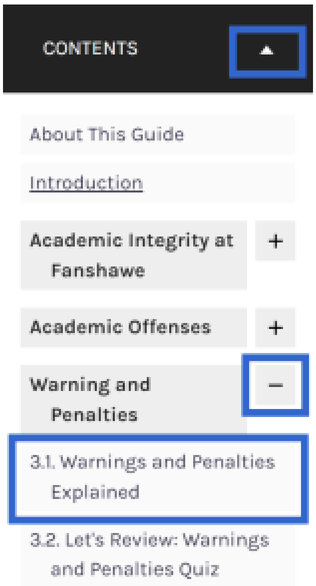
To move to the previous page, click on the "Previous" button at the bottom left of your screen.

Keyboard arrows can also be used to navigate. (*Note: On smaller screens, the "Previous" and "Next" buttons are stacked at the bottom of the page.*)

To scroll back up to the top of the page, click on the bottom middle of your screen (Note: *this will only appear if the page is long*).



To jump to a specific section or sub-section, click on "Contents" in the top left section of the page. Use the plus sign (+) to expand and the minus sign (-) to collapse the content sections. (Note: *On smaller screens, the "Contents" button is at the top of the page.*)



About This Book

Introduction

This text aims to provide students with additional study resources as they are introduced to taxation. This text will provide students with simple explanations of complex tax principles, most of which have been reproduced by learners as they understand the concepts.

The text captures details that prepare the learner to understand the personal tax return process and the variables involved, such as incomes, deductions, tax credits, losses, tax amount, etc. and how they each impact the tax return. Learners will also understand the administration of the income tax system. Although the emphasis is on the personal tax process, learners will explore corporate tax and the benefits and implications to the individuals who are owners of the corporation.

The text continues to be improved, and you may note that sometimes the tax rates reflected are not current. Rates will change each year; however, tax principles are generally consistent. We aim to improve the text to make rates up-to-date and broaden tax planning applications.

Accessibility Statement

We are actively committed to increasing the accessibility and usability of the textbooks we produce. Every attempt has been made to make this OER accessible to all learners and is compatible with assistive and adaptive technologies. We have attempted to provide closed captions, alternative text, or multiple formats for on-screen and off-line access.

The web version of this resource has been designed to meet Web Content Accessibility Guidelines 2.0, level AA. In addition, it follows all guidelines in Appendix A: Checklist for Accessibility of the *Accessibility Toolkit – 2nd Edition*.

In addition to the web version, additional files are available in a number of file formats including PDF, EPUB (for eReaders), and MOBI (for Kindles).

If you are having problems accessing this resource, please contact us at oer@fanshawec.ca.

Please include the following information:

- The location of the problem by providing a web address or page description
- A description of the problem

- The computer, software, browser, and any assistive technology you are using that can help us diagnose and solve your issue (e.g., Windows 10, Google Chrome (Version 65.0.3325.181), NVDA screen reader)

Feedback

Please share your adoption, and any feedback you have about the book with us at oer@fanshawec.ca

CHAPTER 1: STRUCTURE OF THE PERSONAL TAX RETURN

Chapter Overview

1.1 Describe the ITA Section 3 ordering rules formula. How does this tie into Net Income for Tax Purposes (also known as 'Division B' income)?

AMRA BAYASGALAN

Division B income (Net Income for Tax Purposes) is determined by using the ordering rules found in Section 3 of ITA. Under the ordering rules formula, a person's net income for tax purposes would be calculated using the following steps:

1. ITA 3(*a*) – Determining income (revenues net of expenses) from employment, business, property and other sources for the year.

Example:	Net employment income	$40,000	
	Net property income	$5,000	$45,000
			$45,000

2. ITA 3(*b*) – Net taxable capital gains arise when taxable capital gains for the year exceed allowable capital losses for the same year. If allowable capital losses are greater than the current year's taxable capital gains, the net taxable capital gains for the year will be $0, and the difference will become a Net Capital Loss that can be applied against net taxable capital gains in other taxation years.

Example:	Taxable Capital Gains	$15,000	
	Allowable Capital Losses	($20,000)	Nil
			$45,000

Note: Taxable Capital Gains = 50% of a Capital Gain. Allowable Capital Losses = 50% of a Capital Loss.

3. ITA 3(*c*) – At this point, other deductions found in ITA Subdivision e (such as spousal support payments made or moving expenses incurred) are deducted from the

subtotal of the amounts in Step 1 and Step 2. If the other deductions exceed the amounts determined in Step1 and Step 2, then the subtotal is $0. It is important to note that many Subdivision e deductions are only deductible in the current year so, if you don't use them in the current year, they disappear.

Example:	RRSP deduction	($7,000)	($7,000)
			$38,000

4. ITA 3 (*d*) – We then deduct losses incurred in the year (typically from business or property income). Losses are created when expenses exceed revenues for any given source of income. These losses are then deducted from the Step 3 subtotal. If the total amount is negative, then Net income for Tax Purposes (Division B income) is $0, and the difference becomes a non-capital loss that can be deducted from net income for tax purposes in other taxation years.

Example:	Business loss	($12,000)	($12,000)
Net income for tax purposes (Division B income):			$26,000

Note losses are recorded in 3(D) rather than offsetting income in 3(A) so you are able to maximize your 3(C) deductions in the year. Remember that many of the 3(C) deductions expire if they are not used in the year. Therefore by maximizing the income in 3(A) (by leaving losses in 3(D)) you may be able to increase the amount of 3(C) deductions you can use in the year.

References and Resources

- *Income Tax Act*, RSC 1985, c1, (5th Supp.) s 3
- Chartered Professional Accountants. (2022). The Chartered Professional Accountant Competency Map. Part 1: The CPA Competency Map: 6.3.2

1.2 How do you get from Net Income for Tax Purposes to Taxable Income to Tax Payable?

GURVEER BRAR

After determining **Net Income for Tax Purposes** using the Section 3 ordering rules, Division C deductions are subtracted to get to the **Taxable income** (note, don't confuse Division 'C' deductions with Section 3(c) deductions). Then, Marginal rates are applied to the Taxable Income to calculate the Tax Payable before credits. Lastly, credits are deducted to get to the **Tax Payable**. This is best illustrated with an example using 2023 marginal rates and tax credits.

FORMULA	EXAMPLE
Section 3 ordering rules	
3a. Employment Income	$72,000
Business Income	$1,200
	$73,200
+	$73,200
3b. (TC Gains > AC Losses)	
Taxable Capital Gains	$4,500
Allowable Capital Losses	-$700
	$3,800
–	$77,000
3c. RRSP Deduction	-$2,000
	-$2,000
–	$75,000
3d. Loss from Property	-$4,000
	-$4,000
	$71,000

Reference: ITA 3(a)-3(f)

Net Income for Tax Purposes		**$71,000**
Less: Division C Deductions		
Non-capital Loss	-$6,000	
Net-capital Loss	-$2,000	
	-$8,000	See ITA 109 to
Taxable Income		**$63,000**
Apply Marginal Rates	15% for $53,359	ITA 117
	$8,004	
	20.50% for $9,641	
Tax payable before credits	**$1,976**	**$9,980**
Less:		
Personal credits	-$2,250	
EI credits	-$150	
Employment credits	-$205	
CPP credits	-$468	
	-$3,074	ITA 118
Tax Payable (after credits)		**$6,906**

This is a video walkthrough of a tax payable worksheet. Note that some tax rates and credits used in the video may be slightly outdated, but the concepts remain the same.

Interactive Content

Video author (Sam Newton); Source document (BCIT, author unknown).

Video: "Walkthrough of the Part I tax payable handout" by Kwantlen Tax [5:14] is licensed under the Standard YouTube License. Transcript and closed captions available on YouTube.

References and Resources

- *Income Tax Act*, RSC 1985, c1, (5th Supp.) ss 3(a)-(f), 109-114, 117, 118
- Chartered Professional Accountants. (2022). The Chartered Professional Accountant Competency Map. Part 1: The CPA Competency Map: 6.3.2

1.3 Describe pension income and how it is treated for tax purposes.

KARNVIR BHOONPAUL

What is Pension Income?

Pension income is the result of a retirement plan that will provide one with a monthly (or periodic) payment once a certain age is reached. This monthly income is meant to replace a portion of the previous income one was earning before retirement. The pension amount earned typically depends on three things; the amount you have contributed to the CPP (Canadas Pension Plan), the average income you earned throughout your work life and the age you take the pension. For example, a person with a low income throughout their career who decides to take an earlier pension at the age of 60 will have a low pension payment. On the other hand, a person who had higher work income and delayed their pension until the age of 65 will have a much higher pension payment.

How is pension taxed?

Pension income is taxable. Once retired, tax will have to be paid in one of three ways:

1. Tax withheld at the source- if your main income is pension you may have enough tax withheld at the source to pay the tax you owe
2. Paying your income tax by instalments- if you receive income through investments or other self-employment income you may have to pay your tax in instalments.
3. Social benefits repayment- if your income exceeds a certain annual amount you may have to pay back some of your benefits.

How would one reduce pension tax?

In some cases, if all requirements are met a couple may be eligible for income splitting to reduce their overall taxable income. There are also many credits that an individual may be eligible for as well as charges and expenses that can be claimed for other investments. For more information, the following link to the CRA contains more detailed information on pension income taxes.

References and Resources

- Article – "Changes to your taxes when you retire or turn 65 years old" (Author: Government of Canada)
- Article – "CPP Retirement Pension: Overview" (Author: Government of Canada)

1.4 Describe spousal support and child support payments and how they are treated for tax purposes.

DIPLESH PURIA

Spousal support can be defined as the monetary payment made by one spouse (generally the higher income earning spouse) to ensure that the lower income earning spouse is able to maintain the same level of lifestyle that he/she was used to living during the period of the marriage. Child support is the monetary payment which is paid by the non custodial parent to ensure the support and welfare of the child to meet his/her daily needs.

The basic idea is that Spousal support payments are deductible to the payer and included in the income of the recipient. In contrast, the child support payments have no impact on the tax of either the payer or the recipient of the child support.

Child support amounts are neither taxable nor deductible because they are considered an obligation of raising a child. Normal expenses of raising a child aren't deductible for married or divorced couples. For example, suppose a married father takes his son to a mall to buy him a pair of shoes, he doesn't get an income tax deduction for the pair of shoes that he buys for his son as this is considered a personal expense and there are no deductions for personal expenses. In case of a marital breakdown, the father (assuming the father pays the child support) gives the money to his ex-spouse to pay for the shoes. The amount is not deductible as the money is still being used for the personal expense of one's child. Whereas, in the case of spousal support, it works as an additional income source for the receiving spouse so it is added to the recipient's income for taxation purpose and deducted from the payer's income.

The taxable and deductible portions of the support payments can be derived by the formula $A - (B + C)$, where A, B, C are described in the table below:

Amount to be included in 3(a) as Other Income ITA 56(1)(b)	**Amount to be deducted in 3(c) as Other Deductions** ITA 60(b)
A: The total support amount received after 1996 and before the end of the year (all support payments received from the beginning of the agreement)	A: The total support amount paid after 1996 and before the end of the year (all the support payments paid from the beginning of the agreement)
B: The total of all child support receivable from the start of the contract	B: The total of all child support payable from the start of the contract
C: The total of all support amount received after 1996 that has been included in taxable income for the preceding years	C: The total of all support amount paid after 1996 that has been deducted from the taxable income for the preceding year

Note: The calculation is made from the inception of the agreement. The 'receivable' and 'payable' clauses in the 'B' part of the formula ensure that the childcare portion is always considered to be paid/received before the spousal support.

References and Resources

- *Income Tax Act*, RSC 1985, c1, (5th Supp.) ss 56(1)(b), 60(b)
- Article – "Income Tax Folio S1-F3-C3, Support Payments" (Author: Government of Canada)
- Chartered Professional Accountants. (2022). The Chartered Professional Accountant Competency Map. Part 1: The CPA Competency Map: 6.3.2

1.5 What are tax credits?

WAHAJ AWAN

After you calculate taxes payable by applying marginal rates to the taxable income, tax credits are applied to reduce the taxes payable.

Types of tax credits

There are two types of tax credits, **non-refundable** and **refundable**. Non-refundable credits can only be used to reduce taxes payable to zero. Most of these credits, if unused during the current year are lost; however, some of these credits like the tuition credit may be carried forward to following years. Refundable tax credits are paid to individuals even if their tax payable is zero. (note: almost all the tax credits you deal with in this course are non-refundable tax credits.)

Why do tax credits exist?

Tax credits were created by the government to provide tax benefits to specific groups of people. Typically these credits are aimed to help out people with disadvantages: low income, disabilities, senior citizens etc.

Difference between a tax credit and a tax credit base

A **tax credit base** is an amount that is multiplied by the "appropriate percentage" (currently 15%) which then gives us the tax credit. **Tax credit** is the amount that will reduce the tax payable. You can find tax credits bases for individuals in the FITAC > Tax Rates and Tools under "Income tax rates and credits – Individuals". For those of you who have been employed in Canada you may have noticed amounts 'taken off' your pay cheque for Employment Insurance and the Canada Pension Plan. This amount is the tax credit base and is multiplied by 15% (you'll see this referred to as 'an appropriate percentage' in the ITA) to get your tax credit.

Common credits for individuals with employment income as of 2023: (assume the maximum Employment Insurance ("EI") and CPP amounts are available)

Credits	Tax credit base	Appropriate percentage	Tax credit	ITA citation
Basic personal credit	$15,000	15%	$2,250	ITA 118(1.1)
Canada Employment credit	$1,368	15%	$205	ITA 118(10)
EI credit	$1,002	15%	$150	ITA 118.7
CPP credit (*)	$3,123	15%	$468	ITA 118.7

* The CPP calculation is a bit more nuanced, see chapter on the CPP credit for further details

Basic Personal Amount Credit

The Basic Personal Amount ("BPA") is reduced for individuals with Net Income for Tax Purposes (NITP) beyond a certain threshold as follows:

- For individuals with NITP of $165,430 or less, the BPA is $15,000
- For individuals with NITP of $235,675 or more, the BPA is $13,521
- For individuals with NITP between $165,430 and $235,675 the Basic Personal Amount is calculated using the formula: $15,000 – ($1,479 x (NITP – $165,430) / $70,245)).

References and Resources

- *Income Tax Act*, RSC 1985, c1, (5th Supp.) ss 118(1.1), 118(10), 118.7
- Article – "8.3.5 Tax credits" (Author: Government of Canada)
- Article – "8.3.6 Non-refundable and refundable tax credits" (Author: Government of Canada)

1.6 What is the difference between a refundable and non-refundable tax credit? Describe the tax implications of some of the more common tax credits.

1.7 What are tax credits that might be relevant to a typical 20-year-old student who is also working part-time?

MANPREET KAUR

A tax credit is an amount that is subtracted from the tax payable owed to the government. Credits can be refundable or non-refundable; however, they are typically "use it or lose it" credits (i.e. if they are not used by the taxpayer in the year, they cannot be carried forward). Some of the tax credits that might be relevant to a single student (with no kids) working part-time are as follow:

- *Tuition credit* – This is based on your tuition fees paid in the year. In some circumstances, a portion of your tuition fees can be transferred to your parents (and other individuals specified in the ITA).
- *Credit for interest on a student loan* – only on a student loan, e.g., if you receive it under the Canada Student Loan Act, Canada Student Financial Assistance Act.
- *Credit for EI and CPP contributions* – Canadian pension plan (CPP) and Employment Insurance (EI) are programs run by the federal government and are deducted from the pay of an employee, the employer may also make the contribution to CPP and EI on the behalf of the employee.
- *Personal tax credit* – all residents of Canada are eligible for the Personal tax credit.
- *Employment tax credit* – a non-refundable tax credit referred to as Canada employment credit recognizes that employees often incur various work-related expenses.

A student in Canada can claim any of these tax credits. The more tax credits that apply to a student, the more they can reduce the income tax they owe to their government. Remember that the tax credit is typically calculated by taking the tax credit base (for example, the tuition fees paid would be the base) and multiplying it by the 'appropriate percentage' (currently 15%).

References and Resources

- *Income Tax Act*, RSC 1985, c1, (5th Supp.) 117 – 122
- VIDEO – Simple Tax Hacks for Canadian Students (Author: Student life networking)
- Chartered Professional Accountants. (2022). The Chartered Professional Accountant Competency Map. Part 1: The CPA Competency Map: 6.3.2

January 14, 2019

1.8 Who can claim the tuition credit?

KEVIN LEE

Students typically receive a tax credit based on the amount of tuition they pay in the year. ITA 118.5(1)(a) states that an individual is eligible for tuition credits if "the individual was during the year a student enrolled at a post-secondary educational institution in Canada."

Fees paid by a student to a post-secondary educational institution in Canada or by a deemed resident of Canada to a post-secondary educational institution outside Canada, for courses that are not at the post-secondary school level, are eligible for the tuition tax credit, if the student meets both of the following conditions:

- is at least 16 years of age at the end of the year
- is enrolled in the educational institution to obtain skills for, or improve their skills in, an occupation

The tax credit will equal the tuition paid multiplied by an 'appropriate percentage', which at this time is 15%. So, for example, if a student paid $8,000 in eligible tuition fees during the year they could potentially claim a $1,200 tax credit ($8,000 X 15%).

What are the limits?

A student must use the tuition tax credit to reduce their tax payable to $Nil. Any excess amount can be carried forward to be applied against the student's tax payable in future periods (there is no limit to the number of years it can be carried forward) or a portion of the tuition tax credit can be transferred to a spouse, common-law partner, parent or grandparent.

How does the tuition credit transfer work? (ITA 118.8 to 118.9))

As mentioned above, the student must first use enough of their tuition tax credit to reduce their tax payable to $Nil. The remaining amount can be transferred to a parent, grandparent etc. up to a maximum of $750 in tax credits for the year (or $5,000 in tax credit base before applying the 15% 'appropriate percentage') less the amount used by the student in the year. For example, if the student used $150 of the tuition tax credit to reduce their tax payable to $Nil, a maximum of $600 ($750 – $150) in tax credits could be transferred to an eligible family member to help reduce their tax payable.

If the student and the parent can both utilize the tuition credit, to which individual is it more valuable?

The situation depends on whoever owes taxes in the current year because tuition credits are worth 15% of the tuition amount to both parties. For example, if the student does not owe any taxes and the parent owes taxes, it is beneficial for the parent to claim the tuition credit from its dependent in the current tax year. Otherwise the student can carry-forward the tuition amount and claim the tax credit in future years when their earnings are higher.

References and Resources

- *Income Tax Act*, RSC 1985, c1, (5th Supp.) ss 118.8 – 118.9
- Article – "Amounts which cannot be claimed as tuition fees" (author: Government of Canada)
- Chartered Professional Accountants. (2022). The Chartered Professional Accountant Competency Map. Part 1: The CPA Competency Map: 6.3.2

January 2019

1.9 Medical Expense Tax Credit

I asked Chat-GPT the following question:

Sam: “Can you provide a 500 word university level explanation of the medical expense credit in Canada? Please include an example and provide any relevant CRA reference sources”

Here is Chat-GPT 4’s response (See if you can figure out the pros and cons of its response):

“The Medical Expense Tax Credit (METC) in Canada is a non-refundable tax credit that assists taxpayers by reducing the financial burden of eligible medical expenses incurred for themselves, their spouse or common-law partner, and their dependent children under the age of 18. The purpose of the credit is to provide some relief for individuals who have incurred substantial medical expenses, which can have a significant impact on their financial situation. The METC operates under the Income Tax Act and is administered by the Canada Revenue Agency (CRA).

To be eligible for the METC, medical expenses must be recognized by the CRA as qualifying expenses, as outlined in the Income Tax Act. A comprehensive list of eligible medical expenses can be found on the CRA’s website at the following link: eligible medical expenses. Some examples of eligible expenses include dental services, prescription medications, and medical equipment or devices prescribed by a medical practitioner.

To calculate the METC, taxpayers must first determine their total eligible medical expenses for themselves, their spouse or common-law partner, and their dependent children under 18. The credit is then calculated as the lesser of either 3% of the taxpayer’s net income or $2,421 (as of the 2021 tax year) subtracted from the total eligible medical expenses. This amount is then multiplied by the lowest federal tax rate (15% as of the 2021 tax year) to determine the value of the tax credit.

It is important to note that the METC is a non-refundable tax credit, meaning it can only be used to reduce the taxpayer’s tax liability to zero. If the calculated METC is greater than the taxpayer’s tax liability, the excess amount will not be refunded.

Example 1.9.1

Consider a taxpayer with a net income of $50,000 and eligible medical expenses totaling $6,000 for the tax year. To calculate the METC, the taxpayer would first determine the lesser of either 3% of their net income or $2,421:

3% of $50,000 = $1,500 Since $1,500 is less than $2,421, the taxpayer would use $1,500.

Next, the taxpayer would subtract this amount from their total eligible medical expenses:

$6,000 – $1,500 = $4,500

Finally, the taxpayer would multiply the remaining amount by the lowest federal tax rate:

$4,500 * 15% = $675

In this example, the taxpayer would be eligible for a $675 Medical Expense Tax Credit, which would reduce their tax liability accordingly.

For more information on the METC, including detailed guidelines and examples, taxpayers are encouraged to consult the CRA's resources on the subject, such as the Income Tax Folio S1-F1-C1: Medical Expense Tax Credit. This resource provides extensive information on eligibility criteria, calculations, and the process for claiming the credit.

Author: Chat-GPT (with minor edits to links by S.Newton)

References and Resources

1. *Income Tax Act*, RSC 1985, c1, (5th Supp.) s 118.2
2. Income Tax Folio S1-F1-C1: Medical Expense Tax Credit

1.10 How are charitable donations and political donations treated on a tax return? Why are they treated this way?

ARVIND HARRY

Charitable and Political donations create tax credits on an individual's tax return. The calculations are as follows:

Charitable Donations (ITA 118.1(1))

For those with taxable income up to the upper federal income threshold ($210,372 for 2019)

- A federal level credit limit will be 15% of the first $200 donations
- 29% of additional donations

For taxable income greater than the upper federal income threshold

- The credit will be 15% of the first $200
- 33% of the lesser of the amount that your taxable income exceeds $210,372 or by the amount your donation exceeds $200
- This increase is to encourage the wealthy to donate more

This is formulized as $(A \times B) + (C \times D) + (E \times F)$, where:

A	The appropriate percentage for the year (15%)
B	The first $200 of the donation
C	33%
D	The lesser of the amount that either your income exceeds $210,372 or your donation exceeds $200 (only applicable when income exceeds $210,372 limit)
E	29%
F	The remaining amount of the donation that surpasses $200

So, in the formula above, $(C \times D)$ would only apply to individuals who are taxed at the highest federal marginal tax rate.

Example 1.10.1

John, who has a taxable income of $50,000 donates $800 during 2019. His tax credit would be calculated as follows:

15% of the first $200 = $30

29% of the remaining $600 = $174

$204 ($30+$174) is the amount of his charitable donation tax credit in 2019.

Example 1.10.2

Deepesh has a taxable income of $312,000, he donates $16,000 during the year. What are his tax credits for the year?

15% of the first $200 = $30

33% of the lesser of ($16,000-$200) or ($312,000-$210,372) -> $15,800<$101,628

33%*$15,800 = $5,214

$5,244 ($30+$5,214) is the amount of his charitable donation tax credit in 2019.

An individual can only claim donations up to 75% of their Net Income For Tax Purposes. Additional amounts can be carried forward 5 years.

Political Donations (ITA 127(3))

The political donation federal tax credit is dependent on the amount donated as follows:

$1 to $400: Tax credit equals 75% of the amount (Max $300)

$401 to $750: $300 plus 50% of the amount > $400

$750 to $1,275: $475 plus 33 1/3% of the amount > $750

$1,275 plus: $650 maximum

Why are these rates different than other tax credits?

In general, better tax credit percentages (i.e. greater than 15%) are given to donations to encourage individuals (particularly wealthy individuals) to donate.

References and Resources

- Article – "Tax Benefits of Charitable Donations" (Author: Turbotax)
- Article – "Claiming charitable tax credits" (Author: Government of Canada)
- *Income Tax Act*, RSC 1985, c1, (5th Supp.) s 118.1(3)

1.11 What is the OAS tax credit? What is the Claw back? How is it calculated? Why does it exist?

PAVIN HUNDAL

The Old Age Security (OAS) tax credit is a monthly payment available to Canadians aged 65 or older. It is funded from the general tax revenues of the Government of Canada (you do not pay directly into it) and exists to assist low-income seniors. To qualify, you must be:

- 65 or older
- A Canadian citizen or legal resident when your application is approved
- A Canadian citizen or legal resident on the day prior to leaving Canada, if you no longer live in the country
- Have lived in Canada for at least 10 years since your 18th birthday to receive OAS in Canada
- Have lived in Canada for at least 20 years since your 18th birthday to receive OAS outside of Canada

From January to March 2020, the OAS maximum monthly payment amount regardless of your marital status is $613.53. Further details regarding the payments can be found at: [Article – "Old Age Security payment amounts" (Author: Government of Canada)]

OAS Claw back

If your worldwide income exceeds the minimum threshold amount (see table below), you must repay either a portion of your OAS pension, or the entire amount. After the maximum threshold amount, you are no longer eligible to receive the OAS pension.

To calculate the claw back amount, you take the difference between your income and the minimum threshold and multiply this amount by 15%.

Recovery Tax Period	Income Year	Minimum Threshold	Maximum Threshold
July 2020 – June 2021	2019	$77,580	$126,058
July 2021 – June 2022	2020	$79,054	$128,137

Example 1.11.1

If your income in 2019 was $90,000, the claw back amount would be:

$$\text{Income} - \text{Minimum Threshold} = \text{Difference}$$
$$\text{Difference} \times 15\% = \text{Claw Back Amount}$$

$$\$90,000 - \$77,580 = \$12,420$$
$$\$12,420 \times 15\% = \$1,863$$

You are required to pay back $1,863 of your OAS pension.

References and Resources

- *Income Tax Act*, RSC 1985, c1, (5th Supp.) s 180.2
- Article – "Old Age Security – Overview (Author: Government of Canada)
- Article – "Old Age Security payment amounts" (Author: Government of Canada)
- Article – "Old Age Security pension recovery tax" (Author: Government of Canada)

1.12 Disability Tax Credit

SUSAN GILL

The disability tax credit is a non-refundable credit provided for under 118.3 of the Income Tax Act. The credit can be claimed by the person with the disability or their eligible family member.

In 2021, the claim was $8,662 with an additional credit of $5,053 available for an eligible dependent under 18 that has not had claims for child care expense or an attendant care expense. The disability tax credit is adjusted to inflation on an annual basis.

Individuals with a disability must complete form T2201, "Disability Tax Credit Certificate" and have portions filled out by a medical practitioner to certify that the disability is a severe and prolonged impairment

Prolonged and severe are defined as follows:

- A prolonged disability as an impairment of at least 12 continuous months
- A severe disability is defined as it usually takes a person three times longer to do a basic task compared to a person without the limitation at least 90% of the time.

Marked restrictions or the cumulative effects of 2 or more areas that are prolonged and severe will be considered for the disability tax credit in the following areas:

- Sight
- Speaking
- Auditory
- Walking
- Elimination
- Feeding oneself
- Dressing oneself
- Mental function
- Need for life-sustaining therapy

Transferring of the Claim

The claim maybe transferred if the taxpayer is unable to use the credit and is supported by a spouse or other supporting person if of the following are met:

- Eligible for disability tax credit
- Resident of Canada
- Dependent on taxpayer for some/all basic necessities of life

And one of the following:

- Dependent had no income
- Dependent was your or your partners' parent, grandparent, child, grandchild, sibling, uncle, aunt, nephew or niece and was 18 or older in the tax year

How much can you claim with the disability tax credit?

Here's an example: In 2021, Sandy was a single parent of a child with an approved application for the disability tax credit. The child was under 18 years of age and had no income. Nor did the child have an attendant during the year. As such, Sandy will be able to claim the DTC base of $8,662 and the additional supplement base of $5,053.

Other possible claims for individuals with disabilities are as follows:

- Medical expenses
- Disability supports deduction
- Child disability benefit
- Registered disability savings plan

References and Resources

- Article – "Eligibility criteria for the disability tax credit" (Author: Government of Canada)
- *Income Tax Act*, RSC 1985, c1, (5th Supp.) s 118.3 (1)

CHAPTER 2: RESIDENCY, FILING RULES, APPEALS ETC.

Chapter Overview

2.1 Who is liable to pay tax in Canada and on what sources of income?

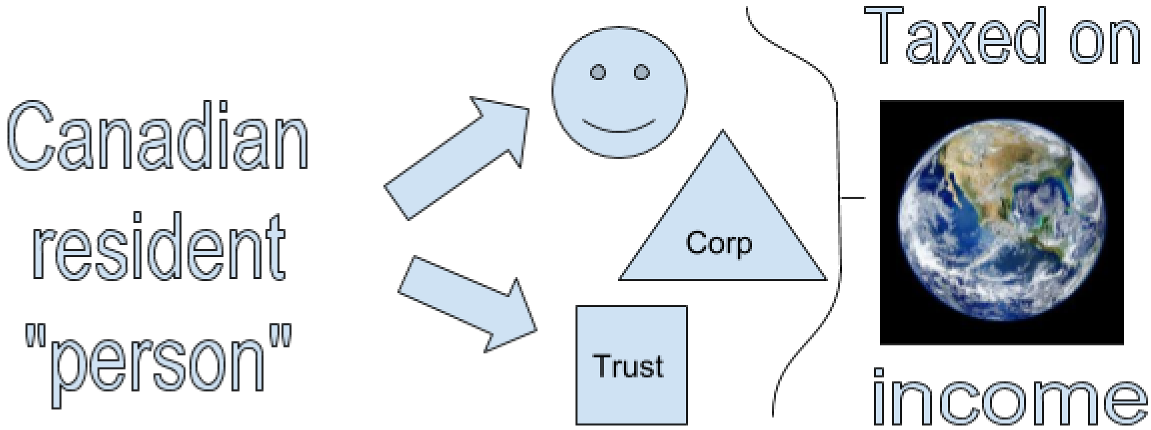
SAM NEWTON

Basically, every person resident in Canada is required to pay income tax on their worldwide taxable income. A "Person" is defined in the Income Tax Act ("ITA") as a corporation, individual or a trust. Here are some relevant sections from the ITA.

ITA 2(1) states that "An income tax shall be paid, as required by this Act, on the taxable income for each taxation year of every person resident in Canada at any time in the year."

ITA 248(1) defines a "*Person*" as a corporation, individual or trust and ITA 3(a) states that a taxpayer's income includes sources "inside or outside Canada". Therefore, Canadian resident corporations, individuals and trusts are taxed on their worldwide income

"Persons" non-resident in Canada are required to pay tax on their Canadian source income, which is basically income earned/generated in Canada (See ITA 2(3) for further details).



A Canadian resident "person", which could be an individual, corporation, or a trust, is taxed on their worldwide income. [Image Description]

Why are residents taxed on worldwide income and non-residents taxed only on Canadian sourced income?

Residents are taxed on worldwide income to discourage individuals and corporations from storing their assets and sourcing revenue in tax havens with low tax rates (like Switzerland or the Cayman Islands) to avoid tax. Since Canadian residents are taxed on worldwide income there may be no point in sourcing your income in a low tax country if you – as a resident of Canada – are still required to pay tax on the amount in Canada.

Non-residents are only taxed on their Canadian source income as it wouldn't seem fair to tax someone on their worldwide income if they aren't resident in Canada. For example, let's say a software developer resident in Mexico temporarily moves to Canada for 2 months and takes a contract with Hootsuite. Although she would be taxed in Canada on her income earned in Canada for the 2 months, it wouldn't make sense (or be fair) to tax her in Canada on her income earned in Mexico during the rest of the year.

References and Resources

- *Income Tax Act*, RSC 1985, c1, (5th Supp.) ss 2(1), 2(3), 3(a), 248(1)
- Chartered Professional Accountants. (2022). The Chartered Professional Accountant Competency Map. Part 1: The CPA Competency Map: 6.1.1

Image Description

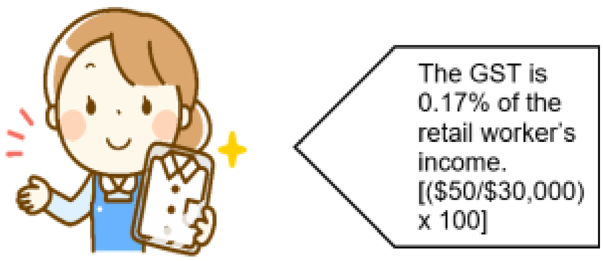
The image is a diagram illustrating the tax implications for a Canadian resident "person." In the middle of the image is a simple smiley face icon representing the "person." Two arrows point from the smiley face to a triangle labeled "Corp" and a square labeled "Trust." On the left side of the image, there is text reading "Canadian resident 'person'." On the right side, there is an image of the Earth with text above and below it saying "Taxed on income." [Return to Figure]

2.2 Describe the differences between a regressive, progressive and flat tax. Provide some examples of each in Canada.

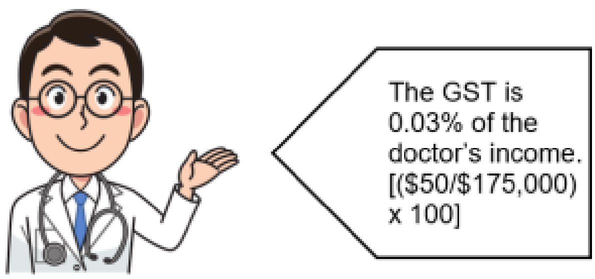
CYNARA ALMENDAREZ AND SUKHMAN BHATHAL

Regressive taxes are applied uniformly, and they do not change based on an individual's level of income. A regressive tax system affects low-income taxpayers more than high-income taxpayers because it takes a higher percentage of their earnings.

A great example of a regressive tax is the 5% Goods and Services Tax (GST). For example, say a doctor earns $175,000 annually and a retail worker earns $30,000 annually. They both purchase a laptop for $1,000, and are charged $50 GST ($1,000 X 5%). Although the $50 GST amount is the same for both the doctor and the retail worker it is a higher percentage of the retail workers overall income. This is known as a regressive tax because it has a larger percentage impact on lower income individuals.



The GST is 0.17% of the retail worker's income



The GST is 0.03% of the doctor's income

Progressive taxes are the opposite of regressive taxes. Progressive taxes increase based on your taxable income. Canada has a progressive income tax system; therefore, high-income taxpayers pay a progressively higher percentage of tax than low-income taxpayers. Using our previous example, because of the doctor's higher annual income, the doctor will have to pay more taxes than the retail worker based on Canada's federal tax rates of 2023.

Tax Rate	Tax Brackets		
15%		up to	$53,359
20.50%	$53,360	to	$106,717
26%	$106,718	to	$165,430
29%	$165,431	to	$235,675
33%	$235,676	and over	

The doctor will have to pay $37,799 in taxes (an average tax rate of 21.6%) while the retail worker will only have to pay $4,500 of taxes (an average tax rate of 15%). Progressive taxes get progressively higher as your taxable income increases.

Table 2.2.1: "Doctor Tax"

Tax Rate	x	Taxable income in tax bracket	=	Taxes Payable
15%	x	$53,359	=	$8,004
20.50%	x	$53,358	=	$10,938
26%	x	$58,713	=	$15,265
29%	x	$9,570	=	$2,775
		$175,000		$36,983

Table 2.2.2: "Retail Worker Tax"

Tax Rate	x	Taxable income in tax bracket	=	Taxes Payable
15%	x	$30,000	=	$4,500
		$30,000		$4,500

A flat tax system applies the same tax rate regardless of an individual's income. For example, if the tax rate is set at 15%, a taxpayer earning $20,000 pays $3,000 (15%) and someone making $300,000 pays $45,000 (15%) worth of taxes. Canada does not have a flat tax system, but at one point, the province of Alberta had a flat provincial tax system from 2001 to 2015. Flat taxes are sometimes referred to as proportional taxes.

Interactive Content

Author: Cynara Almendarez, January 2019

Interactive Content

Author: Joyce Hards, April 2019

Interactive Content

Author: Matthew Amisano, January 2020

References and Resources:

- Article – "Canadian Income Tax Rates for Individuals – Current and Previous Years" (Author: Government of Canada)
- Article – "Alberta government may consider bringing back flat tax system, Kenney says"(Author: Tyler Dawson)
- Chartered Professional Accountants. (2022). The Chartered Professional Accountant Competency Map. Part 1: The CPA Competency Map: 6.1.1

2.3 What are the filing deadlines for an individual? Why are there different tax filing deadlines for different individuals? (6.4.1)

ARSHPREET KULAR

In Canada, the filing deadline (i.e. the date you need to file your tax return with the CRA) for most individuals is April 30th. However for individuals with business income, or if their spouse has business income, the filing deadline is extended to June 15th. This extension is provided to give business owners more time to calculate their revenues and expenses for the year.

The filing deadline is extended for the spouses of individuals with business income because of the potential transfer of the spousal tax credit. You need to know the spouse's income to be able to determine if there is a spousal credit available. To facilitate this, if either spouse has business income, the filing deadline for both spouses is extended to June 15th. Note that income tax must be paid by April 30th regardless of your tax return filing deadline.

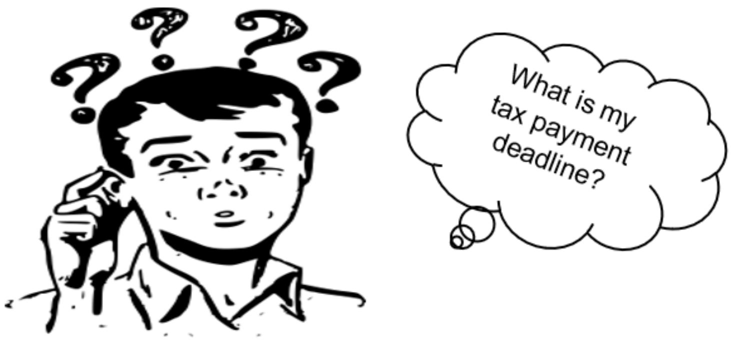
Category	Filing Date	Payment Date
Individuals without business income	April 30th	April 30th
For individuals with business income (and their spouses)	June 15th	April 30th

References and Resources

- *Income Tax Act*, RSC 1985, c1, (5th Supp.) s 150(d)
- Chartered Professional Accountants. (2022). The Chartered Professional Accountant Competency Map. Part 1: The CPA Competency Map: 6.4.1

2.4 What are the filing and payment deadlines for an individual, a trust and a corporation?

SHUBHNEET KAUR GREWAL



According to ITA 248(1) the **Balance-due day** is a deadline for payment of tax which varies for individuals, trusts and a corporations.

Under ITA 249(1), **Taxation Year** is defined as the calendar year for an individual, and the fiscal year for a trust and corporation.

Tax Filing and Payment Deadlines – per ITA 248(1) "Balance-Due day"		
Taxpayer	**Filing deadlines**	**Balance-due Day**
Individual	April 30th	April 30th
Individual (Self-Employed)	June 15th	April 30th
Trust	Within 90 days of their fiscal year-end (for most trusts the calendar year will be the fiscal year)	90 days after the end of their fiscal year (again, this will usually be the calendar year)
Corporation	Within 6 months of the year-end	2 months after the corporation's fiscal year end
Corporation (Private)	Within 6 months of the year-end	3 months after the corporation's fiscal year end*

*Note: Refer to section 125 deductions and business limits for further details on corporate tax payment deadlines.

References and Resources

- *Income Tax Act*, RSC 1985, c1, (5th Supp.) ss 156.1(4), 248(1), 249(1)
- Chartered Professional Accountants. (2022). The Chartered Professional Accountant Competency Map. Part 1: The CPA Competency Map: 6.4.1

2.5 How are penalties and interest calculated on late payments and late filings?

GURWANT SINGH

Late filing of tax returns and late payment of taxes are two different concepts, which could increase overall tax owed significantly. The interest penalty on late payment of taxes is charged when installments and/or final payments of tax are late or insufficient.

Every individual is required to file tax returns with Canada Revenue Agency (CRA) by April 30th (regular filing date) or June 15th (if they, or their spouse, operate a business). The inability of an individual to file taxes within the due date is subject to a 5% immediate penalty, and 1% for each complete month on the amount owing (the penalty doubles for repeat offenders). The interest is then charged on the outstanding balance as well as on the penalty and the interest is compounded daily. Interest is calculated using the prescribed rate of interest which is updated quarterly. Prescribed rates for 2018 are:

Quarters In the year 2018	**Prescribed Interest rates**
January-March	5%
April-June	6%
July-September	6%
October-December	6%

Example 2.5.1

Mr. Jackson is self-employed and has tax payable of $75,000 based on his income in the 2017 calendar year. He files his tax return and pays the outstanding tax on October 1st, 2018. His penalty and interest are calculated as follows:

	Taxes Payable	Penalty	Notes
	$75,000	$6,000	(5% + (3 complete months * 1%)) * $75,000
Interest on Tax payable	$1,875		6% prescribed rate * 5/12 * $75,000
Interest on penalty		$105	6% prescribed rate * 3.5/12 *$6,000
Total tax liability	**$82,980**		

Note, for simplicity, the above table does not consider compounded daily interest.

The tax is payable by April 30th, therefore, the interest on tax payable is calculated for 5 months (from April 30th until it is paid on October 1st) using a 6% prescribed rate. The tax return was due on June 15th (as he is operating a business) therefore the interest on late filing penalty is calculated for 3.5 months (from June 15th filing deadline to the date the return is filed on October 1st) using a 6% prescribed rate.

References and Resources

- *Income Tax Act*, RSC 1985, c1, (5th Supp.) s 150(1)
- Video – "Tax – Interest and Penalties" (Author: Natasha Dutt)
- Article – "Prescribed Interest Rates" (Author: Government of Canada)
- Chartered Professional Accountants. (2022). The Chartered Professional Accountant Competency Map. Part 1: The CPA Competency Map: 6.4.1

2.6 What are prescribed rates?

HARMAN HAYER

The prescribed rates are used to determine the interest on overdue taxes and penalties. The prescribed rate is also used to calculate interest on refunds (when the government owes you money) and to help calculate the amount of taxable benefits on items like interest-free or low-interest employee loans.

Which tax rates apply on late payments? What do the other prescribed rates apply to?

2022 Quarter	Late Tax [Reg. 4301(a)]	Refunds [Reg. 4301(b)]		Benefits [Reg. 4301(c)]
		Individuals	Corporations	
October – December	7%	5%	3%	3%
July – September	6%	4%	2%	2%
April – June	5%	3%	1%	1%
January – March	5%	3%	1%	1%

(prescribed rates are available in the FITAC under “Tax Rates and Tools”)

The “Late Tax” column indicates the prescribed rate of interest that the tax payer must pay on the overdue amounts owing to the CRA.

The “Refunds” column indicates the prescribed rate of interest that CRA must pay to on the overdue amounts owing to the tax payer.

The “Benefits” column shows the prescribed rate that is used when calculating relevant employee benefits (for example, employee loans).

References and Resources

- Income Tax Act, RSC 1985, c1, (5th Supp.) ss 4301(a), 4301(b), 4301(c)

- Article – "Prescribed Interest Rates" (Author: Government of Canada)
- Chartered Professional Accountants. (2022). The Chartered Professional Accountant Competency Map. Part 1: The CPA Competency Map: 6.4.1

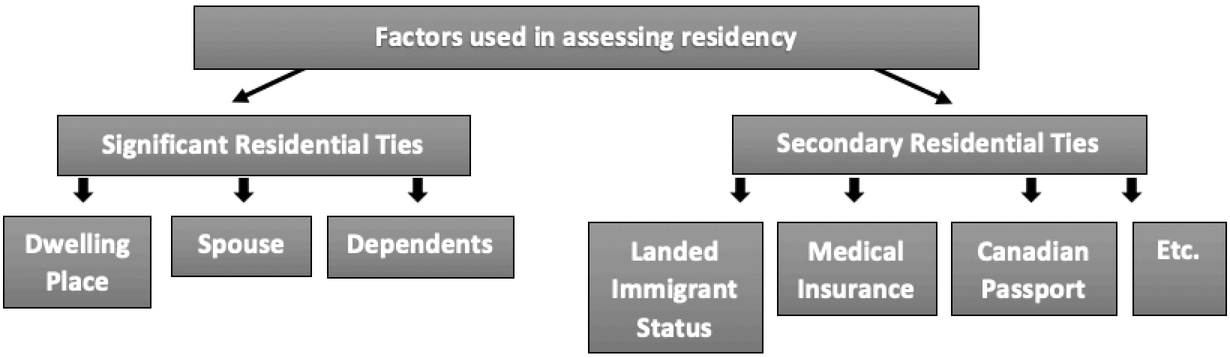
2.7 How does the CRA assess residency?

AMRICK SIDHU AND MANISHA SOORAH

Residents of Canada are divided into three main categories: part-year residents, ordinary residents and deemed residents. We'll address ordinary and deemed residents now (part-year residents will be addressed later in the textbook). Both ordinary residents and deemed residents are taxable in Canada on their worldwide income. Ordinary residents are assessed based on their Primary/Significant and Secondary residential ties in Canada, with more emphasis being placed on the Primary/Significant residential factors.

Primary/Significant residential ties include whether a dwelling place is available for an individual to use in Canada, and the location of that individual's spouse and dependents.

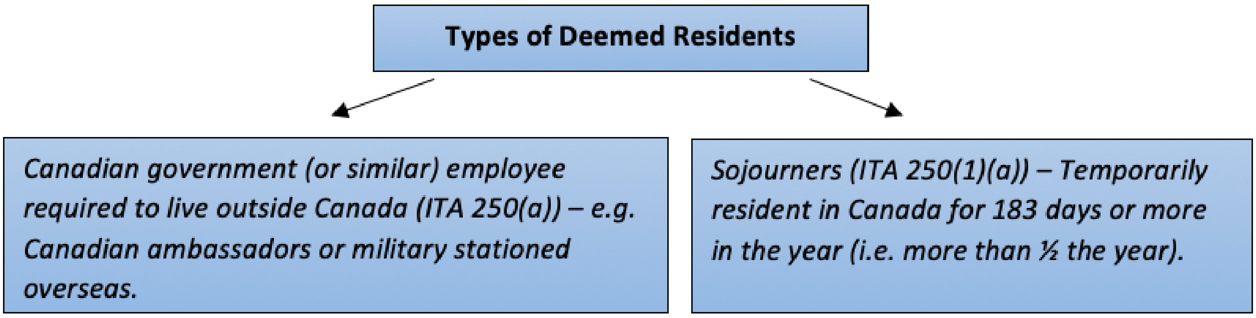
There are lots of Secondary residential ties including Landed Immigrant Status, whether an individual has medical insurance, membership in local clubs, citizenship etc. Again, all these factors are considered as a whole – with Significant ties given more 'weight' – when assessing residency.



Factors used in assessing residency [Image Description]

Some individuals are 'deemed' to be residents of Canada despite not meeting the requirements for 'ordinary' residents. These deemed residents are broken into two basic categories: Individuals required to live outside Canada by virtue or their employment with (or connected to) the Canadian government; and Sojourners, i.e.

individuals who are temporarily resident in Canada for 183 days or more in the year.



Types of deemed residents [Image Description] Note, in the image (above left) the reference should be to ITA 250(1)(b) and (c) rather than ITA 250(a)

References and Resources

- "Income Tax Folio S5-F1-C1, Determining an Individual's Residence Status" (Author: Government of Canada)

Image Description

- Factors used in assessing residency: Factors used in assessing residency are significant factors like dwelling place, spouse and dependents, and secondary factors like landed immigrant status, medical insurances and memberships, medical insurance etc. [Return to Factors used in assessing residency]
- Types of deemed residents: A flowchart titled "Types of Deemed Residents" at the top. It has two branches. The left branch reads: "Canadian government (or similar) employee required to live outside Canada (ITA 250(a)) – e.g., Canadian ambassadors or military stationed overseas." The right branch reads: "Sojourners (ITA 250(1)(a)) – Temporarily resident in Canada for 183 days or more in the year (i.e., more than ½ the year)." Each branch is represented with a connecting arrow from the main "Types of Deemed Residents" box at the top. [Return to Types of deemed residents]

2.8 What are the tax differences between a full-year, part-year and deemed resident?

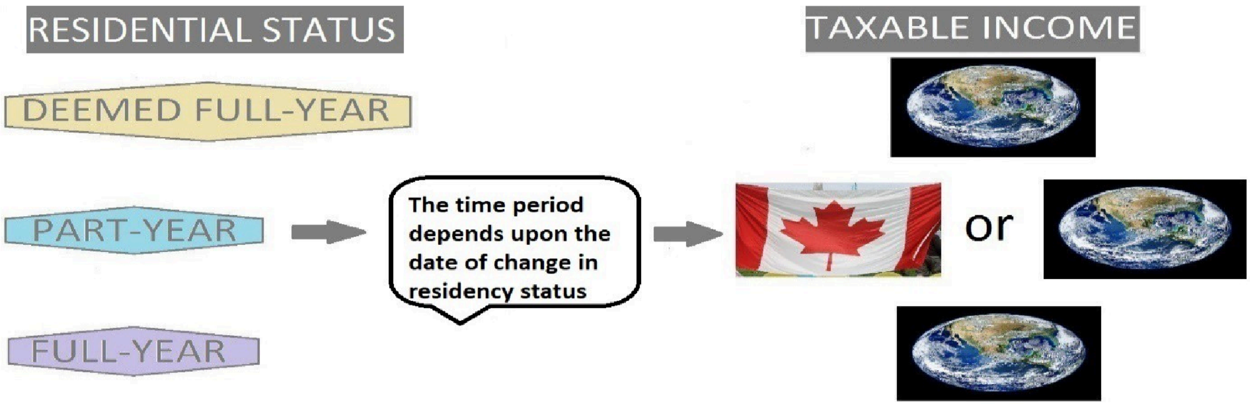
GURPREM DHALIWAL

Part-year residents: ITA 114 states that any person who establishes residential ties in Canada or leaves Canada with an intention to settle somewhere else during a calendar year is considered a part-year resident.

Part-year residents are taxed on their income both inside and outside Canada ("worldwide income") for the portion of the year that they are residents of Canada. They are taxed on Canadian-source income only, during the period when they are non-residents of Canada (ITA 114). For example, if a person is a resident of Canada for eight months in a tax year, they are taxed in Canada on their worldwide income for eight months they are resident and taxed on their Canadian source income for the four months they are non-resident.

Deemed residents: It is mentioned in ITA 250(1)(a) that there are certain individuals who Canada says are residents of Canada regardless of typical residential rules (such as dwelling place, spouse, kids). This includes people like military stationed overseas, and Canadian ambassadors. Also, a person who sojourns (frequently moves between Canada and foreign countries) in Canada for a period of 183 days or more is considered a deemed resident.

Deemed residents are taxable in Canada on their worldwide income (ITA 250) for the year. Deemed residents are different from part-year residents because part-year residents leave or enter Canada permanently; whereas, deemed residents' stay is temporary. For example, a person who lives in Bellingham, Washington but commutes to Surrey, B.C. for work 200 days in a year, is a deemed resident as they exceed the 183-day rule.



Residential Status and Taxable Income [Image Description]

Full-year residents: According to Canadian Revenue Agency ("CRA"), full-year residents are those persons who have significant residential ties in Canada throughout the year.

Full-year residents are taxable in Canada on their worldwide income. For example, Daniel is a full-year resident of Canada and he lives in Vancouver. He makes $50,000 as an employee at Vancity Credit Union and has $15,000 in net rental income from a rental property in Seattle, USA. He will be taxed in Canada on his $50,000 of Canadian employment income and his $15,000 in U.S. rental income.

References and Resources

- *Income Tax Act*, RSC 1985, c1, (5th Supp.) ss 250, 250(1)
- Video- "Tax and Residency in Canada" (Author: John McIlroy)
- Article-"Factual Residents- Temporarily outside of Canada" (Author: Canada Revenue Agency)
- Chartered Professional Accountants. (2022). The Chartered Professional Accountant Competency Map. Part 1: The CPA Competency Map: 6.5.1

Image Description

The image shows a diagram with the title "Residential Status" on the left and "Taxable Income" on the right. There are three sections under "Residential Status": "Deemed Full-Year" in yellow, "Part-Year" in blue, and "Full-Year" in purple. Each section points to a central box that states, "The time period depends upon the date of change in residency status," which has an arrow pointing to the Canadian flag. The Canadian flag is positioned between two sets of images of Earth, indicating that the taxable income status could be based on either Canadian or international residency. [Return to Residential Status and Taxable Income]

2.9 How are non-residents taxed in Canada?

RITESH DHALL

ITA 2(3)(a) "Persons" non-resident in Canada are required to pay tax on their "Canadian Source Income", which is income earned/generated in Canada. (1)

Taxation of non-residents [Image Description]

CRA assess residency based on a variety of factors such as the location of dwelling, where the taxpayer's dependents and the spouse resides, and other personal property and social ties of the taxpayer to the country amongst others.

Example 2.9.1

Assume Ritesh lives in India with his wife and children and generated $10,000 in the year from working in India. He comes to Canada by himself to work temporarily from March 15th to May 15th and, earns $2,000 from Canadian employment during that time. On May 16th Ritesh returns home to India. As Ritesh's dwelling, spouse and dependents were are in India he would likely be considered a non- resident of Canada and would only be taxable in Canada on the $2,000 employment income earned in Canada. Ritesh would not be taxable in Canada on his employment income from India.

References and Resources

- *Income Tax Act*, RSC 1985, c1, (5th Supp.) ss 2(3)(a), 248(1)
- Article – "Determining your residency status" (Author: Government of Canada)
- Article – "Non-residents of Canada" (Author: Government of Canada)
- Chartered Professional Accountants. (2022). The Chartered Professional Accountant Competency Map. Part 1: The CPA Competency Map: 6.5.2

Image Description

Taxation of non-residents: The image has a blue background with the title "Non-Residents of Canada Will be Taxed If:" on the left. Below the title, there are three bullet points: "Employment income is earned in Canada," "Business income is earned in Canada," and "Gains from real estate sold in Canada." On the right side of the image, there is a world map with illustrations of six people standing on different continents, each holding a large green coin with a dollar sign on it.. [Return to Taxation of non-residents]

2.10 What are instalment payments and how are they calculated for an individual?

JEEWANPREET KAUR

Instalment payments represent ongoing tax payments to the government throughout the year. They are usually required if an individual's 'net tax owing' was greater than $3,000 (known as the 'instalment threshold') in either of the previous two taxation years. Typically this would occur when regular tax withholding payments throughout the year were insufficient (See ITA 156.1(2) for further details).

If an individual is required to make instalments, the payments will be made quarterly on March 15th, June 15th, September 15th and December 15th. As per ITA 156(1) Individuals (other than farmers and fishermen) can calculate their instalment payments using any of the following three methods:

1. *Current year option*: The quarterly installments are based on the individual's current year estimated tax payable.
2. *Prior year option*: The quarterly installments are based on the individual's tax payable for the previous year (i.e. you would base your 2019 installments on your tax payable in 2018)
3. *No-calculation option*: The first two quarterly instalments are based on the tax paid in the second preceding taxation year (2017 is the second preceding year for 2019) and last two instalment payments are based on the tax paid in the preceding taxation year. This calculation is explained in more detail below.

Why are there three options available? Largely this has to do with the problems in guessing or estimating the instalment amounts using the current year or prior year methods.

1. *Current year method*: the problem with this method is that you are making installment payments based on an estimated amount, as you will not know your actual tax payable until the next year when you file your tax returns.
2. *Prior year method*: Installment payments are due on March 15th, June 15th, September 15th, and December 15th. So even with this method, you will most

likely be making the first payment (March 15th) based on as estimated tax payable.

3. *No-calculation method*: CRA provides us with this method which does not require any estimates. First two payments are based on the tax payable from the 2nd preceding year, and the last two on the preceding year. This method is called the no-calculation method because the CRA calculates the installment payments for us

The individual can choose any of the available options according to his/her discretion. Typically the taxpayer would choose the option with the least tax paid up front.

Under the 'no-calculation' method the instalments are determined as follows (for 2019):

a. An amount equivalent to 1/4 of the installment base of the second preceding taxation year (2017) is to be paid on March 15, 2019 and June 15, 2019.
b. For the installments to be paid on September 15, 2019 and December 15, 2019, the amounts already paid under (a) are deducted from the total tax paid in the preceding taxation year (2018). The resulting amount is then spread over the last two installments.

Example 2.10.1

John's estimated tax payable for 2019 is $16,881. He paid $11,250 for 2018 and $9,750 for 2017 as tax. The calculation for tax installments payable under three available options for 2019 is as follows:

Payment Date	Current year Option	Prior Year Option	No-calculation Option
	Estimated Tax Payable for 2019 = $ 16,881	Tax Paid for 2018=$11,250	Tax Paid for 2017=$9,750 Tax Paid for 2018=$11,250
March 15, 2019	(16881/4) = $4,220	(11250/4) $2,813	(9,750/4) $2,438
June 15, 2019	$4,220	$2,813	(9,750/4) $2,438
September 15, 2019	$4,220	$2,813	(11,250-2,438-2,438)/2 $3,187
December 15, 2019	$4,221	$2,811	$3,187
Total	$16,881	$11,250	$11,250

Note: Under option #2 and option #3 John would need to make a final payment of $5,631 on April 30th, 2020 to get the total payments for the year to equal his overall tax liability (assuming he ultimately owed $16,881 for the year).

References and Resources

- *Income Tax Act*, RSC 1985, c1, (5th Supp.) s 156(1)
- Chartered Professional Accountants. (2022). The Chartered Professional Accountant Competency Map. Part 1: The CPA Competency Map: 6.4.1

2.11 What options are available when a taxpayer disagrees with a CRA assessment?

KAREN RANA

If a taxpayer receives their CRA assessment and disagrees with it, they have the option to dispute it. Before filing an official objection, taxpayers are encouraged to contact their local CRA tax office to resolve their issue. If that does not address their concern, the next step is to file a Notice of Objection and the process of doing so has been outlined below. (Ed Note: In the File Objection section below it should say "either one year after the filing due date or 90 days…" rather than "either one year after the date of filing the return or 90 days")

1. File Objection:

- File a Notice of Objection either online, with a letter to the Chief of Appeals or by completing form T400A
- The Notice must be filed by whichever date is later: either one year after the date of filing the return or 90 days after the date of the original Notice of Assessment from CRA

2. Await Decision:

- Once the Notice of Objection has been filed the formal process has begun and there will be an impartial review by the Appeals Division
- The Appeals Division will send a letter of acknowledgement or a notice that the objection is invalid if it was not filed within the correct timeframe
- The Appeals Division will send out a Notice of Decision with one of three possible outcomes which have been outlined in Table 1 below

3. Appeal (Optional):

- If the taxpayer does not agree with the decision of the Appeals Division, they can appeal to the Tax Court of Canada within 90 days from when the Notice of Decision was sent

Process of Filling a Notice of Objection

As mentioned above, there are three possible decisions that the Appeals Division can make. The three outcomes have been listed in further detail below.

Decision	Action	Reasoning
The objection has been allowed in full	The assessment under question is fully reversed as the Appeals Division agrees with the taxpayer; the amount due on the assessment is reversed	Additional information was made available to the CRA which changed the circumstances
The objection has been partly allowed	The Appeals Division agrees with parts of the objection but not all of it so the amount due is adjusted based on what the Appeals Division agrees with. A reassessment will be issued to reflect the adjustment.	It is decided that the taxpayer is correct on some of the objections raised.
The objection has been denied	The Appeals Division does not agree with the taxpayer; the amount due is upheld and the taxpayer must pay the full amount due plus interest	The taxpayer cannot demonstrate that the original assessment was incorrect and therefore nothing is changed

For more information regarding this topic, please refer to Section 165(1) of the Income Tax Act which briefly outlines the process of filing an objection or the article linked below.

References and Resources

- Article – "Guide to Objecting to a CRA Assessment" (Author: Tax Solutions Canada)
- Article – "File an appeal to the Court – Income tax or GST/HST" (Author: Government of Canada)
- Chartered Professional Accountants. (2022). The Chartered Professional Accountant Competency Map. Part 1: The CPA Competency Map: 6.1.1

2.12 What is the difference between tax evasion, tax avoidance, tax planning and tax deferral? Provide some examples.

DEEPALI

Tax evasion occurs when an individual intentionally understates their revenue or overstates their expenses to reduce their tax payable. Tax evasion is considered a crime. Unlike tax avoidance, tax evasion has criminal consequences and the individual may face prosecution in criminal court.

For example, Alex works at an accounting firm and wants to minimize his tax bill, he claims $700 in deductions for fictitious meals and entertainment, moreover he neglects to report $7,000 he earned in cash from renting out a room from his house. Alex is committing tax evasion.

Tax avoidance is associated with tax evasion, but it's not considered a crime. Tax avoidance occurs when a person reduces or eliminates tax within the letter of law but not within the spirit and intent of the law. KPMG's Isle of Mann scheme is a good example of a tax avoidance scenario.

If CRA believes there is an avoidance transaction they may challenge your application of tax law under the General Anti-Avoidance Rules (GAAR).

Tax planning is an attempt to reduce one's tax liability, within the framework and spirit of existing tax rules and laws. An individual could reduce their income, increase their deductions and take the advantages of the tax credits through proper tax planning.

Tax deferral is an attempt to use existing tax rules and law to push tax payments/liability into the future. Tax deferral is not considered a crime.

A good example of both tax planning and tax deferral can be found in a Registered Retirement Savings Plan (RRSP). RRSP deductions reduce tax in the current year and defer it to the future when amounts in the RRSP are withdrawn. If, for example, you withdraw amounts from your RRSP when you are retired you will have achieved deferral (you've pushed taxation of the amount into the future when it was withdrawn) and you may have achieved tax planning/tax reduction if you are in a lower tax bracket during retirement than you were when you were working.

References and Resources

- *Income Tax Act*, RSC 1985, c1, (5th Supp.) ss 245, IC73-10R3
- Article – "IC88-2 General Anti-Avoidance Rule – Section 245 of the Income Tax Act" (Author: Government of Canada)
- Chartered Professional Accountants. (2022). The Chartered Professional Accountant Competency Map. Part 1: The CPA Competency Map: 6.3.2

2.13 What are Preparer Penalties?

AZHAR JAFFARI

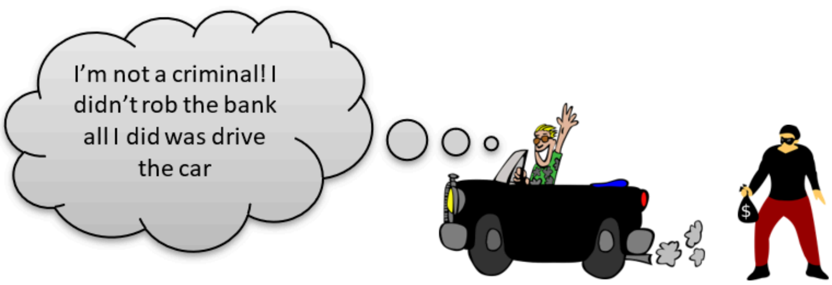
Any person who helps, advises, or participates (voluntarily or paid), directly or indirectly, in any accounting or financial matter comes under the scrutiny of ITA 163.2(4). Despite the name "preparer penalties," these penalties can also apply to any person who performs this act and is not limited to the tax return preparer. A person who gives tax advice to a specific person or any person preparing a tax return for a specific taxpayer can fall under this category and face these same penalties.

Example 2.13.1

John is an accountant and he advises one of his clients Ben to illegally forge invoices that will help Ben avoid taxes. Even though John has not forged the documents himself he can face penalties because he showed Ben ways to illegally avoid taxes.

According to ITA163.2(5) The penalties include the greater of $1,000 and the lesser of (i) a penalty equal to the penalty faced by the person who used the false statement or (ii) $100,000 and the person's gross compensation.

Sometimes people believe that if they were not the ones who directly committed a crime they are innocent. However, in the eyes of the CRA and the law anyone who assists knowingly in the breaking of a law in any way can face charges.



Why are there preparer penalties?

These penalties are placed as a discouragement for any person who participates in unlawful financial activities regardless of who benefits from them. These penalties make it so that individuals who have an influence on other people's tax returns are less likely to engage in or knowingly participate in advising unlawful activities that would result in avoiding taxes in a prohibited manner. Tax preparers rely on the information given by their clients or the persons who need to pay taxes. However, as a tax professional it is vital for them to be vigilant and they are not supposed to give wrong advice to their clients. Any advice that helps a client save tax in an illegitimate manner is considered as an offence by the tax preparer and they can be prosecuted or penalized for the crime.

Interactive Content

Author: Jas Sihota, June 2019

References and Resources

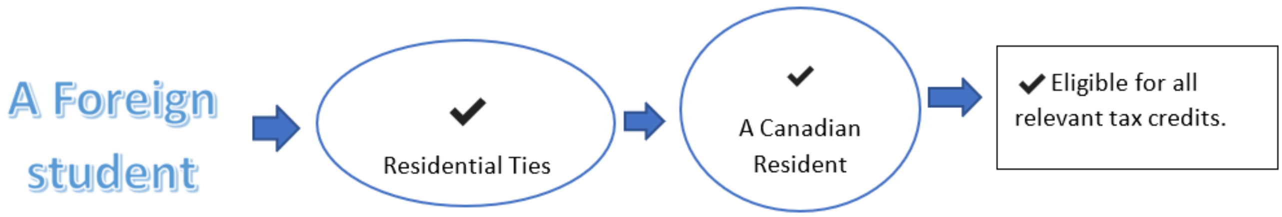
- *Income Tax Act*, RSC 1985, c1, (5th Supp.) ss 163.2(4),164.2(1)(a)(b),163.2(5)(a)(b)
- Chartered Professional Accountants. (2022). The Chartered Professional Accountant Competency Map. Part 1: The CPA Competency Map: 6.1.1

2.14 Are foreign students in Canada eligible for residency? Are they eligible for all relevant tax credits?

KAUR RAJDEEP

Canadian tax residency rules apply equally to everyone. So, if a foreign student meets the Canadian residency requirements then they are considered to be a tax resident of Canada and are eligible for all relevant tax credits.

As a refresher, tax residency in Canada is assessed based on Primary and Secondary residential ties. Primary residential ties include having dependants, a spouse or a home in Canada. Secondary residential ties include personal property, social ties, a driver's license, and medical insurance coverage. CRA considers all these factors when assessing an individuals tax residency status.



Eligibility of students for tax credits. [Image description]

Foreign students that are considered Canadian residents for tax purposes are eligible for all relevant tax credits (for example, tuition tax credits). The tax credits available to non-residents are more complicated and I suggest you go to the CRA guide (link in references) for further details.

The Canadian tax system is based on residency, not citizenship; Therefore, if an international student is a resident, they should enjoy the benefits just like another resident. So remember, if you are an international student who is considered a resident in Canada for tax purposes, you are eligible for all the tax credits available to a Canadian resident student who was born in Canada.

Image Description

The image is a flowchart that describes the process of a foreign student becoming eligible for all relevant tax credits in Canada.

From left to right, the flowchart consists of the following elements:

- The text "A Foreign student" in a blue, stylized font.
- A right-pointing blue arrow leading to an oval shape with the text "Residential Ties" and a checkmark inside it.
- A second right-pointing blue arrow leading to another oval shape with the text "A Canadian Resident" and another checkmark inside it.
- A third right-pointing blue arrow leading to a rectangle with the text "Eligible for all relevant tax credits." and a checkmark beside it.

References and Resources

- Article – "Taxes for international students studying in Canada." (Author: Government of Canada)
- Guide- "General Income Tax and Benefit Guide for Non-Residents and Deemed Residents of Canada." (Author: Government of Canada)
- Article- "Tax information for International Students in Canada." (Author: TurboTax)
- Chartered Professional Accountants. (2022). The Chartered Professional Accountant Competency Map. Part 1: The CPA Competency Map: 6.3.2

2.15 How and why does tax legislation exist?

SAM NEWTON

Income tax was introduced in Canada in 1917 as a temporary measure to fund the 1st World War. This temporary measure has proven to be remarkably resilient and has stuck around for more than a century.   During this time tax rules have grown from 11 pages in 1917 to thousands of pages today.

In the 2016-2017 fiscal year, the Canadian government raised $293 billion dollars in revenue. Of this amount approximately 50% came from individual income tax, 15% from corporate taxation, 12% from GST/HST and 7% from the employment insurance premiums. Personal and corporate taxation play a huge role in funding schools, the Canadian military our national healthcare systems etc.

It is important to understand that there is nothing immutable about taxation and that it is often driven by the political will of the day. For example, left-leaning governments may implement wealth taxes on high net worth individuals or increase taxes paid by higher income earners arguing that this is a way to address wealth imbalance and create a more egalitarian and fairer society. Right-leaning governments, on the other hand, tend to reduce taxes for high income earners and corporations believing that this will increase job creation and help the overall economy.

Again, there is nothing set in stone for taxation. You should consider taxation policies of the various parties whenever you vote. You can make a difference.

2.16 What is the role of CRA?

CHANDHAR ARVIND

The Canada Revenue Agency plays an important role as an administrator of the Canadian taxation system.

CRA keeps a check on:

1. Payroll
2. GST/HST
3. Income Tax
4. Excise Tax/Duties
5. Business Number Registration

The CRA has the authority to audit any company, corporation or individual to ensure they are compliant with Canadian tax law.

Effectively, the CRA plays the role of tax police. They enforce tax law and can penalize or charge you (through tax reassessments); however, you can challenge them in court if you disagree with their claim.

References and Resources:

- Article – "Canada Revenue Agency" (Author: Government of Canada)
- Video – "What is the PPCS's role in a CRA criminal investigation?" (Author: Canada Revenue Agency)
- Chartered Professional Accountants. (2022). The Chartered Professional Accountant Competency Map. Part 1: The CPA Competency Map: 6.1.1

2.17 What Are the Main Purposes of International Tax Treaties?

JASMINE DHESI

What is a Tax Treaty?

A tax treaty is an agreement between two countries to settle tax issues such as double taxation and tax evasion. A tax treaty usually outlines the taxes that are to be paid and helps decide in which country a person is considered resident. Every tax treaty is different and it is important to familiarize yourself with the details of the specific treaty Canada has with the country you are interested in.

Issues Resolved by a Tax Treaty

Tax treaties may impact Canadians choosing to work, study, or invest abroad. Without a treaty, an individual could face 'double-taxation' on their earnings (i.e. taxation in two countries on the same source of income). If the country where the income is generated and the country of residence enter into a tax treaty, the two countries can decide how the income should be taxed to prevent the same income being taxed twice (or by providing a foreign tax credit on income taxed in a foreign country).

Entering a tax treaty also helps address **tax evasion**, which is the non-payment or underpayment of tax owed. Tax evasion can be done in ways such as declaring inaccurate income, hiding income, or claiming expenses and tax credits you are not entitled to. Tax evasion is considered a crime, and therefore you may be subject to other penalties by law.

Example:

With tax treaty	If you are a Canadian resident and worked in the U.S. for part of the year, you may have to pay tax on that income in the U.S. and Canada; however, because of the tax treaty between the two countries you would receive a foreign tax credit for tax paid in the U.S., affectively eliminating double taxation
Without tax treaty	If you are a Canadian resident and worked in Costa Rica for part of the year, you may have to pay tax on that income in Costa Rica and Canada. In this situation because these two countries do not have a tax treaty, you will not get a foreign tax credit, and double taxation will not be eliminated.

In addition to addressing the tax issues above tax treaties can also be used to deal with other issues between countries including things like withholding taxes, cross border trading etc.

References and Resources

- Article – "Tax treaties" (Author: Government of Canada)
- Article – "What is Tax Evasion in Canada" (Author: Farber Tax Solutions)
- Chartered Professional Accountants. (2022). The Chartered Professional Accountant Competency Map. Part 1: The CPA Competency Map: 6.5.2

2.18 What are the main deemed disposition issues when you cease to be a resident of Canada?

MD ANCHER

ITA-128.1(1)(b). When a taxpayer ceases to be a resident in Canada, some of the taxpayer's assets are deemed to have been disposed of at their fair value. Deemed disposition means CRA will treat the assets as if they were sold at fair market value when a taxpayer ceases to be resident of Canada even though he or she may not have actually sold any of the assets. This process ensures that the taxpayer is subject to tax on any gains accrued during their period of residency in Canada.

For instance:

Assets	Original Cost of Property	Fair Market Value when cease to be a Canadian resident	Deemed Disposal Value as per CRA	Capital Gain or (Loss) at departure	Taxable Capital gain (50% capital gain)
Land	$300,000	$500,000	$500,000	$200,000	$100,000
Pubco Shares	$30,000	$35,000	$35,000	$5,000	$2,500

Normally any accrued gains on property at the time of departure are taxed in the year of departure but the payment of tax may be delayed by the taxpayer through an election and by posting a tax bond to offset the tax liability.

ITA-128.1(4)(b). Exemption from deemed disposal

There are certain properties – generally, those that would be subject to Canadian tax in the hand of non-residents – that are exempt from the deemed disposition. This includes things like real property in Canada and capital property used in a business carried on through permanent establishment in Canada. You will find more information on possible exemptions in ITA 128.1(4)(b)

There are also exemptions for individuals who owned property when they became resident of Canada, if they resided in Canada for 60 months or less during the 10-year period preceding their departure. Under this rule they will be exempted from all deemed disposition of assets that they brought with them and took away. Also exempted are properties inherited after the individual became resident in Canada. ITA 128.1(4)(b)

ITA-2(3), Taxpayer will continue to be liable for tax on the disposition of exempted property as a non-resident.

But- As there is always a but

128.1(4)(d). The taxpayer can elect to apply the deemed disposal rules on certain properties that are specifically exempt from the departure tax rules under section ITA 128.1(4)(b). A taxpayer might elect to do this to trigger accrued losses to offset accrued gains (or vice versa).

Capital losses triggered on an elected deemed disposal property may only be offset against the capital gains resulting from the application of departure tax rules 128.1(4)(d). In this situation, losses, except listed personal property losses, are restricted to the taxable capital gains actually triggered by deemed disposal.

References and Resources:

- *Income Tax Act*, RSC 1985, c1, (5th Supp.) ss 128.1(1)(b), 128.1(4)(d)
- Chartered Professional Accountants. (2022). The Chartered Professional Accountant Competency Map. Part 1: The CPA Competency Map: 6.5.2

2.19 What are the main deemed acquisition issues when you become a resident of Canada?

BASIL EDAVILAYIL

The Canadian income tax system treats the assets acquired by new residents before they became a Canadian resident, as if they bought the assets (based on the fair value of the asset) on the day they became a resident.

The Income Tax Act explains it as follows:

ITA 128.1(1) (c) **Deemed acquisition** — the taxpayer shall be deemed to have acquired at the particular time each property deemed by paragraph (b) to have been disposed of by the taxpayer, at a cost equal to the proceeds of disposition of the property; this means that new residents to Canada are not taxed on unrealized gains generated prior to becoming a resident in Canada.

For example, in June 2017 before moving to Canada, Daljinder purchased a property in India. He became a resident of Canada on January 20, 2018 and sold the Indian property on July 31, 2018. His taxable capital gain will be calculated as follows:

Value of his property when he bought it	$10,000
Fair market value of his property on January 20, 2018	$100,000
Value of the property sold on July 31, 2018	$120,000
Capital Gains in Canada ($120,000 – $100,000)	$20,000
Taxable Capital gains in Canada ($20,000 x 50% capital gains inclusion rate)	$10,000

When calculating the capital gain on sale CRA considers the 'cost' of the property to be the $100K fair value of the property at the time Daljinder became a resident of Canada.

Other deemed acquisition rules and issues

• **Tax evasion** –New residents to Canada with significant assets may want to hide these assets to avoid having to pay tax in Canada. "Tax evasion is a crime. Whether you're cheating on your taxes here in Canada or hiding assets or money in foreign jurisdictions, the consequences are serious. Tax evasion has a financial cost. Being convicted of tax evasion can also lead to fingerprinting, court-imposed fines, jail time, and a criminal record"- CRA (article linked below)

• **Double Taxation** – When selling a property in a foreign country, a Canadian resident may be required to report and pay tax in both Canada and the foreign country. This is known as double taxation. If a **tax treaty** is in place between Canada and the foreign country the taxpayer may be able to claim Foreign Tax Credits in Canada for tax paid in the foreign country to reduce the potential double taxation.

References and Resources

- *Income Tax Act*, RSC 1985, c1, (5th Supp.) s 128.1(1) (c)
- Article – "Tax treaties" (Author: Government of Canada)
- Article – "Tax evasion. There are consequences." (Author: Government of Canada)
- Chartered Professional Accountants. (2022). The Chartered Professional Accountant Competency Map. Part 1: The CPA Competency Map: 6.5.2

CHAPTER 3: DEDUCTIONS

Chapter Overview

3.1 Child Care expenses and how they are treated for tax purposes?

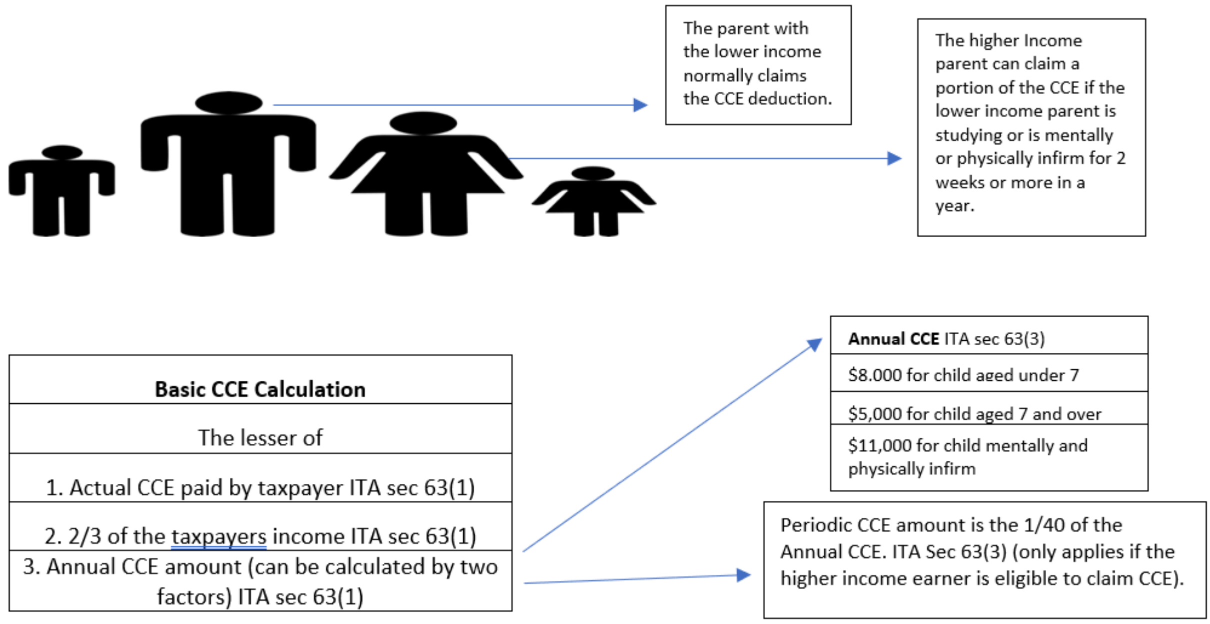
BHAVISH TOOR

Child care expenses are amounts you or your spouse or Common-law partner spend to have someone look after an eligible child so that you or the other person could work to generate income or handle business or attend school ITA 63 (3). An eligible child is

- Under the age of 16 at any time during the year (exceptions are made to the age limit if the child is mentally or physically infirm).
- You or your spouse's or common-law partner's child.
- Was dependent on you, your spouse or common-law partner in the taxation year.

Examples of child care expenses ("CCE") are the amount paid to a child care provider, day care centers, day nursery school, nannies, day camps and overnight camps, not including fees paid for education, leisure or recreational activities, medical or hospital bills, clothing or transportation cost.

CCE is recorded as deductions in section 3(c) of the section 3 ordering rules, when calculating Net Income for Tax Purposes.



Who can claim the CCE? [Image Description]

Ed.Note: Per ITA 63(2), for the higher income spouse to claim some of the childcare expenses, the lower income spouse must be attending school for a minimum of 3 weeks or in a hospital or imprisoned for a minimum of 2 weeks.

In order to understand it in much detail there is a good example in income tax folio S-1,F-3,C-1 on paragraph 1.44.

Example 3.1.1

Martina and Joe sent their kids Max, age 19, with a disability; Jax, age 6; and Rex, age 4, to a summer camp for 4 weeks. The total cost for the camp was $4,500. They also incurred $11,090 in regular childcare during the year. Martina has earned income of $55,000 and Joe has earned income of $61,000.

Calculate the deductible childcare costs to see which would be the least of the 3 methods. (Actual, 2/3, Annual)

ITA 63(3) Annual Child Care Expense Amount:

Max 19 with a disability = $11,000

Jax 6 =$8,000

Rex 4 =$8,000

To get the weekly eligible amount (Actual Amount) we divide the Annual Expense Amount by 40 to get the following:

Max 19 with a disability = $11,000 divided by 40 = $275

Jax 6 =$8,000 divided by 40 = $200

Rex 4 =$8,000 divided by 40 = $200

Martina is the lower income spouse and, since the exceptions in 63(2) don't apply, she will be the one claiming the childcare expenses for the year. Here is the calculation.

2/3 method = $55,000 x 2/3 = $36,667

Annual Method =$8,000 + $8000 + $11,000 = $27,000

Actual Method = $11,090 + (($200 + $200 + $275) X 4 weeks) = $13,790

Since Martina is the Lower Income Spouse, her deduction will be $13,790 (the lesser of the three amounts calculated above).

(Example by: Priya Dhariwal)

References and Resources

- *Income Tax Act*, RSC 1985, c1, (5th Supp.) ss 63(2), 63(3)
- Article – "Income Tax Folio S-1, F-3, C-1, Child Care Expense Deduction", (Author- Government of Canada)
- Image – "family" by Bhavish Toor licensed under CC BY 4.0
- Chartered Professional Accountants. (2022). The Chartered Professional Accountant Competency Map. Part 1: The CPA Competency Map: 6.3.2

Image Description

Who can claim the CCE?: A diagram illustrating the Child Care Expense (CCE) deduction process. At the top, there are icons of a family (two parents and two children). An arrow from the lower-income parent points to a box that reads, "The parent with the lower income normally claims the CCE deduction." Another arrow from the higher-income parent points to a box that reads, "The higher income parent can claim a portion of the CCE if the lower income parent is studying or is mentally or physically infirm for 2 weeks or more in a year."

Below the family icons, there is a box titled "Basic CCE Calculation" with three points:

1. Actual CCE paid by taxpayer ITA sec 63(1)
2. 2/3 of the taxpayer's income ITA sec 63(1)

3. Annual CCE amount (can be calculated by two factors) ITA sec 63(1)

To the right, another box titled "Annual CCE ITA sec 63(3)" lists the amounts:

- $8,000 for a child aged under 7
- $5,000 for a child aged 7 and over
- $11,000 for a child mentally and physically infirm

An arrow from "Basic CCE Calculation" points to "Annual CCE ITA sec 63(3)," and another arrow from "Annual CCE ITA sec 63(3)" points to a final box that reads, "Periodic CCE amount is the 1/40 of the Annual CCE. ITA Sec 63(3) (only applies if the higher income earner is eligible to claim CCE)." [Return to Who can claim the CCE?]

3.2 Describe moving expenses and how they are treated for tax purposes.

LEONOR LANON AND KAYLEIGH BUDLONG

Who can claim moving expenses in respect of an eligible relocation? ITA – 248(1)

Self-employed individuals or employees and students can claim eligible moving expenses related to their relocation from one place to another within Canada.

What are the conditions to claim moving expenses (an "eligible relocation")? ITA – 248(1)

To qualify, the person's new home must be at least 40 kilometres (by the shortest usual public route) closer to a new work location or post-secondary institution.

What are examples of eligible and non-eligible "moving expenses"? ITA – 62(3)

Eligible Moving Expenses

Travel costs (ITA – 62(3)(a)) incurred by taxpayer and household members in process of moving from old residence to new. Including:

- Meals
- Lodging, and
- Vehicle use

Transportation and storage costs (ITA – 62(3)(b)) for household effects. Such as:

- Moving van

Cost of meals and lodging (ITA – 62(3)(c)) near old or new residence for taxpayer and household members.

- Maximum of 15 days

- Also called temporary living costs

Cost of cancelling lease (ITA – 62(3)(d)) for old residence. Including:

- Penalties, and
- Forfeiture of deposit

Costs of selling (ITA – 62(3)(e)) old residence. Including:

- Advertising
- Legal fees
- Commissions, and
- Mortgage penalties

Costs of buying (ITA – 62(3)(f)) new residence. Only if the taxpayer or their spouse or common-law partner is the owner of and sold the old residence. Including:

- Legal fees, and
- Taxes (other than GST/HST)

Costs to maintain old residence (ITA – 62(3)(g)) when vacant. Maximum of $5,000. Including:

- Interest
- Property taxes
- Insurance
- Utilities, and
- Heating

Incidental costs (ITA – 62(3)(h)) of moving. Including:

- Changing address on legal documents
- Replacing drivers' licenses, and
- Connecting or disconnecting utilities

Ineligible Moving Expenses

- Costs for improvements or repairs done to make the old residence more saleable.
- Any loss from the sale of the old residence.
- Travel costs for house hunting trips before the move.
- Travel costs for job hunting in another city.
- Costs of cleaning or repairing a rented home to meet the landlord's standards.
- Costs of selling the old residence if the taxpayer delayed selling for investment purposes or until the market improved.
- Incidental costs of replacing items lost or damaged in the move.

Either the detailed or simplified method can be used to claim expenses for meals and vehicle use incurred in the process of moving.

Detailed Method – If the detailed method is used to calculate meal and vehicle expenses, the taxpayer must keep all receipts and claim the actual amount spent.

Simplified Method – If the simplified method is used to calculate meal and vehicle expenses, the taxpayer can claim a flat rate amount. To calculate vehicle expenses under the simplified method, the number of kilometers driven is multiplied by the cents/km rate for the province or territory where travel began. The vehicle rate varies by province or territory. For example, the vehicle rate for BC was $0.56 per kilometer in 2021, but the rate for Alberta was $0.51 per kilometre. As of 2021, the meal rate under the simplified method was $23/meal up to a maximum of $69/day per person.

The rates for the simplified method change each year. However, current rates – as of 2021 – can be found here.

Example 3.2.1

During 2021, Jack moves 950 km from Alberta to Surrey, BC with his three children for a new job. He incurs travel costs of $600 to move himself and his children to Surrey. These costs include a hotel for one night at $100 per night, meals for 4 persons over 2 full days, and gas and insurance for Jack's car. Jack also incurs temporary living costs while he waits to move into the house in Surrey. These costs include a hotel (20 nights x $100) for $2,000 and meals (20 days x $50) for $1,000. Jack chooses to use the simplified method to calculate his meal and vehicle expenses. What is the maximum amount he can deduct for moving expenses in section 3(c)?

Travel costs:

Hotel – ($100 x 1 night)	$100	
Meals – ($69 x 2 days x 4 persons)	$552	
Vehicle – ($0.51 x 950 km)	$485	$1,137
Temporary living costs:		
Hotel – ($100 x 15 nights)	$1,500	
Meals – ($69 x 15 days x 4 persons)	$4,140	$5,640
Total deduction:		$6,777

The simplified method can be used to calculate meal and vehicle expenses. However, temporary living costs are limited to 15 days. Since travel began in Alberta, a rate of $0.51 per km is used to calculate Jack's vehicle expenses for 2021.

References and Resources

- *Income Tax Act*, RSC 1985, c1, (5th Supp.) ss 62(1), 62(2), 62(3)
- *Income Tax Act*, RSC 1985, c1, (5th Supp.) s 248(1)
- Article – "Income Tax Folio S1-F3-C4, Moving expenses" (Author: Government of Canada)
- Article – "Line 21900 – Moving expenses" (Author: Government of Canada)
- Chartered Professional Accountants. (2022). The Chartered Professional Accountant Competency Map. Part 1: The CPA Competency Map: 6.3.2

3.3 What are some common Division 'C' deductions and how do they impact taxes payable?

FALAK SHARMA

The taxable Income of an individual is equal to Net Income for Tax Purposes (also known as Division 'B' Income) less a group of deductions found in Division 'C' of the ITA. There are lots of Division 'C' deductions however we will focus on two important ones: Net Capital Losses and Non-Capital Losses.

Net Capital Losses are generated when Allowable Capital Losses (1/2 of Capital Losses) exceed Taxable Capital Gains (1/2 of Capital Gains) in a year. In this scenario, the net taxable capital gain in S3(b) will be $Nil, and the negative amount will become a Net Capital Loss. Net Capital Losses can only be applied against S3(b) net Taxable Capital Gains in a year. They can be carried back 3 years or forward indefinitely. See ITA 111(1.1) for more details

Non-capital losses are created when the S3 ordering rules create a negative amount. In this situation, Net Income For Tax Purposes ('NITP') will be $Nil, and the negative amount will become a Non-Capital Loss. Non-Capital Losses can be applied against NITP in a given year. They can be carried back 3 years or forward 20 years. See ITA 111(5.4) for more details.

Example 3.3.1

Mr. Smith has NITP of $25,000. He has a Net Capital Loss of $4,000, and a Non-Capital Loss of $2,200 carried from previous years. Mr. Smith's S3(b) amount is $1,500. His Taxable Income would be calculated as follows:

NITP.. $25,000

Less:

Net Capital loss......................... $(1,500) (can only be applied against S3(b) amount)

Non-Capital loss...................... $(2,200) (can be applied against all sources of income)

Taxable income = $21,300

The remaining Net Capital Loss of $2,500 ($4,000-$1,500) could be applied against net TCG's in other years.

References and Resources

- *Income Tax Act*, RSC 1985, c1, (5th Supp.) ss 111(1.1), 111(5.4)
- Chartered Professional Accountants. (2022). The Chartered Professional Accountant Competency Map. Part 1: The CPA Competency Map: 6.3.2

3.4 What is a business investment loss? What is the impact on Taxable Income? Why does it exist?

BHANVI GHAI

A Business Investment Loss ("BIL") arises when you invest in certain types of small businesses in Canada (either through buying shares or providing loans) and lose your investment. The BIL is more flexible than a normal capital loss and provides a tax incentive for people to invest in small businesses in Canada.

Just as an Allowable Capital Loss represents the deductible 50% portion of a Capital Loss, an Allowable Business Investment Loss ("ABIL") represents the deductible 50% portion of a BIL. When calculating net income for tax purposes, ABIL's are deducted in 3(d) in the year they occur. Any unused portion of the ABIL becomes a Non-Capital Loss which can be applied against all sources of income and carried back 3 years and forward 10 years.

If the ABIL cannot be deducted within 10 years, then it becomes a Net-Capital Loss that can be carried on indefinitely and can only be claimed against Taxable Capital Gains.

Example 3.4.1

If you purchase $20,000 shares in a public corporation and the corporation goes bankrupt, this would create a $20,000 Capital Loss. 50% of this amount ($10,000) would be your Allowable Capital Loss and could only be applied against Taxable Capital Gains.

The same investment with an eligible small Canadian corporation would create a $20,000 BIL. 50% of this amount ($10,000) would be your ABIL and could be applied in 3(d) against ALL sources of income. As mentioned earlier, any unused amount would initially be added to your non-capital loss balance.

This whole concept exists so that if a taxpayer loses money on this type of investment, they are rewarded with a much more flexible type of loss. This special tax treatment encourages people to invest more in Canadian small businesses.

References and Resources

- Article – "Lines 21699 and 21700 – Business investment loss" (Author: Government of Canada)
- "Income Tax Folio S4-F8-C1, Business Investment Losses" (Author: Government of Canada)

3.5 Describe retiring allowances and how they are treated for tax purposes.

RAMNEEK KAUR

What is Retiring Allowance?

a retiring allowance is an amount received by an employee after they retire from their employment/work.

A retiring allowance includes:

- Payment for unused sick- leave credits on termination
- The amount that an individual receives when their office or employment is terminated.

Tax implications to the recipient

Under subparagraph 56(1)(a)(ii), a retiring allowance is included in computing the income of an individual in the year it is received. If an employee chooses to receive the retiring allowance in installments, they will be taxable in the year received.

An individual might terminate employment but die before receiving all or a part of a retiring allowance to which they were entitled. In this case, any remaining amount received by their dependent, relation or legal representative will normally be included in the recipient's income as a retiring allowance under subparagraph 56(1)(a)(ii).

Treatment for tax purposes: Retiring allowances are treated as other sources of income in the year received under 3(a).

Transfer to RRSP

Employees who have years of service prior to 1996 can directly transfer the retiring allowance to a registered pension plan (RPP) or a registered retirement savings plan (RRSP) without reducing their RPP/RRSP contribution room. This portion is known as an eligible amount of transfer.

The eligible amount for the transfer under 60(j.1) of the Income-tax Act is limited to $2,000 for each year (or partial year) of employment prior to 1996 and an additional $1,500 for each year (or partial year) of employment prior to 1989. There is no eligible transfer for years of employment from 1996 onwards.

Example: On June 2018, Ramneek retired and got $50,000 as her retiring allowance for the service period from 1986 to 2018 (32 years, including part years services). He did not make any contributions to a pension plan.

Ramneek's eligible retiring allowance, that could be transferred to his RPP/RRSP without impacting the deduction limit, will be $20,000 ($2,000 × 10 years (from 1986 to 1995, including part-years)) plus $4,500 ($1,500 × 3 years (from 1986 to 1988, including part-years)) = $24,500.

References and Resources

- Article – "Income Tax Folio S2-F1-C2, Retiring Allowances" (Author: Government of Canada)

3.6 Describe indirect payments and how they are treated for tax purposes.

SEAN CO

Definition

A typical indirect payment would occur when person 'A' (the person who does the work) instructs the payor to pay person 'B' for work performed by person 'A'. For example, I might instruct my employer to pay my spouse (instead of me) because my spouse is in a lower tax bracket. The indirect payment rules (ITA 56 (2)) bring this income back into the hands of the individual who actually provided the service rather than the one who received the payment.

In Chapter 2, we learned about tax avoidance, tax evasion, tax deferral and tax planning, as well as the purpose of the General Anti-Avoidance Rule (GAAR). Indirect payments would lean towards tax avoidance, considering that these payments exist to reduce a family's overall tax burden.

As per all taxable income, if an indirect payment satisfies all the conditions, that payment would be taxed accordingly as an addition to the taxpayer's taxable income.

Four conditions required to satisfy subsection 56(2) rule

A. If the payment or transfer of assets is made to a person other than the taxpayer
B. The payment was made in pursuant to the direction or concurrence with the taxpayer (does not need to be obvious, can be passive or implicit)
C. There is a benefit involved in the payment, whether to the taxpayer or another person that the taxpayer wishes to give the payment to
D. The payment would have been included in the taxable amount of the taxpayer if the payment was directly made to the taxpayer

Application

An example of this would be if Corporation Neasco decides to give gifts to their shareholders' family members, such as apparel or appliances. Let's say these gifts are worth $20,000 in total. The first condition is already satisfied, as Neasco transfers the said $20,000 assets to the family members other than the shareholders themselves. Since that the gifts were given to the shareholders' family members, both the shareholders and Corporation Neasco concurred to make this happen. This satisfies Rule B. Moreover, the gifts worth $20,000 were to the shareholders' family members so that they can use them, which would be considered as a benefit, satisfying rule C.

Lastly, if this $20,000 was given directly to the shareholders, it would be included as a part of their income because of subsection 15(1), which says that if a benefit received by a shareholder from a corporation, that benefit would be included in their taxable income. In this case, the $20,000 worth of gifts that the family members of the shareholders received would still be included in the shareholders' taxable income as all the conditions of subsection 56(2) are satisfied.

Exemption

Any amount in a retirement plan assigned by a taxpayer under subsection 65.1 ("portion of a contributor's retirement pension to the contributor's spouse or common-law partner") of the Canada pension plan or a similar provincial pension plan as stated in section 3 of the Canada pension plan/prescribed provincial pension plan is exempt from the rules mentioned in Subsection 56(2).

Some forms of split income (like split pension income) are also exempt from the indirect payment rules.

References and Resources:

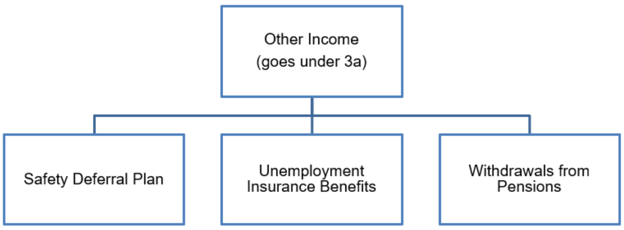
- *Income Tax Act*, RSC 1985, c1, (5th Supp.) s 56(2)
- Article – "Indirect Payments" (Author: Government of Canada)

3.7 What are Other Incomes and Other Deductions?

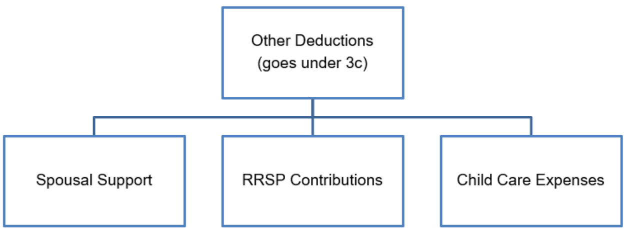
JAYDEEP SHERGILL

According to ITA 56(1), other income amounts to be included in the recording of income tax are amounts not obtained through employment, business, or property income such as: pension benefits (CPP, provincial pension plans, and private pension benefits), unemployment insurance benefits, parts of registered pension plans that are redeemed within a tax year, spousal support payments received, and salary deferral plans.

Other Deductions are similar to other income in that they do not originate from employment, business, or property income. ITA 60 states, "There may be deducted in computing a taxpayer's income for a taxation year such of the following amounts as are applicable: Support payments made, Pension income reallocation, Repayment of support payments…". Examples of these "Other Deductions" include childcare expenses, spousal support payments paid, moving expenses, and deducted RRSP contributions.



Other income (3a) [Image Description]



Other deductions (3c) [Image Description]

It is important to identify whether certain items represent income or a deduction. For example, spousal support payments received would be included as income in 3(a) whereas spousal support payments made would be deductible in 3(c).

Order of Other Income and Other Deductions in Calculating Net Income for Tax Purposes

Other Income amounts are included under ITA 3(a) in the calculation of Net Income for Tax Purposes. Other deductions are applied against the sum of ITA 3(a) and ITA 3(b). If the 3(c) exceeds the sum of 3(a) and 3(b) then the subtotal is $Nil. Although there are some exceptions most of the ITA 3(c) deductions are "use it or lose it" deductions meaning that they expire if they are not used within the year.

References and Resources

- *Income Tax Act*, RSC 1985, c1, (5th Supp.) ss 56, 56(1), 60, 248(1)
- Chartered Professional Accountants. (2022). The Chartered Professional Accountant Competency Map. Part 1: The CPA Competency Map: 6.3.2

Image Description

- Other income (3a): A flowchart titled "Other Income (goes under 3a)" at the top. It has three branches: Safety Deferral Plan, Unemployment Insurance Benefits, and Withdrawals from Pensions. Each branch is represented with a connecting line from the main "Other Income" box at the top. [Return to Other income (3a)]
- Other deductions (3c): A flowchart titled "Other Deductions (goes under 3c)" at the top. It has three branches: Spousal Support, RRSP Contributions, and Child Care Expenses. Each branch is connected by a line to the main "Other Deductions" box at the top.[Return to Other deductions (3c)]

CHAPTER 4: EMPLOYMENT INCOME

Chapter Overview

4.1 Why is it important to determine if someone is an employee or self-employed and how would CRA assess it?
4.2 What are CPP and EI contributions, and how do we calculate them?
4.3 What are the optimal kinds of employee benefits (for both the employer and the employee)?
4.4 What is an employee benefit and what are the tax implications of the most common employee benefits?
4.5 What is an allowance? What is a reimbursement? How are they treated differently for tax purposes?
4.6 How are the following common employment deductions calculated and treated for tax purposes: legal expenses, sales expenses, automobile expenses, meals, entertainment and professional dues?
4.7 What are the general rules for deduction of home office expenses for an employee vs self-employed?

4.1 Why is it important to determine if someone is an employee or self-employed and how would CRA assess it?

ARSHDEEP KAUR

It is important to determine if a person is an employee or self-employed because it directly impacts things like the kinds of deductions/expenses they can claim, contributions to Employment Insurance (EI), ability to claim EI benefits if unemployed, payments of amounts to the Canada Pension Plan etc. If you are considered to be an employee, it is the employer who is responsible for deducting and remitting their employees EI premiums, Canada Pension Plan (CPP) premiums and Income Tax withholding. One of the major benefits to self-employed individuals is that they have access to far more deductible expenses than employees.

How CRA assesses whether someone is an employee or self-employed

CRA has a two-step approach determining whether a person is an employee or self-employed:

Step 1: CRA tends to ask the intent of the worker and payer when they entered into the business contract, if it was an employee-employer relationship or business relationship. Sometimes it is very clear because both the parties have a written agreement documenting their working relationship. Both parties set up the terms and conditions through the written agreement. To decide the party's intentions CRA keeps a copy of agreement or testimony and examines the actions taken by both parties.

Step 2: CRA ask the worker and payor questions about their working relationship. Questions are related to the following elements (Factors to consider):

1. Level of Control the payer has over the worker
2. Tools and Equipment provided to, or by the worker

3. The ability of the worker to sub-contract to another worker.
4. The degree of financial risk the worker can take
5. The degree of responsibility the worker is allowed for investment and management
6. The worker's opportunity for profit

CRA looks at the situational facts as a whole before assessing whether someone is an employee or self-employed. This determination can be very subjective and leads to lots of court cases.

References and Resources:

- Video — "Independent Contractor vs. Employee: What's the Difference?" (Author: Canadian Employment Lawyer Lior Samfiru)
- Article — "Employee or Self-Employed?" (Author: Government of Canada)
- Chartered Professional Accountants. (2022). The Chartered Professional Accountant Competency Map. Part 1: The CPA Competency Map: 6.3.3

4.2 What are CPP and EI contributions, and how do we calculate them?

WAHAJ AWAN

CPP Contributions

Canada Pension Plan (CPP) is a taxable benefit given to individuals after they retire. To qualify for this benefit you must be at least 60 years of age, and must have at least one valid contribution to the CPP. The amount a person receives will vary depending on how much one contributed to the CPP, their average earnings, and the age they decide to start receiving pension.

As of 2023, the employer and the employee are each expected to contribute 5.95% of the employee's gross wages up to a maximum of $66,600 reduced by the basic exemption of $3,500. This results in a maximum CPP contribution of $3,754 (($66,600 gross wages – $3,500 exemption) x 5.95%) each for the employer and the employee with a total CPP contribution of $7,509. The employee gets a personal tax credit of 15% on their portion of the contribution.

> *Note*: for purposes of our course we've simplified the CPP tax treatment slightly. We treat the entire CPP contribution as eligible for the CPP tax credit. In reality, for higher income earners, there is an ITA 60(e.1) Enhanced CPP Contribution which gets deducted from Net Income, this is calculated within all tax software and I don't require you to do the calculation in our course.

If a person is self-employed, they are required to pay both the employee and the employer's portion of the CPP contribution. CPP is not withheld on the business income earned so the person is required to make the contribution by April 30th or, if required, as quarterly instalments. They would have to pay 5.95% x 2 x their net income, up to a maximum income of $63,100 ($66,600 – $3,500 exemption) for 2023.

EI Premiums

Employment insurance (EI) are benefits given to eligible individuals who have lost their job through no fault of their own, and are able to and willing to work but cannot find a job.

Employees are required to participate in the EI program under most scenarios. 1.63% of the employee's gross income is withheld, and the maximum insurable earnings as of 2023 are $61,500 resulting in a maximum EI contribution of $1,002 by the employee. The employer is required to contribute an additional 1.4 times the amount contributed by the employee for EI.

Self-employed individuals can opt-in to the EI program, but they are not required to do so. They do not have to pay the employers portion of the EI contribution for employees, unlike CPP, so the maximum EI contribution for self-employed individuals would be $1,002 for 2023.

Example 4.2.1

What would be the CPP and EI contribution for an employee with gross wages of $42,000 for 2023? What would be the tax credits for CPP and EI?

	Contribution amount	Tax credit
CPP	($42,000 – $3,500) x 5.95% = $2,291	$2,291 x 15% = $344
EI	$42,000 x 1.63% = $684	$684 x 15% = $103

References and Resources

- Article – "CPP contribution rates, maximums and exemptions" (Author: Government of Canada)
- Article – "CPP Retirement pension" (Author: Government of Canada)
- Article – "EI regular benefits" (Author: Government of Canada)
- Article – "Employment insurance – Important notice about maximum insurable earnings for 2022" (Author: Government of Canada)
- *Income Tax Act*, RSC 1985, c1, (5th Supp.) s 118.7

4.3 What are the optimal kinds of employee benefits (for both the employer and the employee)?

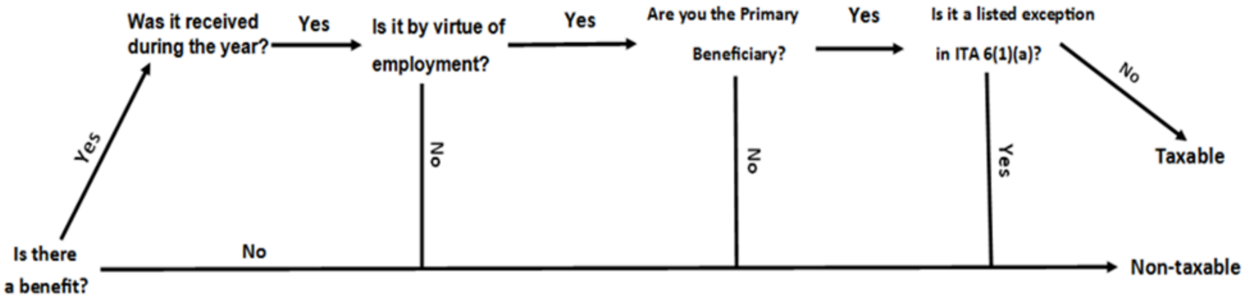
KARN JOSAN

ITA 5(1) states that "Income from office or employment includes salary, wages and other remuneration that is received by the taxpayer during the year as a virtue of their employment." Per ITA 6(1)(a) this includes the value of "benefits of any kind that is enjoyed by the taxpayer during the year as a virtue of their employment." This section of the ITA also features an "except for" clause which documents numerous benefits which, although they provide a benefit, are not taxable. This includes items like some private health insurance plans, registered pension plans and group life insurance policies.

We can use these sections of the ITA (along with some ITA sections regarding deductibility of business expenses) to help find 'optimal' employee benefits, i.e. benefits that are non-taxable to the employee but still deductible to the employer.

In addition to the ITA guidance provided above we may need to determine who is the primary beneficiary of the benefit. Typically, if the employee is the primary beneficiary the benefit is taxable, but if the employer is the primary beneficiary it would not create a taxable benefit.

Ultimately, any benefit received in the year by virtue of your employment is taxable unless there is a specific exemption or the employer is the primary beneficiary. The taxable benefit would be added to your employment income and include in S3(a) when calculating Net Income for Tax Purposes. The following flowchart is a helpful guide to determining if a benefit is taxable:



Flowchart for Determining the Taxability of a Benefit under ITA 6(1)(a) [Image Description]

In many situations, there isn't a clear or distinct answer. For instance, if an employer provides payments to each employee to purchase a laptop, is this a taxable benefit? You could argue that the employee is the primary beneficiary as they receive a free laptop, but you could also argue that the employer has a greater benefit as this could increase productivity.

What are the optimal benefits?

Optimal benefits are essentially not taxable for employees, and deductible for employers. This means they aren't included in the employee's income, and according to ITA 18(1), can be deducted from the employers' business income.

References and Resources

- *Income Tax Act*, RSC 1985, c1, (5th Supp.) ss (5)(1), (6)(1)(a), and (18)(1)
- Article – "T4130 Employers' Guide – Taxable Benefits and Allowances" (Author: Government of Canada)
- Chartered Professional Accountants. (2022). The Chartered Professional Accountant Competency Map. Part 1: The CPA Competency Map: 6.3.2

Image Description

Flowchart for Determining the Taxability of a Benefit under ITA 6(1)(a): A flowchart for determining the taxability of a benefit. It starts with the question, "Is there a benefit?" If yes, an arrow leads to "Was it received during the year?" If yes, another arrow leads to "Is it by virtue of employment?" If yes, the next question is "Are you the Primary Beneficiary?" If yes, the final question is "Is it a listed exception in ITA 6(1)(a)?" If yes, the outcome is "Non-taxable." If at any point the answer is no, the outcome is "Taxable." Arrows guide the progression through each question with "Yes" or "No" branching paths. [Return to Flowchart for Determining the Taxability of a Benefit under ITA 6(1)(a)]

4.4 What is an employee benefit and what are the tax implications of the most common employee benefits?

What is an employee benefit?

An employee may receive additional benefits, by virtue of their employment, over and above their gross salary. All these perks and benefits are presented by the employer to make the job offer more lucrative and to keep up the motivation levels of the employees. ITA 6(1)(a) states that any benefit received by virtue of one's employment is taxable (assuming the primary beneficiary is the employee), however there are a number of exceptions to this rule.

Tax treatment of the most common taxable benefits

Some of the most common taxable benefits are described below with links to CRA's Publication T-4130 "Employers' Guide – Taxable Benefits and Allowances"

1. *Health and Dental Insurance*– If an employer pays the premiums for an employees health and dental insurance there is no taxable benefit to the employees. i.e. the employee would not need to include the value of the benefit in their income. See "Private Health Services Plan Premiums".
2. *Group Life Insurance* – A group life insurance is a type of life insurance in which a single contract covers an entire group of people. If an employer is paying the premiums for the employees group life insurance, it creates **a taxable benefit** for the employee and will be included in the employees income. Note that while ITA 6(1)(a)(i) states that Group Term Life Insurance benefits paid are not taxable however ITA 6(4) supersedes this and states that Group Term Life Insurance benefits ARE taxable (based on prescribed amounts). See "Group Term Life Insurance Policies"
3. *Training Expenses* – An employer generally pays for the training expenses on the behalf of the employees. If the training is related to the employment and upgradation of work-related skills, it is **not a taxable benefit**. If the training expense is primarily for the benefit of the employee (rather than the employer) it

would typically be considered **a taxable benefit**. See "Scholarships, Bursaries, Tuition and Training"

4. *Vehicle Allowances* – An allowance is an amount received by an employee from an employer for using their own/personal vehicle for work-related purposes. This payment is on top of the existing salary and is **a taxable benefit** unless it is considered 'reasonable'. Reasonable automobile allowances must be based on kilometres and the payment per kilometre should be within the CRA prescribed rate for the province. The rationale behind this is that a reasonable per-kilometre allowance is not meant to create any additional economic benefit for the employee and hence, is not taxed. See "Reasonable per kilometre allowance"
5. *Gifts and Awards* – The tax treatment for gifts and awards depends on the specific circumstances. Cash or near-cash awards (gift cards, securities, stocks) are always classified as a taxable benefit. A non-cash award up to a monetary value of $500 is not considered a taxable benefit. For example, a sporting event ticket or a voucher to buy a Christmas tree from a particular store are examples of non-cash gifts. As long as the non-cash gifts remain under the worth of $500, these are non-taxable. The specific details are fairly complex, see "Gifts, Awards and Long-Service Awards" for more details.
6. *Cellular Phone Service* – If an employee uses a cellular phone which is owned by the employer, there exists no taxable benefit. On the other hand, if an employee uses his own cell phone and is reimbursed for it, the fair market value of the phone is a taxable benefit. If an employer reimburses an employee for their cell phone plan, the portion attributable to personal use would be considered a taxable benefit. See "Cellular Phone and Internet Services"
7. *Counselling Service* – An amount paid by the employer to provide financial and legal counselling to an employee creates a taxable benefit. For example, employer provided income tax preparation and legal sessions create an economic benefit and are taxed. Services like re-employment, retirement, mental or physical health counselling for the employees do not create a taxable benefit. See "Counselling Services"

Editor's note: I have not included the tax implications of employer provided automobiles (operating cost benefit and standby-charge) or stock option benefits. Although these are included in the CPA competency map I don't believe they are "common benefits", in fact they didn't even make it into the top 10 most common employee benefits in a 2016 survey by the Canadian Payroll Association (see link at bottom of page). Instead we have focused on the more common benefits identified in that survey.

References and Resources

- Article – "T4130 – Employers' Guide – Taxable Benefits and Allowances" (Author: Government of Canada)
- Article – "Top 10 Employee Benefits in Canada" (Author: Daryl Smith)

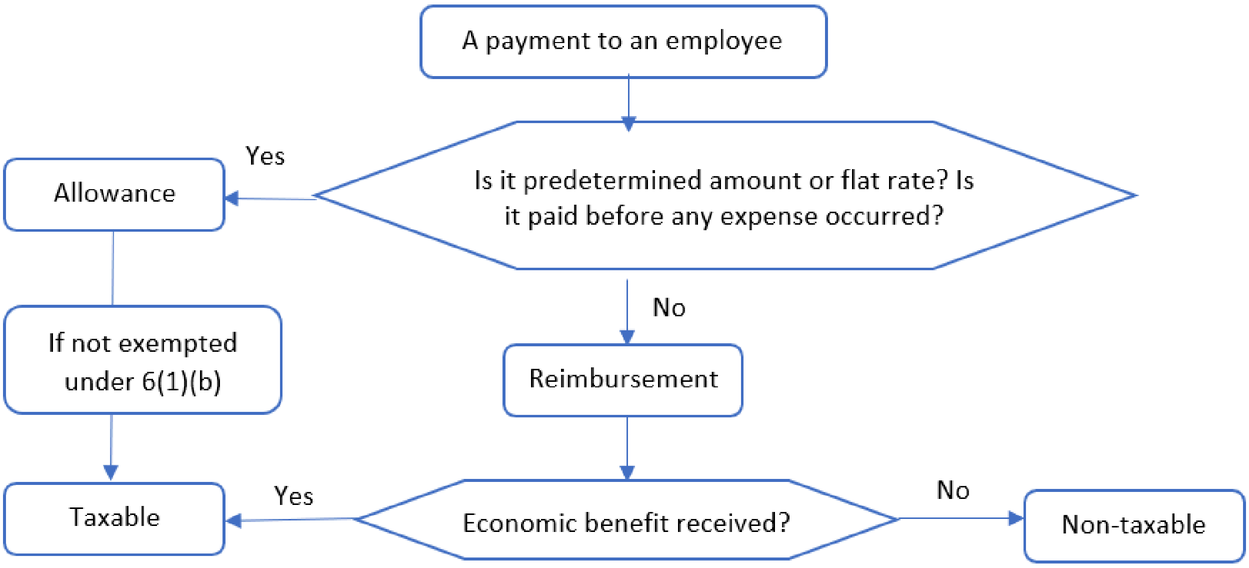
4.5 What is an allowance? What is a reimbursement? How are they treated differently for tax purposes?

LANGSHA TAO

An allowance is a predetermined amount or flat rate which is paid to an employee for an expense incurred (use of automobile for work, meals while travelling for work etc.) and is not required to be substantiated by receipts. Reimbursements involve a repayment for an expense incurred. In the most common scenario you purchase something for work, give your employer the receipt and they 'reimburse' you for your payment.

For tax purposes, all allowances received must be included in employment income, unless specifically listed as an exception under ITA 6(1)(b). Most 'reasonable' allowances (as described in 6(1)(b)) are not included in income. If the allowance does not meet the exceptions listed in 6(1)(b) it has to be included in your employee's income as a taxable benefit.

If the payment is a reimbursement, then a further determination must be made as to whether the employee has received an "economic benefit" (for example, the reimbursement exceeded the amount actually spent by the employee). Generally, a reimbursement is not a taxable benefit to the employee, but if there is an "economic benefit", the benefit is taxable.



Payment to employee [Image Description]

One very common allowance occurs when an employer pays an employee that is using their own automobile for work purposes. For this to be considered a 'reasonable' allowance as described in 6(1)(b) and therefore not taxable, the following three conditions must be met:

1. The allowance is based only on the number of business kilometers driven in a year;
2. The rate per-kilometer is reasonable (The CRA rate in 2019 is 58¢ per kilometer for the first 5,000 kilometers driven; 52¢ per kilometer driven after that);
3. You did not reimburse the employee for expenses related to the same use of the vehicle".

References and Resources

- Article– "Reasonable per-kilometre allowance" (Author: Government of Canada)
- Article – "Taxable Benefits and Allowances" (Author: Government of Canada)
- Chartered Professional Accountants. (2022). The Chartered Professional Accountant Competency Map. Part 1: The CPA Competency Map: 6.3.2

Image Description

Payment to employee: A flowchart to determine if a payment to an employee is taxable. It starts with "A payment to an employee." If "Yes," the next question is, "Is it a

predetermined amount or flat rate? Is it paid before any expense occurred?" If "Yes," it is categorized as an "Allowance." If not exempted under 6(1)(b), it is "Taxable." If "No," it is a "Reimbursement." The next question is, "Economic benefit received?" If "Yes," it is "Taxable." If "No," it is "Non-taxable." Arrows guide the flow from each decision point.
[Return to Payment to employee]

4.6 How are the following common employment deductions calculated and treated for tax purposes: legal expenses, sales expenses, automobile expenses, meals, entertainment and professional dues?

Employees don't tend to have access to as many deductions as individuals that are self-employed. That said, there are some expenses that may be deductible to employees. The Income Tax act section 8 covers the common deductions that employees can have on their employment income.

Legal Expenses

- Under section 8(1)(b) in the Income Tax Act, legal expenses are amounts paid by a taxpayer regarding legal inquiries.
- The amounts paid are to be collected or established if incurred by the taxpayer and should be included in the Taxpayer's income if received.

Sales Expenses

- Under section 8(1)(f) in the Income Tax Act, sales expenses are limited to commission-based income.
- A taxpayer can deduct sales expenses if their income comes from commission of selling goods or negotiating a service if these expenses are for the purpose of earning their commission.

Automotive Travel Expenses

- Under section 8(1)(h.1) in the Income Tax Act, motor vehicle expenses can be deducted when a taxpayer is required to carry out their duty of their employment away from the office and the contract of their employment states that they are required to pay for motor vehicle expenses that are incurred.

Meals

- Under section 8(4) in the Income Tax Act, meals expenses cannot be deducted by an individual unless a meal was eaten while away from the office and the individual was required by the duties of the job to be away at that time and that time has to be for a period not less than twelve hours.

Entertainment

- Entertainment expenses incurred by an employee are not usually deductible. That said, if the business reimburses the employee for the entertainment expense and the expense was incurred for the purpose of generating income (usually client retention or development) then 50% of the expense will be deductible by the business.

Dues

- Under section 8(1)(I) in the Income Tax Act and according to the CRA, dues expenses that can be deducted are: professional or malpractice insurance, professional board dues and annual dues for memberships that are in a trade union.

Interactie content (Author: Parvir Haer, January 2020)

References and Resources

- *Income Tax Act*, RSC 1985, c1, (5th Supp.)
- Article – "Meals and entertainment expenses" (Author: Government of Canada)
- Article – "Line 21200 – Annual union, professional, or like dues" (Author: Government of Canada)

"How are the following common employment deductions calculated and treated for tax purposes: legal expenses, sales expenses, automobile expenses, meals,

4.7 What are the general rules for deduction of home office expenses for an employee vs self-employed?

CHANPREET KANG

For employees home office expenses may be deductible if "the workplace is where the individual principally performs the duties of the office or employment used exclusively during the period in respect to earning income". ITA 8(13)(a).

For self-employed individuals home office expenses may be deductible if the home office is "(i) the individual's principal place of business, or (ii) used exclusively for the purpose of earning income from business and used on a regular and continuous basis for meeting clients, customers or patients of the individual in respect of the business;" ITA 18(12).

Wherever you spend most of your time working is your workplace. When one is working at home as either an employee or self-employed there are a few expenses you can deduct from your income. These expenses range from electricity to gas and ordinary office supplies like pens and paper clips. When you are employed or self-employed you can deduct a portion of most costs to operate your home (electricity, gas, water rent, maintenance etc.). Since it is very difficult to determine the actual amount of these costs used by your home office, the square footage rule is used to allocate these expenses.

House size is 2000 square feet. Room size is 400 square feet → 400 ÷ 2000 = 20% → Claim 20% of electricity, gas, water, rent…

Square Footage Rule

Although not perfect the square footage rule provides a reasonable allocation of costs to the home office. Note that mortgage interest is not a deductible home office expense for employees but is deductible for individuals who are self-employed. You also cannot deduct objects like chairs and tables, the reason being is because they are capital items and not expenses. You also can not deduct house expenses that do not affect your workplace in any way.

It is important to note that home office expenses cannot be used in a year to increase or create a loss. In this situation the expenses may be available to be applied against income in other years.

References and Resources

- *Income Tax Act*, RSC 1985, c1, (5th Supp.) ss 8(13), 18(12)
- Article – "Work-space-in-the-home expenses" (Author: Government of Canada)
- Article – "Business expenses." (Author: Government of Canada)
- Chartered Professional Accountants. (2022). The Chartered Professional Accountant Competency Map. Part 1: The CPA Competency Map: 6.3.2

CHAPTER 5: BUSINESS/ SELF-EMPLOYMENT INCOME

5.1 What are the differences and similarities between a sole-proprietorship, partnership, corporation, and trust?
5.2 How do you determine if something creates business income, property income or capital gain (loss)? Why is this distinction important? (6.3.2)
5.3 Why do we need to reconcile accounting/business income to taxable income? What are some common reconciling items?
5.4 What are the relevant sections of the ITA that deal with business income? Where does business income go in the S3 ordering rules?

5.1 What are the differences and similarities between a sole-proprietorship, partnership, corporation, and trust?

WAHAJ AWAN

A **sole-proprietorship** has one owner who has unlimited liability for the business.

A **partnership** involves two or more people who combine resources for the business and share profits and losses.

A **corporation** is considered to be a separate legal entity from its shareholders. For tax purposes a corporation is a "Person".

A **trust** or estate usually has beneficiaries that benefit from it. A trust can include an *inter vivos* trust (gifted during one's lifetime) and a **testamentary trust** (given because of someone's death) as explained in ITA 108(1).

The following table outlines some of the similarities and differences of the different tax entities:

	Sole proprietorship	Partnership	Corporation	Trust
Ownership	A single owner	Two or more owners	Usually owned by many shareholders	Owner passes the ownership to a trustee
Profit or losses	All profits go to the sole owner	Profits split equally, or by pre-determined terms amongst the owners	Dividends declared and given to shareholders	Beneficiaries of the trust benefit from the profit
Liability	The owner has unlimited liability	Usually split amongst the owners based on the terms	Limited liability – individuals are not usually directly liable for activities within the corporation	The trustee responsible for operating the trust
Decision-making	All decisions for the firm are made by one owner	Owners in the partnership are responsible for the decisions	Board of director and shareholders	The trustee
Tax	Owner is taxed on his personal income/profit from the company	Owners are taxed on their respective incomes	A corporation is taxed as a "person"	A trust is taxed as a "person"

See ITA – 82(1), 96(1), 104 for an in-depth explanation of how types of entities are taxed.

References and Resources

- *Income Tax Act*, RSC 1985, c1, (5th Supp.) ss 98(5), 248(1), 108(1)
- Article – "Sole proprietorship, partnership, corporation…?" (Author: Government of Canada)
- Article – "T3 Trust Guide – 2019" (Author: Government of Canada)
- Chartered Professional Accountants. (2022). The Chartered Professional Accountant Competency Map. Part 1: The CPA Competency Map: 6.1.1

5.2 How do you determine if something creates business income, property income or capital gain (loss)? Why is this distinction important? (6.3.2)

GURMEHAR S. GREWAL AND SAM NEWTON

One of the most important reasons to differentiate business and property income from capital gains is that 100% of business and property income (and losses) are taxable whereas only 50% of capital gains are taxable.   This has a big tax impact (which often ends up in court) and therefore it is important for us to understand how to differentiate business and property income from capital gains.

Business Income vs. Capital Gain

There is limited specific guideline in the ITA on whether economic activity represents business income. If you look up 'business' in ITA 248(1) it basically says a business is "…an adventure or concern in the nature of trade but does not include an office or employment." This is not particularly helpful guidance as it basically says 'well we don't really know what a business is, but we know it <u>is not</u> office or employment'.

The CRA has filled this void by publishing IT-459 "Adventure or Concern in the Nature of Trade". This Interpretation Bulletin provides guidance to determine whether amounts represent business income or capital gains. In determining whether something is an 'Adventure or Concern in the Nature of Trade' (i.e. business income) the CRA primarily looks at "Taxpayer Conduct", the "Nature of the Property" and the "Taxpayer's Intention"

Taxpayer's Conduct

One of the major considerations is whether the taxpayer is acting in a manner that is consistent with the way other taxpayers would typically act with the same property, goods or services.   So, per IT-459, you would compare the activity to what "dealers would do with the same kind of property and what the taxpayer did when he purchased the property, when he sold it and during the time when it was in his possession." If the taxpayer's activity is consistent with what a dealer in the property would typically do, then this would be an indication of business income.

Other elements of the taxpayer's conduct that might indicate business income include the following:

- Evidence that the taxpayer attempted to find a purchaser for the property shortly after the initial purchase
- Evidence that the taxpayer improved the property to increase potential re-sale value.
- The purchaser has a commercial background dealing with similar property.

Nature of the Property

When property is of such a nature that it couldn't create income on its own (for example a building might be able to create rental property income on its own) or be enjoyed by the taxpayer on its own, then it likely would be considered business income. Effectively this criteria is looking at the goods or services themselves and saying 'look, you did a wholesale purchase of 15,000 rolls of toilet paper, the only reason to have this would be for resale and therefore this will create business income.'

Taxpayer's Intention

IT-459 states that "A taxpayer's intention to sell at a profit is not sufficient, by itself, to establish that he was involved in an adventure or concern in the nature of trade. That intention is almost invariably present even when a true investment has been acquired, if circumstances should arise that would make it financially more beneficial to sell the investment than to continue to hold it." So, intention to sell at a profit does not, on its own, indicate business income. If however intention to sell is linked to the other criteria (Taxpayer Conduct, Nature of the Property) then this would provide further support that this is business income.

The CRA will look at both the taxpayer's primary intention and their secondary intention when considering whether activity creates business income or capital gains.

Business Income vs Property Income

The difference between *business* income and *property* income is usually based on the amount of activity needed to generate the income. If it is an active source of income it is typically considered business income whereas a passive source of income would be considered property income.

References and Resources

- IT-459 "ARCHIVED – Adventure or Concern in the Nature of Trade" (Author: Government of Canada)
- Chartered Professional Accountants. (2022). The Chartered Professional Accountant Competency Map. Part 1: The CPA Competency Map: 6.3.2

5.3 Why do we need to reconcile accounting/business income to taxable income? What are some common reconciling items?

JATIN GUPTA

Businesses often follow Generally Accepted Accounting Principles (GAAP) while preparing their own financial statements. The Income Tax Act, however, has a different set of rules for determining business income. The difference between these two sets of rules (GAAP vs ITA) requires us to reconcile business income for accounting to business income for tax purposes when preparing tax returns.

The reconciliation typically starts with accounting business income and then adjusts for all the differences between GAAP and the ITA. Most of the ITA rules for businesses can be found in Sections 9 to 37 of the ITA but some key criteria for business deductions are as follows:

18(1)(a) – States that you are only allowed deductions for expenses that were incurred for the purpose of generating income

20(1) – States that regardless of Section 18, if an item is listed in Section 20 it is deductible.

The relationship between these two sections can be seen in the treatment of accounting deprecation and Capital Cost Allowance ("CCA" – tax depreciation). 18(1)(b) of the ITA states that accounting depreciation is not deductible while 20(1)(a) says that you can deduct CCA. So, to reconcile these amounts you would start with your accounting business income, add back the accounting depreciation and deduct CCA. This revised amount would be your business income for tax purposes.

For Example, say your accounting income was $500,000 and includes $75,000 in depreciation. Your CCA is $85,000. The reconciliation of these amounts to determine business income for tax purposes would be as follows:

Business income for Accounting Purposes	$500,000
Add: -Depreciation ITA 18 (1) (b)	$75,000
Less: – CCA ITA 20 (1) (a)	($85,000)
Business Income for Tax Purposes	$490,000

Here are some of the more common reconciling items look out for:

Particulars	Examples	Citations
Deductions Generally Non- deductible/ Restricted		
	General limitation	ITA 18 (1) (a)
	Accounting depreciation and amortization expenses	ITA 18 (1) (b)
	Recreational facilities and club dues	ITA 18 (1) (l)
Deductions Allowed Generally		
	Capital Cost Allowance	ITA 20 (1) (a)
	Expenses re financing	ITA 20 (1) (e)
	Bad debts	ITA 20 (1) (p)
	Meals and Entertainment	ITA 67.1 (1)

References and Resources

- *Income Tax Act*, RSC 1985, c1, (5th Supp.) ss 18(1), 20(1), 67.1(1)
- Chartered Professional Accountants. (2022). The Chartered Professional Accountant Competency Map. Part 1: The CPA Competency Map: 6.3.2

5.4 What are the relevant sections of the ITA that deal with business income? Where does business income go in the S3 ordering rules?

AMANDA LUIES

ITA 9(1) – "*Subject to this Part, a taxpayer's income for a taxation year from a business or property is the taxpayer's profit from that business or property for the year.*"

248(1) "*business*" — "*For purposes of the Act, a business is defined to include a profession, calling, trade, manufacture, or undertaking of any kind whatever, as well as an adventure or concern in the nature of trade. It does not include an office or employment.*"

In accordance with the ordering rules, business income is recorded under Division B S3(a) if revenues are higher than expenses. If a business has a net loss for the year (i.e. revenue is less than expenses) then the net loss will be allocated under S3(d) and recorded as a loss.

When calculating the Net Income for Tax Purposes, business income goes under S3(a) if there is a profit. For example, if you have a restaurant that has revenue of $1,000,000 and expenses of $300,000, then the total income is recorded as a profit of $700,000 under S3(a). However, if the restaurant had expenses greater than revenues then the net loss for that restaurant would be recorded in S3(d)

	Revenue	Expenses	Total Income (Loss)
Restaurant #1	$1,000,000	$300,000	$700,000 under S3(a)
Restaurant #2	$600,000	$650,000	($50,000) under S3(d)

Let's say that in addition to your restaurant, you also have an electronics store that has revenue of $500,000 and has expenses of $1,400,000. This would cause the electronic store to have a total loss of $900,000. The income from the restaurant would still be recorded under S3(a) and the business loss of the electronic store would be recorded under S3(d). These two business incomes would not be combined and are intended to be assessed separately.

In this case, there is a total loss of $200,000, but the Net Income for Tax Purposes will be recorded as $0. The $200,000 loss is added to your non-capital loss balance and can be applied against income for other years.

	Revenue	Expenses	Total Income
Restaurant	$1,000,000	$300,000	$700,000 *under S3(a)*
Electronic Store	$500,000	$1,400,000	($900,000) *under S3(d)*
Total	$1,500,000	$1,700,000	$0 – NITP

References and Resources

- *Income Tax Act*, RSC 1985, c1, (5th Supp.) ss 9(1), 39(1), 248(1)
- Chartered Professional Accountants. (2022). The Chartered Professional Accountant Competency Map. Part 1: The CPA Competency Map: 6.1.1, 6.3.2

CHAPTER 6: PROPERTY INCOME

Chapter Overview

6.1 What is the purpose of CCA? How is it calculated? Why are items typically 'pooled' into the same CCA class?

DALJINDER NIJJAR

Capital Cost Allowance ("CCA") is the depreciation mechanism used for tax purposes. Unlike accounting depreciation, CCA can be deducted from income for tax purposes. Capital assets require depreciation because the capital assets wear out over time. Undepreciated Capital Cost (UCC) is the capital cost of an asset minus the CCA claimed in previous years.

How is it calculated?

CCA is usually calculated based on the Declining Balance Method. Let's consider the following example: Assume Alpine Industries has machinery with an Undepreciated Capital Cost (UCC) of $40,000 at the start of 2016. The machinery falls under class 53 and has a 50% CCA rate. In this situation CCA is calculated as UCC multiplied by the CCA rate. The following examples shows CCA in 2016, 2017 and 2018.

Year	UCC	CCA
2016	$40,000	$40,000 × 50% = $20,000
2017	$40,000 − $20,000 = $20,000	$20,000 × 50% = $10,000
2018	$20,000 − $10,000 = $10,000	$10,000 × 50% = $5,000

CCA is also impacted by other tax laws such as the half-year rule, short fiscal year rule, available for use rule, recapture and terminal losses which will be addressed in subsequent sections of this text. The rates for different classes can be found in the Income Tax Regulations 1100(1). In general, the rates are intended to reflect the anticipated depreciation of the related assets. So, for example buildings, which tend to have a long useful life, will have a relatively low CCA rate (usually 4%) whereas computer software, which tends to depreciate quickly, has a much higher CCA rate (up to 100%).

Why are items typically 'pooled' into the same CCA class?

Assets are pooled into certain classes largely because the government believes they depreciate in a similar manner. For example, tools, medical and dental instruments, and kitchen utensils are grouped together in class 12. Similarly, roads, parking lots, sidewalks, airplane runways, storage areas or similar surface construction are pooled into class 17. The assets in these classes really don't have much in common other than the belief that they depreciate the same way.

References and Resources

- ITR 1100(1)
- Video – "CCA Part 1 2015" (author: BCC Education)
- Article – "Income Tax Folio S3-F4-C1, General Discussion of Capital Cost Allowance" (author: Government of Canada)
- Article – "CCA classes" (author: Government of Canada)
- Article – "T4002...Capital Cost Allowance" (author: Government of Canada)
- Chartered Professional Accountants. (2022). The Chartered Professional Accountant Competency Map. Part 1: The CPA Competency Map: 6.3.2

6.2 What is a Terminal Loss? What is Recapture? How are they recorded in net income for tax purposes?

GURTAJ PANNU

Terminal loss

According to TaxTips the author states that, "*When a depreciable fixed asset is sold, its capital cost allowance (CCA) class is reduced by deducting the lower of its original cost, or its proceeds of sale. If all the assets in a class have been sold, but at the end of the fiscal year there is still a balance of undepreciated capital cost (UCC) remaining in the class, this balance can be fully written off against business or property income as a "terminal loss"*."

So, if you have disposed of all the assets in a specific CCA class but there is still a remaining UCC balance in the class, effectively it means you didn't claim enough CCA in previous years. The ITA addresses this by allowing you to claim a Terminal Loss on this remaining balance in the current year. The Terminal Loss is deducted from your business or property income and reduces the remaining UCC balance in the class to $Nil.

Recapture

According to TaxTips, the author states that, "*When a depreciable fixed asset is sold, its capital cost allowance (CCA) class is reduced by deducting the lower of its original cost, or its proceeds of sale. If, at the end of a fiscal year, the balance of the class is negative, a gain has occurred. This gain is referred to as a "recapture" of CCA and must be included in business or property income for the year.*"

Example 6.2.1

If we sell an asset and the balance in the class is negative at the end of the fiscal year, we have created Recapture. This means we have claimed too much CCA in the past. The ITA addresses this by adding back the Recapture amount to the business or property income in the year.

	Terminal Loss	Recapture
UCC, beginning of year	$6,000	$6,000
Sold asset for…	$4,000	$9,000
Terminal Loss	$2,000 ($6,000 – $4,000)	Not applicable
Recapture	Not applicable	$3,000($6,000-$9,000)
Note: Terminal losses are only recorded when there are no other assets in the CCA class.		

Remember, Terminal Losses are subtracted from your business or property income, and Recapture is added to your business or property income.

Now let's look at how the above example would impact our "GAAP to Tax" business reconciliation. Assume the individual had GAAP net income of $10,000 and CCA of $500 (from assets in a different CCA class than in the example above).

Business Income Statement

		ITA Citation	Notes
GAAP Net Income	$10,000	ITA 9(1)	Taxpayer's Income for the Year
Terminal Loss	($2,000)	ITA 20(16)	Deduction from Business Income
CCA	($500)	ITA 20(1)(a)	Deduction from Business Income
Recapture	$3,000	ITA 13(1)	Inclusion in Business Income
Business Income for Tax Purposes	$10,500	Amount will be placed in Section 3a (Business Income)	As the Business Income for Tax Purposes is positive, It will be placed in Section 3a

(Example by: Clarissa D'Souza**)**

References and Resources

- Article- "Terminal Loss" (Author: TaxTips)
- Article- "Recapture" (Author: TaxTips)
- Article- "Example for the calculation of recapture of CCA and terminal loss" (Author: Government of Canada)
- Chartered Professional Accountants. (2022). The Chartered Professional

Accountant Competency Map. Part 1: The CPA Competency Map: 6.3.2

6.3 What is the purpose of the half-year rule?

DAVID REN

The half-year rule reduces the amount of CCA (tax depreciation) that can be claimed in the year that you purchase an asset.

Income Tax Regulation subparagraph 1100(1)(b)(i) states "*If the capital cost of the property was incurred in the taxation year and after* November 12, 1981, (B) *if the property is not an accelerated investment incentive property and is not described in any of subparagraphs (b)(iii) to (v) of the description of R in subsection* (2), 50 *per cent of the amount for the year calculated in accordance with* Schedule III."

Effectively it says 'we are going to pretend you bought the asset halfway through the year and therefore you are only going to be able to claim CCA on half of the purchase amount this year…don't worry you can claim the remaining CCA in future years.'

How the half-year rule works

The half-year rule temporarily cuts the cost of an asset purchased during the year in half. This lower amount is then used to calculate CCA for the year.

For example, say I bought a $25,000 car during the year for my new car-rental business. I checked on the CCA "classes list" and determined the new car would be recorded in CCA class 10 which has a 30% CCA rate. I add the $25,000 car to my class 10 pool but then must reduce this amount by $12,500 for the half-year rule. In the 1st year I can claim $3,750 in CCA ($12,500 X 30%).

I then add the $12,500 back to my UCC balance and will be able to claim $6,375 CCA on the remaining balance in the following year (($25,000 cost – $3,750 1st year CCA) X 30% CCA rate). CCA on the full remaining amount in the next year as follows:

Original purchase	Capital Cost Allowance	Accumulated CCA	UCC
			$25,000
1st year	$25,000*50%* 30%=$3,750	$3,750	$21,250
2nd year	$21,250*30%=$6,375	$10,125	$14,875

You can find the appropriate CCA class and rates for a given asset in the "Classes list" in the FITAC under "tax rates and tools"

Why do we use the half-year rule?

The half-year rule allows taxpayers to claim CCA regardless of the actual purchase date of the asset. Without this rule, taxpayers would have an incentive to buy assets at the end of the year and claim CCA for the whole year. In addition, half-year rule creates convenience to both taxpayers and CRA, because this method makes the calculating process of CCA a lot easier, as the actual purchase date of the property does not matter.

References and Resources

- Article – "Income Tax Folio S3-F4-C1, General Discussion of Capital Cost Allowance" (Author: Government of Canada)
- Article – "PART XI Capital Cost Allowances – DIVISION I – Deductions Allowed" – 1100(1)(b)(i) (Author: Government of Canada)
- Chartered Professional Accountants. (2022). The Chartered Professional Accountant Competency Map. Part 1: The CPA Competency Map: 6.3.2

6.4 What is the purpose of the short-fiscal period rule?

GURVIR SAHOTA

ITA 249(2) (a)- A "Fiscal Period" is the time when a new taxation year is beginning and the current taxation year is ending (See ITA 249.1(1) for further explanation).

A fiscal period is the time between a start of a business and its year-end which is usually the calendar year. A fiscal period cannot be more than 12 months; however, it can be shorter than 12 months also known as a "short-fiscal period". For example, if Gary opens a business on June 1st and his fiscal periods ends on December 31st then his fiscal period would consist of 214 days instead of 365 days. This would be known as a "short-fiscal period" for Gary's business. A business reports its income based on the fiscal period. A business that goes bankrupt prior to its fiscal year-end would also have a "short-fiscal period".

How the short-fiscal period relates to capital cost allowance

CCA rates are based on a full year. Therefore, an adjustment is made to the CCA of a business that was in operation for less than a year.

If one has a short-fiscal period that consists of less than 365 days, they take into consideration the days the business was operating. For example, Tim shuts down his tire company on September 1st and his CCA would have been $4,000 for the full year. Because Tim had a short-fiscal period of 243 days, his actual CCA would be calculated as $2,663 ($4,000 x (243/365)). Therefore, the CCA has to be prorated, as the CCA claim is based on the days in your fiscal period.

References and Resources

- *Income Tax Act*, RSC 1985, c1, (5th Supp.) s 249(2) (a)
- Article- "Fiscal Period – Government of Canada" (Author: Government of Canada)
- Chartered Professional Accountants. (2022). The Chartered Professional Accountant Competency Map. Part 1: The CPA Competency Map: 6.3.2

6.5 Can you have a capital loss on depreciable property? If not, why not?

POOJA SEHGAL

No, we cannot have a capital loss on depreciable property.

A c**apital loss** occurs when a non-depreciable asset (such as land) is sold for less than its original cost.   However, you cannot have a Capital Loss on depreciable property, i.e. items whose value declines over time, such as cars, buildings, houses, etc.

Why can't you have a capital loss on depreciable property?

You can have a "Capital gain on depreciable property if you sell it for more than its adjusted cost base plus the outlays and expenses incurred to sell the property" (Canada Revenue Agency, 2018). But, "A loss from the sale of the depreciable property is not considered to be a capital loss. However, you may be able to claim a terminal loss" (Canada Revenue Agency, 2018). Depreciable assets are considered a part of the activities of your business and property; therefore, they are better integrated with your business or property through tax depreciation (CCA) and Terminal Losses than as a Capital Loss. Generally, a Terminal Loss is generated when you sell assets for less than their tax carrying value (UCC), and there are no other assets remaining in the CCA class.

When we buy a non-depreciable asset like land for example, and we sell it for less than what we paid for it, there is a Capital Loss. When we buy a depreciable asset like a car, there is no Capital Loss at the time of sale. Instead, we can claim CCA during the lifetime of that asset, and if it sells for less than the remaining UCC balance, we can claim a Terminal Loss (as a reduction to our business or property income) assuming there are no other assets remaining in the CCA class.

Let's say we bought a table for $1,000. We claimed $200 in CCA (tax depreciation) over the last 3 years and its UCC is now $800. The table is subsequently sold for $700 and there are no other remaining assets in the CCA class. The difference between the sale price ($700) and the UCC ($800) creates a $100 Terminal Loss. The Terminal Loss represents additional tax depreciation we can claim in the year.

Original Cost	$1,000	(1,000-800) $200 CCA (Tax depreciation) (800-700) $100 UCC (Terminal loss)
UCC	$800	
Selling Price	$700	

References and Resources

- Article – "Depreciable property – 2018, January 03" (Author: Government of Canada)
- Chartered Professional Accountants. (2022). The Chartered Professional Accountant Competency Map. Part 1: The CPA Competency Map: 6.3.2

6.6 What is the Accelerated Investment Incentive and what are the basics of how it works?

ADDAN AYAZ, STUDENT, KWANTLEN POLYTECHNIC UNIVERSITY

The accelerated investment incentive (AII) began in Canada in 2018. It was introduced as a means to encourage corporations to invest in more capital assets as there is now added benefits to doing so, however, it is only a temporary measure and will be phased out by 2028.

The accelerated investment incentive is just a temporary change to the Capital cost allowance (CCA). CCA works as a tax deduction representing a capital asset's depreciation.

The main benefit of the AII is that it allows for a larger CCA deduction within the first year of acquiring an eligible depreciable asset. For most assets purchased after November 20, 2018 the AII provides two main advantages:

- No half-year rule applied in the year of acquisition
- Net additions for the year (additions less disposals) are multiplied by 1.5 X the CCA rate for the class of assets.

Both of these new rules create a big increase in the amount of CCA that can be claimed in the year of acquisition. Prior to this incentive, in the year that equipment was acquired the taxpayer could only claim CCA on half of its value in the year of acquisition. This is known asthe half year rule and is not applicable under the accelerated investment incentive.

It is important to remember that the AII does not affect the overall amount a taxpayer can deduct. The AII only increases the CCA deduction in the first year, ultimately allowing for decreased deduction throughout the following years. The decreased CCA deduction in the following years would be due to the UCC amount carried forward being less after using AII for the first year.

Example 6.6.1

3C's Inc has the UCC balance of $100 at the beginning of 2018 of Class 10 and purchased an additional property of $200 in January. In 2019, it purchased additional eligible asset of $200. In 2020, it acquired an eligible asset of $300 and disposed the property for $150, which has a capital cost of $200.

Calculation Steps	2018	2019	2020
UCC at the beginning of year (A)	$100	$240	$278
Additions	$200	$200	$300
Disposition during the year: Lessor of Proceeds of Disposition Capital cost	–	–	($150)
Net Additions during the year (B)	$200	$200	$150
50% of net eligible additions as per AII rules (C)	N/A	$100	$75
Half-year rule (D)	($100)	N/A	N/A
Adjusted UCC for CCA calculation(A+B+C-D)	$200	$540	$503
CCA= 30% * adjusted UCC	($60)	($162)	($151)
Less: 50% of net eligible additions as per AII rules	N/A	($100)	($75)
Add: 50% of Half year rule deductions	$100	N/A	N/A
UCC at the end of year	$240	$278	$277

(Example by Panveer Kaur)

Example 6.6.2

Andrews Ltd. acquired the following assets in 2018 and 2019. The 2018 asset was acquired prior to November.

2018:

- – A new building intended to act as a warehouse for $400,000.

2019:

- – New office desks for $4,000.
- – A general-purpose computer for $2,000, which the office manager bought from his brother.
- – A zero-emission Tesla Cybertruck for delivery purposes for $60,000.

How would each asset be treated in terms of CCA in the years they were acquired? Consider the half-year rule and/or accelerated investment incentive for each item.

Building: Class 1

Because the building was acquired before November of 2018, it is not eligible for the accelerated investment incentive. The building would fall under class 1 (see ITR Schedule II, Class 1 (q)) and would likely have a CCA rate of 4% (there are lots of specific rules on the CCA rates for buildings but they are beyond the scope of this example). Since it does not qualify for the accelerated investment incentive, it will also be subject to the half-year rule. The first year CCA would be calculated as follows:

(400,000 / 2) * 4% = $8,000

Office Desks: Class 8

Because the office desks were acquired after November of 2018, they are eligible for the accelerated investment incentive and therefore will not be subject to the half year rule. The desks, being furniture, fall under Class 8 (see ITR Schedule II Class 8 (i)) and will have a CCA rate of 20% per the calculation below:

(4,000 * 1.5) * 20% = $1,200

Computer: Class 50

It is notable that the computer was purchased from a blood relative of the office manager. Because of this, the transaction was not dealt at arm's length. Since the accelerated investment incentive doesn't apply to non arms-length transactions, the computer is subject to the half-year rule. As a class 50 asset (see ITR Schedule II, Class 50), CCA will be calculated as per below.

(2,000 / 2) * 55% = $550

Cybertruck: Class 54

Because the Cybertruck is a zero emission vehicle and is not intended to be rented out, it is classified under class 54 and has a limited prescribed CCA amount of $55,000. Class 54 assets are also eligible for the accelerated investment incentive which for the class is an immediate write-off of 100% of the asset. This is calculated as below:

55,000 * 100% = $55,000

Note: Once you've identified the CCA class of an asset it is important to research whether there are any specific AII rules for that class. For example, class 43.1 and 43.2 (which largely deal with green energy) allows for a 100% CCA deduction in the year of acquisition as long as the asset is available for use prior to 2024.

(Example by Mathew Andrews)

References and Resources

- Article – "Accelerated Investment Incentive" (author: Government of Canada)

6.7 How are eligible, non-eligible and capital dividends taxed in the hands of an individual? Are there any other tax implications? Why do they have different tax treatments?

WAHAJ AWAN

Eligible dividends are typically paid out by public corporations, from income that has been taxed at a higher corporate tax rate.

Non-eligible dividends are generally paid out by private corporations from income that has been taxed at a lower corporate tax rate. Note public corporations may sometimes declare a portion of their dividends as non-eligible (if some of their income has been taxed at lower corporate rates).

Once eligible or non-eligible dividends have been received by an individual, they are subject to gross-up rates. The grossed-up/taxable dividend is intended to reflect the corporate pre-tax income which is then taxed at the individual's marginal tax rate. The individual is also given a dividend tax credit which is equivalent to the tax paid by the corporation on the dividends. (Refer to the "Integration" topic for an example).

Rates as of 2021	Gross-up rate (See ITA 82(1)(b))	Federal dividend tax credit (See ITA 121)
Eligible dividends	38%	6/11
Non-eligible dividends	15%	9/13

(These rates can be found in the FITAC>Tax Rates and Tools under the heading "Eligible dividends reference tool")

ITA 83(2) describes **capital dividends** as dividends paid by a corporation on the shares of the corporation's capital stock.

ITA 83(2)(b) states "no part of the dividend shall be included in calculating the income of any shareholder of the corporation". In other words, there is no tax on capital dividends.

Capital dividends are essentially the non-taxable 50% portion of a capital gain, which 'flow-through' tax free to the shareholder.

Suppose a private corporation has a capital gain of $2,000 and is paying out dividends on that amount. The tax treatment for the corporation and in the hands of the individual for this gain is as follows:

Non-eligible dividends			**Non-taxable portion of capital gain**		
Taxable portion of capital gain	$ 1,000		*Non-taxable portion of capital gain*	$ 1,000	
Tax @ 13% (assumed)	$ (130)		Tax @ 0%	$ -	
Net earnings	$ 870		Net earnings (added to Capital Dividend Account)	$ 1,000	
Individual Shareholder	*Cash*	*Taxable*	Individual Shareholder	Cash	Taxable
Cash dividend received	$ 870		Cash dividend received (from Cap Dividend Account	$ 1,000	
Taxable dividend ($870 X 1.15)		$ 1,000	Capital Dividends are not taxable		$ -
Individual tax @40% (assumed)	$ (400)		Individual tax @ 0% (cap div not taxable)	$ -	
Plus DTC $130 (9/13 fed & 4/13 prov)	$ 130		No DTC since corp not taxed on this portion of cap g	$ -	
Total After Tax Cash	**$ 600**		**Total After Tax Cash**	**$ 1,000**	
Taxable portion of capital gain if earned directly by individual			Non-taxable portion of capital gain		
Business Income Earned	$ 1,000		Non taxable portion of capital gain	$ 1,000	
Tax payable ($1,000 X 40%)	$ (400)		Tax payable ($1,000 X 0%)	$ -	
Total After Tax Cash	**$ 600**		**Total After Tax Cash**	**$ 1,000**	

Example comparing non-eligible dividends and the non taxable portion of capital gain [Image Description]

In the above example you should note that the after tax cash is the same ($1,000 from the capital dividend and $600 from the non-eligible dividend) regardless of whether the capital gain was earned by the corporation (with dividends paid out to the shareholder) or earned directly by the individual.

References and Resources

- Income Tax Act, RSC 1985, c1, (5th Supp.) ss 82(1), 83(2), 89(1), 89(14)
- Video – "Integration" (Authors: Abjeet Khatra and Gursimran Kohli) – uses 2017 rates
- Article – "Eligible dividends" (Author: Government of Canada)

Image Description

Example comparing non-eligible dividends and the non-taxable portion of capital gain: A spreadsheet comparing the tax implications of non-eligible dividends and non-taxable portions of capital gains.

Non-Eligible Dividends:

- **Corporate:**
    - Taxable portion of capital gain: $1,000
    - Tax @ 13% (assumed): ($130)
    - Net earnings: $870
- **Individual Shareholder:**
    - **Cash:**
        - Cash dividend received: $870
    - **Taxable:**
        - Taxable dividend ($870 x 1.15): $1,000
        - Individual tax @ 40% (assumed): ($400)
        - Plus Dividend Tax Credit (DTC) $130 (9/13 federal & 4/13 provincial)
        - Total After Tax Cash: $600
- **If Earned Directly by Individual:**
    - Taxable portion of capital gain: $1,000
    - Tax payable ($1,000 x 40%): ($400)
    - Total After Tax Cash: $600

Non-Taxable Portion of Capital Gain:

- **Corporate:**
    - Non-taxable portion of capital gain: $1,000
    - Tax @ 0%: $0
    - Net earnings (added to Capital Dividend Account): $1,000
- **Individual Shareholder:**
    - **Cash:**
        - Cash dividend received (from Capital Dividend Account): $1,000
    - **Taxable:**
        - Capital Dividends are not taxable
        - Individual tax @ 0% (capital dividends not taxable): $0
        - No DTC since corporation is not taxed on this portion of capital gain: $0
        - Total After Tax Cash: $1,000

- **If Earned Directly by Individual:**
    - Non-taxable portion of capital gain: $1,000
    - Tax payable ($1,000 x 0%): $0
    - Total After Tax Cash: $1,000

Both scenarios show a comparison of after-tax cash amounts in different situations, indicating that non-taxable portions of capital gains result in higher after-tax cash.

[Return to Example comparing non-eligible dividends and the non taxable portion of capital gain]

6.8 What are the attribution rules and why do they exist?

DILPREET GREWAL

Due to the progressive nature of the Canadian income tax system, there is a built-in tax incentive to spread income around the family unit. For example, let's say Charles has $100,000 of interest income on some of his investments and is taxed at a very high marginal rate. If he can somehow transfer a portion of these investments to his young unemployed children, Harry and William, then the tax on the entire family unit will be lower (as they are, presumably, taxed at much lower marginal rates). The attribution rules are intended to address income splitting schemes like this.

The attribution rules are a complex set of laws which are used to handle various income-splitting scenarios. Attribution rules ensure that any income earned, or (in the case of transfer to a spouse) capital gains or losses realized are taxed to the transferor and not the transferee.

Let's get back to the example above. Suppose Charles transferred all of his investments to Harry and William at an amount other than FMV. In this scenario, even though the children own the assets, the $100,000 of income would still be attributed back to Charles and included on his tax return.

Note that the attribution rules apply to transfers to children under the age of 18 and to spouses. For transfers to children only the income earned after the initial transfer is attributed back to the transferor. For transfers to spouses the income AND capital gains/losses (after the initial transfer)are transferred back.

The attribution rules **don't apply** if:

- income earned or lost is realized in a period following death of either the transferor or transferee
- the transferor is not a Canadian resident
- the transferee ceases to be a spouse of the transferor within a time period
- spouses are separated at the time of transfer
- where the transferor receives fair market value on the property which is transferred or through interest-bearing loans

Note, that if the transferor receives fair market value on the property, the payment (or loan) must be from the transferee's own funds.

Attribution Rules Summary Table. Referenced from: RBC Wealth Management article "Income splitting and the attribution rules" (author Karim F. Visram, CFA, CGA, CFP, FMA)

Transferee	Property gifted or sold for an amount other than FMV
Minor child or non-arm's length child: individual under the age of 18 at time of transfer; child, niece, nephew ITA 74.1 (2), 75.1 (2)	Income or losses* are attributable. Capital gains or losses are not attributable. *Exclude business income
Trust ITA 74.3 (1)	Capital gains or losses are attributable.
Spouse or common-law partner ITA 74.1 (1)	Both income or losses* and capital gains or losses are attributable. *Exclude business income

References and Resources

- *Income Tax Act*, RSC 1985, c1, (5th Supp.) 74.1 (1), 74.1 (2), 74.3 (1), 74.2, 75.1 (2), 74.5 (12)
- Video – "What are the attribution rules? – Tax Tip Weekly" (author: Allan Madan)
- Article – "Income splitting and the attribution rules" (author: Karim F. Visram, CFA; CGA, CFP; FMA)

6.9 What is a non-arm's length transaction and what are the tax implications?

VIANNA TRAN

CRA defines a non-arm's length transaction as "a relationship or transaction between persons who are related to each other."

ITA 251(2)(a) describes related persons as "individuals connected by blood relationship, marriage or common-law partners or adoption" with 251(6) elaborating on what is meant by "blood relationship".

Why is the government concerned about non-arm's length transactions?

ITA 248(36) states that fair market value should be applied to the transaction of the property. However, in a non-arm's length transaction it is not always relied on that fair market value was used. In a related party transaction the related individuals may be able to work together to set the property below or above fair market value to their tax advantage.

ITA 69(1)(a) describes inadequate considerations as "where a taxpayer has acquired anything from a person with whom the taxpayer was not dealing at arm's length at an amount in excess of the fair market value thereof at the time the taxpayer so acquired it, the taxpayer shall be deemed to have acquired it at that fair market value." Effectively, the ITA 69 rules state that non-arm's length transactions that are not recorded at fair value will result in extra taxation. For the seller they do this by recording the transaction at the greater of FMV and actual proceeds therefore maximizing the potential capital gain. For the purchaser they do this by recording the transaction at the lesser of FMV and actual proceeds thereby minimizing potential future CCA claims or maximizing capital gains on future sales of the asset.

Non-Arm's Length Transactions (ITA 69): Tax implications for the buyer and the seller depending on the selling price compared to the fair value

Actual Proceeds	Deemed Proceeds	ACB to Purchaser	Double Taxation
= FV	Actual	Price Paid	No
= Nil(Gift)	FV	FV	No
> FV	Actual	FV	Yes
< FV	FV	Price Paid	Yes

You could be subject to double taxation if you are dealing in a non-arm's length transaction, and the CRA thinks you may be selling (or buying) something for not the fair market value to gain some kind of advantage for tax purposes.

Example 6.9.1

Proceeds < Fair Market Value

Assume Manmeet bought a rental property in 2019 for $500,000. Two years later, she sold it to her brother, Isaac for $600,000 even though the fair value was $800,000. They made the sale at the reduced price so that Manmeet could minimize her capital gain.

How does 'extra' taxation take place in this scenario and to what extent?

As per ITA 69, Manmeet is deemed to have sold the property at the $800K fair value (rather than the $600,000 selling price) which will result in a $300,000 capital gain. Her brother Isaac, however, will only be able to record the cost base at the actual selling price ($600,000) which will increase his capital gain (or reduce the amount of tax depreciation he can claim) if he were to sell it in the future.

Ultimately, Manmeet and her brother are double/extra taxed as they didn't record their non-arm's length transaction at fair value.

(Example by Manmeet Kaur)

References and Resources

- *Income Tax Act*, RSC 1985, c1, (5th Supp.) ss 69(1)(a), 251(2)(a), 248(36)
- Article – "Non-arm's length transactions" (Author Government of Canada)
- Article – "Definitions for letter N (Business)" (Author: Government of Canada)
- Chartered Professional Accountants. (2022). The Chartered Professional Accountant Competency Map. Part 1: The CPA Competency Map: 6.3.2

6.10 What are the spousal rollover provisions and why do they exist?

SIMRAN GILL

A spousal rollover is the transfer of retirement funds (RRSPs/ RRIFs) and/or capital property to a spouse, common-law partner or to a trust for a spouse or common- law partner. This can be a transfer between living partners ("inter vivos") covered under ITA 73(1), or it can be a transfer upon death of one of the partners which is covered under ITA 70(6). The goal of these spousal rollovers is that the transfers can occur with no immediate tax consequences.

Note, for purposes of this discussion, spouse, common-law partner and trust will be referred to jointly as "spouse".

Property Transfers

The basic idea under ITA 70(6) and ITA 73(1) is as follows:

- The original ACB and UCC of the assets transfer to the receiving spouse.
- The spouse must be resident in Canada when the property is transferred
- the spousal rollover is automatic
- You need to file paperwork to elect out of these rules if you don't want them to apply. You might do this if, for example, you wanted a capital gain on the transfer to be triggered to utilize some available capital losses

This results in the receiving spouse being able to defer any capital gains or recapture until they die or sell the property. The transfer itself does not generate a capital gain or loss, recapture, or terminal loss.

Let's look at an example. Assume Kim has depreciable assets with a FMV of $70,000 an ACB of $50,000 and a UCC of $40,000. If she sold these assets to a 3rd party she would likely trigger a $20,000 capital gain ($70,000 – $50,000) and $10,000 in recaptured depreciation ($50,000 – $40,000).   If Kim transfers these same assets to her husband Kanye, the spousal rollover provisions allow these assets to transfer at their original ACB and UCC with no immediate tax consequences.

Note that income, gains or losses on these transferred assets may need to be recorded in the hands of the transferring spouse (i.e. Kim) when the income is received or the gains/losses realized in the future. This will be discussed in the section on attribution.

It is possible that Kim could have a bunch of non-capital and net-capital losses that she wants to utilize, in which case Kim and Kanye could jointly elect out of 73(1), in which case this would be treated as a non-arm's length transaction rules under 69(1).

Inadequate Considerations

As mentioned above, the 69(1) rules apply if the spouses 'elect-out' of the spousal rollover rules in 70(6) or 73(1). In this case the transfer is treated like any other non-arms length sale.

Here are the tax rules for FMV transfers (as explained in ITA 69):

ITA 69: Non- Arm's Length Transfers		
Transfer Price	**Adjusted Cost Base for Transferee**	**Proceeds of Dispositions For Transferor**
FMV:	FMV	FMV
Above FMV:	FMV	Actual Proceeds
Below FMV:	Actual Proceeds	FMV
Gift (NIL):	FMV	FMV

References and Resources

- *Income Tax Act*, RSC 1985, c1, (5th Supp.) ss 69, 70(3), 70(5), 70(6), 73(1)
- Article – "Inadequate Considerations" (Author: Government of Canada)
- Article – "Transfers of Property to Your Spouse…" (Author: Government of Canada)

6.11 What is the Tax on Split Income? What are the tax implications? Why does it exist?

LOVELLEN CHEEMA AND NATASHA DUTT

ITA S.120.4 – Tax on Split Income (TOSI), is an anti-avoidance method that is designed to prevent private corporations from splitting income with adult and/or minor family members. The TOSI rules are complex but, in general, TOSI applies to "split income" received by a "specified individual" from a "related business". These terms will be defined further below.

Currently, the TOSI applies the highest marginal tax rate of 33% on the following who receive split income:

- minors under the age of 18,
- children age 18 and over, and
- certain other related adult individuals (including spouses or common-law partners, grandparents, and grandchildren, but not aunts, uncles, nephews, or nieces).

A **specified individual**, for a taxation year, means an individual (other than a trust) who is either resident in Canada or, if the individual has not attained the age of 17 years before the year, has a parent resident in Canada at any time in the year.

A **related business** generally exists when a related person is active in the business on a regular basis or owns at least 10% of the fair market value of the shares in a corporation that carries on the business.

Split income generally includes income derived directly or indirectly from a related business, such as taxable dividends, shareholder benefits, or interest income, but not salary, paid in respect of the individual and certain capital gains unless the amount is an "excluded amount".

Excluded amounts are income received by an individual that TOSI will not apply to, and some examples include amounts received on:

- Inherited property
- The death of a spouse/common-law partner before end of the year
- As a result of breakdown of marriage or common-law partnership;
- Taxable capital gains deemed to be realized on death;

Example 6.11.1

Natasha is 5-years old. Her mother owns a CCPC and last year she gave Natasha shares in the company. This year the company pays Natasha $10,000 in non-eligible dividends. What is the tax implication?

Answer:

Natasha's federal tax is calculated using the highest marginal rate of 33% instead of the normal 15%. Her total federal tax on this income is $11,500 ($10,000 + 15% grossup) x 33% = $3,795.

If Natasha had been taxed at the normal federal tax rate of 15%, her tax would have been $11,500 x 15% = $1,725. Natasha would've paid less than half in taxes if TOSI was not in place. It's also important to note that TOSI restricts the tax credits that can be claimed. Only the dividend tax credit, foreign tax credit (related to the TOSI income) and the disability tax credit can be applied. She wouldn't even be able to use her Basic Personal Amount credit against the tax payable on the TOSI income.

References and Resources

- Article – "Federal tax on split income" (Author: Government of Canada)

6.12 What are the available income splitting opportunities with family members?

ANITA KARTAWIDJAJA

What is income splitting?

Income splitting is a tax saving strategy where you basically allocate income from one family member who has higher income, to another family member who has lower income. The point of this is so that the higher income family member can transfer a portion of their income to another family member who has lower income, and that way they can report their own income at a reduced amount on their tax return, so that they can be taxed at a lower tax bracket. This will usually help reduce the entire family's overall tax bill.

Pension Income Splitting

There is an income splitting strategy called Pension Income Splitting. This is where individuals can split their eligible pension income (monthly income in retirement) with a spouse or a partner, if all the requirements are met. ITA s. 60.03 states that the individual that receives the pension, can transfer up to 50% of their eligible pension income to their spouse or partner. This is also beneficial in that it can possibly create or increase the pension income tax credit for the spouse so they can deduct this amount from their taxes payable (see ITA s.118(3) for more on pension income tax credit).

Example 6.12.1

Table 6.12.1: Income splitting

	Pension Income per Month	Total Income Assumed (prior to transfer)	Transfer of 50% Pension Income	New Income (after transfer)
Fred	**$2,400**	**$55,000**	**$14,400**	**$40,600**
			[(2,400 x 12 months) x 0.50]	(55,000-14,400) 15%
Marginal Tax Rate (%)		20.50%		15%
Wilma	**$1,700**	**$23,000**	–	**$37,400**
				(23,000+14,400)
Marginal Tax Rate (%)		15%		15%

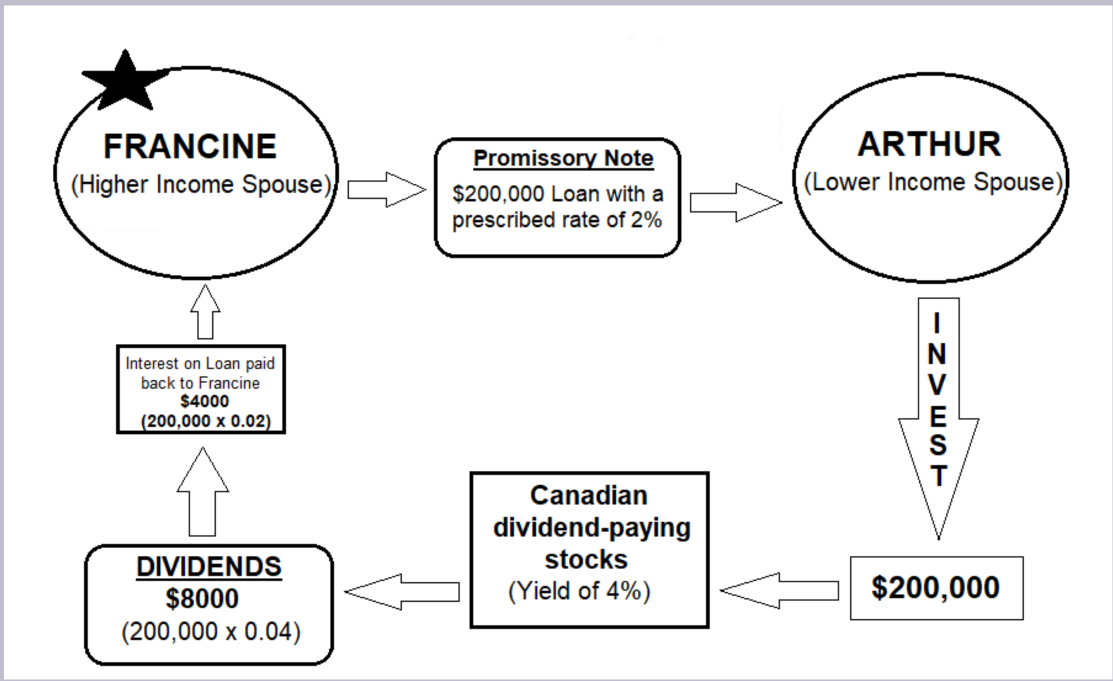
Contribute to a spousal RRSP

If an individual believes that they will have a higher income than their spouse upon retirement, this income splitting opportunity would be very beneficial in the year of withdrawal, in terms of tax saving. The higher income individual can contribute to their spouse's RRSP, and when the funds are withdrawn, it would be taxed under the spouse's name (with the lower income) instead of the contributor's name (with the higher income).

Loaning money to your spouse or child (Prescribed Rate Loan)

If one spouse or partner is in a higher tax bracket than the other, they could lend money to the lower income spouse and/or to one of their children. It is suggested that a promissory note be written for the loan to secure it. Also, the loans must charge interest at the prescribed rate for benefits (or the commercial lending rate if it is lower) and this interest amount must be **paid** by January 30th of each year. The lower income family member can use the loaned funds to purchase investments (e.g. dividend-paying stocks), and the income will be taxed and paid at a lower marginal rate by the lower income family member. Another thing the lower income family member can do is use a portion of the dividend income they earned to pay the interest on the loan to the higher income family member. The prescribed rate on benefits is usually pretty low (2% as of January 2020) so, as long as the investment has a higher return than the prescribed rate, your income splitting strategy is a success.

Example 6.12.2



Prescribed Rate Loan Example, by Anita Kartawidjaja, January 2020 [Image Description]

There are many more income splitting strategies other than the ones listed here, but these are few of the more common examples that tax savers take advantage of.

References and Resources

- *Income Tax Act*, RSC 1985, c1, (5th Supp.) ss 60.03, 74.5(1)
- Article – "Pension income splitting" (Author: Government of Canada)
- Article – "Here are your income splitting options now that the private corporation avenue is dead" (Author: Jamie Golombek)
- Article – "Lend Money to Your Spouse or Child" (Author: TaxTips.ca / Boat Harbour Investments Ltd.)

Image Description

Prescribed Rate Loan Example Image Description: Francine is loaning $200,000 to her spouse Arthur with a prescribed rate of 2%. Arthur decides to invest the money into a Canadian dividend-paying stocks at 4%. He earned $8000 as a dividend (200,00 x 0.04). Then he paid the interest of the loan back to Francine of $4000 (200,000 x 0.02). [Return to Prescribed Rate Loan Example]

6.13 What is the Alternative Minimum Tax? How is the AMT applied? Why does it exist?

SHARON BASI

What is the Alternative Minimum Tax?

The Alternative Minimum Tax has been in effect since 1986. "It is a means to bring fairness to the tax system." (RBC Wealth Management, p.1). The AMT prevents the wealthy and middle class high-income earners and trusts from using certain tax incentives to reduce or eliminate their tax obligations.

How is AMT applied?

AMT is usually triggered when high-income earners invest in tax shelters, such as limited partnership units. It only applies to individuals and trusts and not to corporations. According to the CRA the following table is a list of some of the most common situations in which people need to pay the minimum tax.

<table>
<tr><td>A. When the taxable capital gain reported is $40,000 or more</td></tr>
<tr><td>B. When any of the following is claimed on the tax return:
a loss (including your share of a partnership loss) resulting from, or increased by, claiming capital cost allowance on rental properties
a loss from a limited partnership that is a tax shelter
most carrying charges on certain investments
a loss from resource properties resulting from or increased by claiming a depletion allowance, exploration expenses, development expenses, or Canadian oil and gas property expenses
a deduction for security options</td></tr>
<tr><td>C. When any of the following tax credits are claimed on the tax return:
a federal political contribution tax credit
an investment tax credit
a labour-sponsored funds tax credit
a federal dividend tax credit</td></tr>
</table>

Information Retrieved from CRA webpage

The calculation of the Alternative Minimum Tax can be found in 127.51 of the ITA

Why does it exist?

AMT exists because the government wants those who earn higher incomes to pay at least a minimum amount of tax rather than paying less tax than the lower income earners or even no tax, due to having more incentives than those who earn less.

References and Resources

- *Income Tax Act*, RSC 1985, c1, (5th Supp.) ss 127.5-127.55
- Article – "Minimum Tax" (Author: Government of Canada)

6.14 What is GAAR? What is the Purpose of GAAR? What are the GAAR tests?

MINGYAO GENG

What is GAAR?

The full name of GAAR is "The General Anti-Avoidance Rule" and it can be found in section 245(2) of the Income Tax Act. If a transaction or series of transactions is tax deducted, avoided or deferred, and such transactions or series of transactions are not performed for any primary purpose in order to obtain tax benefits, such tax consequences may be invalid.

What is the purpose of GAAR?

Canada Revenue Agency (CRA) uses GAAR to enhance their ability to target and challenge possible tax avoidance and / or abuse. They use GAAR when tax planning strategies may be within the ITA rules but not within the 'spirit' of those rules.

What are the GAAR tests?

The Canadian Supreme Court made a three-point test in determining whether GAAR applies.

1st test – Does the transaction or series of transactions generate tax benefits?

- This test will almost always be met as CRA would likely only challenge transactions that created a tax benefit.

2nd test – Has the transaction been identified as an avoidance transaction?

- This test addresses whether the main purpose of the transaction was to obtain tax benefits. If there was another purpose (business or other) of the transaction, then this test may not be met.

3rd test – Is the transaction abusive?

- "Abusive" is challenging to define and to prove. It depends on whether the transaction is inconsistent with the object, purpose, or spirit of the tax laws being used by the taxpayer to obtain the tax benefit.

References and Resources

- Article – "IC88-2 General Anti-Avoidance Rule – Section 245 of the Income Tax Act" (Author: Government of Canada)
- Article – "Canada: Tax Avoidance & Tax Planning – General Anti-Avoidance Rule – Canadian Tax Lawyer Analysis" (Author: David Rotfleisch)

CHAPTER 7: DEFERRED INCOME

7.1 What are the similarities and differences between an RRSP and a TFSA? For most students which would be a better investment vehicle?

ASHPREET KAUR

A Tax-Free Savings Account (TFSA) is a savings account that does not apply taxes on the earnings or original contributions when amounts are withdrawn from the account. A Registered Retirement Savings Plan (RRSP) is a retirement savings account for people employed in Canada. The money contributed in RRSP is tax-free until it is withdrawn from the account.

	RRSP	TFSA
Eligibility	Individuals who earn income and have a valid Social Insurance Number can contribute to their RRSP until the age of 71	Individuals who are 18 years old or over and with a valid Social Insurance Number (SIN) can apply for a TFSA
Limitation	In 2020, individuals can contribute 18% of their earned income, up to $27,230	In 2020, individuals can contribute up to $6,000. Note the TFSA contribution room is cumulative. I.e. if you don't contribute in year 1, you could contribute $12,000 in year 2. Here is a CRA link to some TFSA contribution examples
Deposits	Deposits in an RRSP are deductible (see ITA for specific calculations) when calculating an individual's Net Income For Tax Purposes.	Any deposits in TFSA are not deductible for income tax purposes.
Withdrawals	Withdrawals from an RRSP will be fully taxed. Gains within an RRSP are not taxable until they are withdrawn.	Withdrawals and gains from a TFSA are not taxable.
Penalty	Individuals can overcontribute up to $2,000. The CRA will charge 1% every month on the amount that exceeds the limit ($2,000) until it is withdrawn	The CRA will charge 1% every month on the amount that exceeds the limit (see "Limitation" above) until it is withdrawn.

Professor's Comments – There is also a new financial vehicle called the "First Home Savings Account" (FHSA) that will likely be available for contributions in 2022. The FHSA seems to blend the best parts of a TFSA and an RRSP. This might be the best young person/student savings mechanism around. Here is a link to a finance blog that I follow with a 2-part article on the FHSA: Part I, Part II.

References and Resources

- Article – "MP, DB, RRSP, DPSP, and TFSA limits and the YMPE" (Author: Government of Canada)
- Article – "Tax-Free Savings Account" (Author: Government of Canada)
- Article – "Registered Retirement Savings Plan (RRSP)" (Author: Government of Canada)

7.2 How much can you deduct on RRSP? How to calculate RRSP contribution limit?

HOANG PHUC

The amount of RRSP contributions that you can deduct based on your RRSP deduction limit, which appears on your latest notice of assessment or notice of reassessment, or on a T1028.

Under subsection 146(1), the maximum RRSP contribution a taxpayer who has not participated in an Registered Pension Plan (RPP) or a Deferred Profit Sharing Plans (DPSP), is calculated by formula

A+B+R–C, where:

A	Unused RRSP deduction room carried forward from the previous year
B	The lesser of 18% of taxpayer's "earned income" for the preceding year, to an annual maximum (Less): Prior year's pension adjustment
R	Your pension adjustment reversal (PAR) (if applicable)
C	Your net past service pension adjustment (PSPA) (if applicable)

What is "earned income"? ITA – 146(1)

RRSP contribution room is based on "earned income". Generally, earned income includes a taxpayer's income (earned while the taxpayer was resident in Canada).

Include	Deduct	Exclude
Net employment income	Union and professional dues	Pension income (including CPP/QPP and OAS)
Business income (either alone or as an active partner)	Business loss (either alone or as an active partner)	Retiring allowances and taxable DPSP payments
Net rental income from real or immovable property	Net rental loss from real or immovable property	Amounts received from RRSP and RRIF
Taxable support payments received	Deductible support payments made	Death benefits
Qualifying performance income from an amateur athlete trust.		
CPP or QPP disability benefits		
Royalty income regarding a work or invention of which the taxpayer was the author or inventor		

The annual contribution limits for RRSP ITA – 146(1)

Maximum deduction limit:

2022	$29,210	**2019**	$26,500
2021	$27,830	**2018**	$26,230
2020	$27,230	**2017**	$26,010

Example 7.2.1

Minh makes RRSP contributions of $11,000 in 2020. His unused RRSP deduction room carried forward to 2020 from prior years is $1,000. His income for 2019 includes:

- $120,000 employment income
- $5,500 pension adjustment
- $1,200 interest income
- $35,000 rental loss.

He is not a member of an RPP.

Minh's RRSP deduction limit for 2020 would be calculated as follows (using the formula at the top of the page):

A: $1,000 (his unused RRSP deduction room carried forward from previous year) plus

B: $9,800 which is calculated as follows:

- The lesser of
  - **$15,300** prior year earned income (18% X prior year earned income of $85,000 ($120,000-$35,000)) and
  - $27,230 (annual maximum deduction limit for 2020)
- Less **$5,500** (pension adjustment)

Minh's RRSP deduction limit for 2020 is $10,800. Because Minh makes $11,000 of potentially deductible contributions to RRSP, $200 in over-contributions may be carried forward and deducted in a future year.

References and Resources

- *Income Tax Act*, RSC 1985, c1, (5th Supp.) s 146(1)
- "Tax Rates and Tools >> RPPs, RRSPs, DPSPs, and TFSAs – Annual limits" (Author: Canada Revenue Agency)
- T4040 "RRSPs and Other Registered Plans for Retirement [PDF]" (Author: Canada Revenue Agency)
- Article – "RRSP MPP and DPSP Contribution Limits" (Author: TaxTips)

CHAPTER 8: CAPITAL GAINS & LOSSES

Chapter Overview

8.1 What are taxable capital gains and allowable capital losses?

JASMINE MARAHAR

Capital Gains are the profits realized from the sale of Capital Property (see ITA 54 for definition). Although the arguments over whether transactions create business income, property income or capital gains can become pretty complex, in general, if the sale of an asset is a bi-product of its main purpose then it likely creates a capital gain (loss).

A standard example is an apple tree in an orchard business that sells apples. Typically the ongoing sale of apples would generate business income while the sale of the actual apple tree would create a capital gain.

Only 50% of a Capital Gain is included in income, this is known as the **Taxable Capital Gains** ("TCG"). For example, if the Capital Gain is $30,000, then the TCG would be $15,000 ($30,000 x 50%). Similarly, **Allowable Capital Losses** ("ACL") are equal to 50% of the Capital Loss [ITA 38(b)]. ACL's are deducted against TCG's in the year.

Where do TCG's and ACL's go in the S3 ordering rules? What happens if your ACL > TCG?

In terms of the S3 ordering rules, capital gains and losses recorded in Net Income for Tax Purposes in 3(b). ACL's are netted against TCG's however the amount in section 3(b) cannot be negative. If ACL's are greater than TCG's then 3(b) will be $Nil and the difference becomes a Net Capital Loss that can be applied against net TCG's in other years.

Example 8.1.1

Kylee sold two of her properties last year, a building and some shares, both purchased in 2016. There was no depreciation on the building. The building was bought at a price of $100,000, and sold for $160,000. The shares were bought at $50,000 and sold for $30,000.

Purchase of building for $100,000 → Sale of building for $160,000 → **Capital gain of $60,000**

Purchase of shares for $50,000 → Sale of shares for $30,000 → **Capital loss of $20,000**

The first transaction realized a capital gain of $60,000 and the second transaction realized a loss of $20,000. Kylee's TCG would be ($60,000 x 50%) $30,000 and her ACL would be ($20,000 x 50%) $10,000. The amount recorded in 3(b) would be $20,000 (TCG-ACL).

Now, let's say Kylee bought the building for $100,000, and sold it for $110,000. The shares she bought for $50,000 and sold for $30,000.

Purchase of building for $100,000 → Sale of building for $110,000 → **Capital gain of $10,000**

Purchase of shares for $50,000 → Sale of shares for $30,000 → **Capital loss of $20,000**

The first transaction realized a capital gain of $10,000, and the second transaction realized a capital loss of $20,000. Kylee's TCG would be ($10,000 x 50%) $5,000. Her ACL would be ($20,000 x 50%) $10,000. ACL>TCG, therefore the amount recorded in 3(b) would be $Nil and the $5,000 difference ($10,000-$5,000) would be added to her Net Capital Loss balance and could be applied against 3b amounts in other years.

References and Resources

- *Income Tax Act*, RSC 1985, c1, (5th Supp.) ss 248(1), ITA 38(b)
- Article – "Capital Gains and Losses." (Author: TaxTips)
- Chartered Professional Accountants. (2022). The Chartered Professional Accountant Competency Map. Part 1: The CPA Competency Map: 6.3.2

8.2 What is Personal Use Property and Listed Personal Property? What are the tax implications? Why do these rules exist?

RAMINDER SIDHU

CRA defines personal use property (PUP) as property you own primarily for personal enjoyment, this would include most personal or household items such as vehicles, furniture, boats, etc. PUP generally does not increase in value overtime.

Listed-personal property (LPP) is a type of PUP; the main difference between the two is that LPP is property which may increase in value over time such as jewellery, works or art, coins, etc. Capital gains on the sale of PUP and LPP are included in NITP (under section 3(b)). Capital losses for PUP are denied and capital losses for LPP can only be applied against LPP gains. PUP losses are denied because these items typically depreciate due to personal use and are therefore a personal expense (rather than a capital loss).

LPP losses can be applied against LPP gains going back 3 years or forward 7 years. For instance if you incurred a loss from disposition of LPP of $2,000 in 2020 you can now use that loss to reduce gains in 2017, 2018, and 2019 or apply them to any gains up until 2027.

When calculating PUP and LPP gains and losses you need to be aware of the $1,000 "floor rule". This rule basically bumps up the ACB and selling price to $1,000 (effectively this makes it so there are no PUP gains on low value items). The 'floor rule' is as follows:

- If the adjusted cost base (ACB) of the property is less than $1,000, its ACB is considered to be $1,000
- If the proceeds of disposition are less than $1,000, the proceeds of disposition are considered to be $1,000
- If both the ACB and the proceeds of disposition are $1,000 or less, you do not have a capital gain or a capital loss.

- If the ACB or proceeds of disposition is more than $1,000, you may have a capital gain or loss.

Example 8.2.1

John purchased furniture for a price of $1,000 and a painting for $900 in 2017, now in 2019, John sells the furniture and the painting at $800 and $1,400 respectively. On the disposition of the furniture there is no loss as the furniture is deemed to be sold for $1,000 (floor rule. Also, losses are denied on PUP regardless.). The painting will have an LPP capital gain of $400 as the ACB was less than $1,000 so according to the floor rule, the ACB is $1,000.

References and Resources

- Author-"Personal-use property" (Author: Government of Canada)
- Author-"Definitions for Capital gains"(Author: Government of Canada)
- Author-"Personal-use property losses" (Author: Government of Canada)
- Author-"Listed personal property" (Author: Government of Canada)
- Author-"Listed personal property (LPP) losses" (Author: Government of Canada)

8.3 What is the Principal Residence Exemption? How does it impact Taxable Income and what are the basics of the calculation?

AELYSSA BHATTI

The principal residence exemption ("PRE") is an income tax benefit that can reduce or eliminate tax on capital gains realized when you sell your principal residence. The PRE is only available on one property per family unit (this includes your spouse and unmarried children) and, to be designated as a principal residence, your property must be 'ordinarily inhabited' during the year. 'Ordinarily inhabited' is not defined in the ITA but Income Tax Folio S1-F3-C2 states that it can apply "even if a person inhabits a housing unit only for a short period of time in the year."

The PRE represents a potentially huge tax benefit for homeowners in Canada.

Basics of Calculation: A- (A x {B/C})-D

where:

- A is the individual's total capital gain on the disposition of the principal residence;
- B is one plus the number of years the property was designated as the individual's principal residence (and during which the individual was resident in Canada);
- C is the number of taxation year-ends that the individual has owned the property (this includes the year of purchase and the year of sale); and
- D is a specific rule related to certain houses purchased prior to February 23rd, 1994 and won't be considered for this course.

Example 8.3.1

In 2002, Mr. An acquired vacant land for $50,000. In 2005, he constructed a housing unit on the land, costing $200,000, and started to ordinarily inhabit the housing unit. In 2011, he disposed of the property for $300,000. Calculate exemption amount, TCG.

Solution:

A = $300,000-($200,000+$50,000) = $50,000 (assuming there was no cost of disposition);

B = 7+1=8 (Principal Residence for 2005-2011; 2002-2004 excluded because no one lived there);

C = 10 (tax year-ends from 2002-2011);

D = 0

- A – {A(B/C)}-D = $50,000- {$50,000*((7+1)/10)}-0 = $10,000 Capital Gain.

TCG = ($10,000 * 50%) = $5,000 Taxable Capital Gain

Tax planning: For family units that have two or more properties eligible for the PRE, typically you would apply the PRE to the property with the highest capital gain per year to fully eliminate that capital gain. Any remaining years would then be applied to the other property.

References and Resources

- Article – Income tax folio S1-F3-C2, Principal Residence (Author: Government of Canada)
- *Income Tax Act*, RSC 1985, c1, (5th Supp.) ss 40(2)(b), 54, 110.6(19), 110.6(21).

8.4 What are the 'change in use' rules? What are the tax implications?

MARIAH CAWKELL

The change in use rules are used when a property was originally purchased to generate income but is then used for some other reason or vice versa (i.e. from business/property to personal use or personal use to business/property use). ITA 45(1) says that for tax purposes, if a change in the use of property occurs, it is assumed the property is disposed of at fair market value (FMV), then immediately re-purchased at this same FMV. Any capital gains (losses) must be recorded in the year of the change in use. Some of the common changes in use (and their tax implications) are stated below.

Business Use to Personal Use

If the change in use is from business to personal use, proceeds from the deemed disposition of the asset will be equal to its FMV. This same FMV will also be equal to the assets re-acquisition capital cost for personal use. Any capital gains (losses), recapture, or terminal loss shall be recorded as normal. ITA 45(1)

Personal Use to Business Use

If the cost of the asset > FMV:

This is treated similarly to Business to Personal Use. According to ITA 45(1), the asset's proceeds from the disposition and the capital cost of reacquisition will be equal to the asset's FMV.

If the FMV > cost of the asset:

Proceeds from the deemed disposition will be equal to the FMV of the asset. The capital cost of the asset will also be equal to FMV when determining capital gain on the deemed disposition. However, ITA 13(7)(b) states that when calculating CCA, the UCC balance of the re-acquired asset will be equal to its original cost + ½ of the difference between its cost and the proceeds from the disposition (FMV). This calculation is to stop 100% of the capital gain from getting deducted as CCA. I.e. you are only taxed on the 50% taxable portion of the capital gain but – without this rule – you would be able to deduct 100% of the increased value as CCA over the life of the asset.

Tax Consequence: Personal to Business FMV > Cost				
Land Original Cost: $100,000				
Land FMV: $250,000				
For Capital Gain Purposes:			**For CCA Purposes:**	
Proceeds of Disposition	$250,000		Original Cost	$100,000
Adjusted Cost Base	$100,000		Bump Up	$75,000
Capital Gain	$150,000		(1/2)($250,000 - $100,000)	
Taxable Capital Gain	$75,000		UCC	$175,000
New Capital Cost:	$250,000			

Tax Consequence: Personal to Business FMV > Cost [Image Description]

Principal Residence to Rental Property

This should be treated the same as Personal Use to Business Use. Deemed disposition at FMV and re-acquired at FMV. However, the taxpayer can elect that they have not changed the use of their principal residence to a rental property and therefore do not have to record any capital gains on the property for up to 4 years (and this can be extended further if certain criteria are met). If they elect to do this, they cannot claim any CCA on the property during this time. The rules regarding this election are explained in more detail in this document "Changing All your Principal Residence to a Rental or Business Property".

Rental Property to Principal Residence

A deemed disposition at FMV may trigger capital gains, recapture, and terminal losses. However, ITA 45(3) states the taxpayer can elect out of this disposition as long as they have not taken any CCA on the property since 1984. If this election is made, the taxpayer can assign this property as their principal residence up to 4 years in advance, meaning they are not required to report any capital gains when the change in use occurs. See "Changing All your Rental or Business Property to a Principal Residence".

References and Resources

- *Income Tax Act*, RSC 1985, c1, (5th Supp.) s 45(1)
- Article – "Changing all your rental or business property to a principal residence" (Author: Government of Canada)

Image Description

Tax Consequence: Personal to Business FMV > Cost: A spreadsheet titled "Tax Consequence: Personal to Business FMV > Cost" with details on land's tax implications. The land's original cost is $100,000, and the land FMV is $250,000. The table is divided into two sections: "For Capital Gain Purposes" and "For CCA Purposes."

- **For Capital Gain Purposes:**
  - Proceeds of Disposition: $250,000
  - Adjusted Cost Base: $100,000
  - Capital Gain: $150,000
  - Taxable Capital Gain: $75,000
- **For CCA Purposes:**
  - Original Cost: $100,000
  - Bump Up: $75,000
  - (1/2)($250,000 – $100,000): $75,000
  - UCC: $175,000

The new capital cost is $250,000.

[Return to Types of deemed residents]

8.5 What are the rules on identical properties? Why were these rules created?

SHELVIN CHAND

Identical properties are when each property in the group is the same as all the others. An example would be shares of the same class of the capital stock of a corporation or units of a mutual fund trust.

You may buy and sell several identical properties at different prices over a period of time. If this occurs, you need to calculate the average cost of each property in the group at the time of each purchase to determine your adjusted cost base (ACB).

These rules were implemented to clarify the ACB calculation – and to limit a shareholder's ability to manipulate this calculation – when a shareholder sells the property.

Under the identical property rules, the ACB is calculated as follows:

- *1st purchase of property*: ACB per unit is equal to the total amount paid for the property divided by the number of units purchased.
- *2nd purchase of identical property*: ACB is equal to the total amount paid for the property (1st and 2nd purchase), divided by the total number of units (1st and 2nd purchase) purchased.

Example 8.5.1

During year 1, Trevor purchased and sold shares of Matrix Corporation. The chart below shows how the adjusted cost base (ACB) per share changes after each transaction.

Example of sale and purchase of identical properties:

Transaction	A: Cost ($)	B: # of Shares	A / B: Adjusted Cost Base per share ($)
January 1, Year 1: Purchased shares at a price of $25.00 per share.	25,000	1,000	25.00
March 31, Year 1: Purchased shares at a price of $22.50 per share.	24,998	1,111	
New Average Cost per Share	49,998	2,111	23.68
June 2, Year 1: Sold shares at a price of $27.50 per share.	23,708	1,001	
New Average Cost per Share	26,290	1,110	23.68
September 15, Year 1: Sold shares at a price of $17.75 per share.	14,447	610	
New Average Cost per Share	11,842	500	23.68
December 27, Year 1: Purchased shares at a price of $16.25 per share.	8,125	500	
New Average Cost per Share	19,967	1,000	19.97

References and Resources

- *Income Tax Act*, RSC 1985, c1, (5th Supp.) s 47
- Article – "Identical Properties" (Author: Government of Canada)
- Article – "Reporting Capital Gains and Losses From Identical Property" (Author: TurboTax)
- Article – "Capital Gains 2018" (Author: HTK Academy)

8.6 What are the 'replacement property' rules? Why do they exist? What are the tax implications?

TAYLOR CHOW AND JASMINE LEBLANC

What are they?

Replacement property rules allow taxpayers, when applicable, to defer capital gains and/or capital cost allowance when replacing property that was disposed of either voluntarily or involuntarily. Qualifying for replacement property rules lets taxpayers replace disposed assets without having to face immediate tax implications.

Qualifying for replacement property rules

- *Voluntary Disposition*: Assets that have been voluntarily disposed of can only qualify if it is land and fixtures, and was not a rental property.
- *Involuntary Disposition*: Assets that were not disposed of voluntarily such as being stolen, damaged beyond repair, or expropriated.

Timeframes for replacing property (per "IT Folio S3-F3-C1")

"For involuntary dispositions, the replacement property must be acquired before the later of:

- the end of the second tax year following the initial year; and
- 24 months after the end of the initial year.

For voluntary dispositions, the replacement property must be acquired before the later of:

- the end of the first tax year following the initial year; and
- 12 months after the end of the initial year.

For purposes of the replacement property rules, the **initial year** is the tax year in which an amount has become receivable as POD (proceeds of disposition) for the former property."

Qualifying replacement property

- The new replacement property must be used to replace the disposed business property.
- The new replacement property must be used in a similar or identical manner as the property it is replacing.
- If the property being replaced was used to earn business income, the new replacement property must also be used to earn business income.

The purpose of the replacement property rule is to allow the taxpayer to defer the capital gains or recapture of CCA when a business property has been disposed of and it is to be replaced with a similar property so that the proceeds can be used to purchase a replacement property.

Example 8.6.1

Brewed Awakening Coffeehouse had been operating in Lower Lonsdale for 3 years until the owners decided to sell the property and relocate. Brewed Awakening has a December 31st year-end. Brewed Awakening was sold on November 26, 2018, for $320,000 and had an adjusted cost base of $105,000. On January 3, 2019, the owners bought a new property for Brewed Awakening in White Rock for $289,000. How much capital gains, if any, would the owners of Brewed Awakening have to report for the 2018 taxation year?

Capital Gains to be reported, lesser of:

Actual capital gain (Proceeds from Sale – Adjusted Cost Base)

$320,000 – $105,000 = $215,000

Proceeds not reinvested (Proceeds from Sale – Cost of Replacement Property)

$320,000 – $289,000 = $31,000

The owners of Brewed Awakening would have to report capital gains of $31,000.

Impact on Taxable Income

The purpose of the replacement property rule is to allow the taxpayer to defer the capital gains or recapture of CCA when a business property has been disposed of and it is to be replaced with a similar property so that the proceeds can be used to purchase a replacement property. In the example above, the taxpayer is able to defer $184,000 of capital gains as they reinvested that amount when purchasing the replacement property. This results in a lower taxable income for the taxpayer in the year of disposition.

References and Resources

- *Income Tax Act*, RSC 1985, c1, (5th Supp.) ss 44(5), 13(4.1)
- Article – "Income Tax Folio S3-F3-C1, Replacement Property" (Author: Government of Canada)
- Article – "Replacement Property Rules" (Author: HTK Academy)
- Graphic – "Moving Boxers Mover Moving Truck" (Creative Commons)

8.7 What is a capital gains reserve? How is it calculated? Why does it exist?

POOJA DEVI

What is a Capital Gain Reserve?

A capital gain reserve can be utilized when you make a sale of capital property but don't receive full payment. In most cases, you receive full payment on the capital property, but sometimes you may not receive the full refund at the time of sale. The capital gains reserve is intended to help defer tax on the capital gain until payment has been received. Note that there is a 5-year limit on the reserve to restrict people from deferring the gains indefinitely.

Who can claim a reserve

Although there are some restrictions – largely for non-residents, participants in related party transactions and for individuals who are exempt from paying tax – in general, most individuals and corporations can claim the reserve when they dispose of capital property. See ITA 40(2) for further information regarding limitations on who can claim the capital gains reserve.

How do you calculate the capital gains reserve?

The reserve is calculated each year and then brought back into income the following year. The reserve is based on the lesser of the following amounts:

1. Proceeds not yet received / Total proceeds X Capital Gain
2. 20% of the gain X (4 – number of preceding years ending after disposition)

This 2nd calculation effectively forces you to bring in a minimum of 20% of the gain multiplied by the number of years since the date of sale. I.e. By the 3rd you would need to have cumulatively recognized a minimum of 60% of the gain.

The reserve is optional. All or any of the existing reserve may be claimed each year. Remember that the prior year reserve is brought into income in the current year and then a new reserve is calculated.

Example 8.7.1

Mr. John sold a capital property for $500,000 on December 31, 2017. $50,000 was paid immediately in cash, $200,000 is payable on December 31, 2018, and $250,000 on December 31, 2019. The adjusted cost base of the property was $150,000 and the selling costs were $20,000. What is the capital gain reserve?

2017: Cost = $500,000; ACB = ($150,000); Selling Cost= ($20,000); Gain = $330,000

Less 2017 reserve, the lessor of:

20% calculation	$ amount calculation
330,000 (20%) (4-0) 330,000 * 80% = $264,000(lessor)	330,000*450,000/500,000 = $297,000
Capital Gain = $66,000 ($330,000-$264,000) Taxable Capital Gain (1/2) = $33,000	

2018: Inclusion of 2017 reserve of $264,000

Less 2018 reserve, the lessor of:

20% calculation	$amount calculation
330,000 (20%) (4-1) 330,000 * 60% = $198,000	330,000*250,000/500,000 = $165,000 (lessor)
Capital Gain = $99,000 ($264,000 – $165,000) Taxable Capital Gain (1/2) = $49,500	

2019: Inclusion of 2018 reserve of $165,000

Less 2019 reserve, the lessor of:

20% calculation	$amount calculation
330,000 (20%) (4-2) 330,000 * 40% = $132,000	330,000*0 /500,000 = $Nil (lessor)
Capital Gain = $165,000 Taxable Capital Gain (1/2) = $82,500	

References and Resources

- Article – "Claiming a capital gains reserve" (Author: Government of Canada)
- *Income Tax Act*, RSC 1985, c1, (5th Supp.) ss 40(1)(iii) and 40 (2)

8.9 What are the superficial loss rules? What are the tax implications? Why do these rules exist?

JASON GILL

There are many ways in which a person can try to avoid taxes on various things, one of these ways includes creating a loss just to reduce the taxable income. However, the Income Tax Act has rules to prevent people from deducting such false losses, these losses are also known as **superficial losses**.

Without the superficial loss rule a shareholder might sell shares at the end of the year to trigger losses to offset taxable capital gains in the year then immediately re-purchase the same shares.   The superficial loss rules were added in the Income Tax Act to help address these 'fake' sales.

ITA-54 states that a **superficial loss** occurs when the taxpayer (or an affiliated person as defined in 251.1(1)) has a loss from disposing a particular (capital) property, and then that taxpayer or any person affiliated(associated) with the taxpayer buys or has a right to buy the same or identical property (also known as "substituted property") between the period of 30 days before to 30 days after the disposition of the particular property. (**Identical/substituted property** is any property which is the same in all material respects, and therefore there wouldn't be a difference if one was to be substituted for the other)

However, in certain situations, the loss from a disposition of the property may not be considered a superficial loss. Situations such as:

- The property was sold because the taxpayer became or ceased to be a resident of Canada
- The property was sold because the property's use was changed
- The property is sold because the owner passed away
- The property was sold due to the expiry of an option
- The property is sold to a shareholder due to the company/corporation shutting down.

If the loss is determined to be a superficial loss, the taxpayer cannot deduct it from their calculation of taxable income for the year. However, the superficial loss amount is added to the Adjusted Cost Base ("ACB") of the identical property that was purchased. By adding the superficial loss to the ACB the loss is deferred until the shares are permanently sold.

Example 8.9.1

Let's look at the tax impact of two identical scenarios with, and without, the superficial loss rules being applied

Illustration 1: The superficial loss rule is not applied

Date	Transaction	Gold Bars	Price	Adjusted Cost Base	Capital Gain/(loss)
2019-01-21	BUY	10	$ 100	$ 1,000	–
2019-12-31	SELL	10	$ 70	$ 1,000	**$ (300)**
2020-01-21	BUY	10	$ 70	$ 700	–
2020-02-20	SELL	10	$ 130	$ 700	**$ 600**

Illustration 2: The superficial loss rules is applied.

Date	Transaction	Gold Bars	Price	Adjusted Cost Base	Capital Gain/(loss)
2019-01-21	BUY	10	$ 100	$ 1,000	–
2019-12-31	SELL	10	$ 70	$ 1,000	**$Nil ($300 superficial loss)**
2020-01-21	BUY	10	$ 70	**$ 1,000**	–
2020-02-20	SELL	10	$ 130	$ 1,000	**$300**

In the second illustration you'll see that the initial $300 loss is deferred and added to the ACB of the shares. This reduces the gain when the shares are finally sold.

References and Resources

- *Income Tax Act*, RSC 1985, c1, (5th Supp.) ss 54, 248(12)
- Article – "What is a superficial loss" (Author: Government of Canada)
- Article – "Meaning of Identical Properties" (Author: Government of Canada)
- Article – "Non-superficial losses" (Author: Government of Canada)
- Article – "What Is a Superficial Loss?" (Author: TurboTax Canada)

8.10 What is the Lifetime Capital Gains Deduction? How does it impact Taxable Income and what are the basics of the calculation?

RUMABEL MATEO

The lifetime capital gains exemption (LCGE) is provided by Canada to encourage individuals who are residents of Canada to start small businesses (a great generator of income!)

The LCGE is used to offset capital gains that arise from the disposition of certain types of properties: qualified small business corporation shares (QSBC's), and qualified farm and fishing properties (QFFP). For this course, we will be focusing on QSBC's.

To qualify as a QSBC the following criteria must be met:

- The corporation must be a Small Business Corp (SBC) at the time of sale;
    - An SBC is a CCPC where all (or substantially all) of its assets are used to generate Active Business Income in Canada.
- The QSBC's shares must be owned by either the individual claiming the LCGE or a partnership, spouse, or common-law partner related to the individual during, and 24 months, preceding the determination time.
- The corporation must have been a CCPC for the 24-months prior to the sale;
- More than 50% of the fair value of the company's assets must have been used principally in the generation of Active Business Income carried on primarily (90% or more) in Canada.

As of 2019, the lifetime capital gains exemption is $866,912 (indexed to inflation). That means you could eliminate up to $866,912 of capital gains on the sale of QSBC shares. This potentially provides huge tax savings, so you want to make sure you understand when, how and to whom the LCGE would apply.

The calculation itself is fairly complex and is based on the lesser of the following three items:

- The unused lifetime deduction – The lifetime deduction is 50% of the exemption (currently $866,912) less any amounts you have claimed as a deduction in prior years.
- The annual gains limit – This basically limits the amount of the Lifetime Capital Gains Deduction to the net taxable capital gain in 3(b) in a year. Note, this is a tricky calculation that looks at ABIL's and Net Capital Losses, for further details see ITA 110.6(1)
- Cumulative gains limit – This looks at prior year usage of the capital gains deduction and considers the Cumulative Net Investment Loss. This is another tricky calculation, see ITA 110.6(1) for details.

Here is the process you would follow to apply your Lifetime Capital Gains Deduction:

1. Determine if you are eligible for the lifetime capital gains exemption
2. Calculate the taxable capital gain on the sale of your QSBC
3. Calculate the Capital Gains Deduction (using the 'lesser of 3' items listed above)
4. Claim this amount as a Division 'C' deductions.

Example 8.10.1

In 2019, you disposed of qualified small business corporation shares of $1,000,000 that you purchased for $100,000 in 2018. You are eligible for your first-time use of the lifetime capital gains exemption and have access to the full amount. To claim this deduction,

Step 1: Determine if you are a QSBC…we'll assume that is the case here.

Step 2: Determine the amount of the taxable capital gain in 3(b). In this case there is a $450,000 taxable capital gain (50% X ($1M – $100K).

Step 3: Determine the amount of the Lifetime Capital Gains Deduction. Will assume that it is 100% available and therefore the Lifetime Capital Gains Deduction is $433,456 ($866,912 X 50%)

Step 4: Claim your lifetime capital gains deduction of $433,456 as a division 'c' deduction to offset your taxable capital gain in S3(b).

References and Resources

- *Income Tax Act*, RSC 1985, c1, (5th Supp.) s 80.03(8)
- Article — "The Lifetime Capital Gains Exemption" (Author: TurboTax Canada)
- Article — "What is the capital gains deduction limit?" (Author: Government of

Canada)

CHAPTER 9: CORPORATE TAX

Chapter Overview

9.1 Explain the tax concept of "integration"
9.2 What are the similarities and differences between how tax payable is determined for individuals and corporations? (Overview)
9.3 What are the similarities and differences between the various types of corporations (private, CCPC, public). (6.2.1)
9.4 What are some significant differences for the treatment of Division 'C' deductions for individuals and corporations?
9.5 What is Active Business Income and Aggregate Investment Income?
9.6 How is tax payable calculated for a corporation and why is the source of the income (ABI, AII, Specified Investment Business Income etc.) important?
9.7 What is the General tax rate and the General rate reduction?
9.8 What is the Small Business Deduction and how is it determined?
9.9 What are the associated company rules? How do they impact the small business deduction? Why do they exist?
9.10 What is a Small Business Corporation? Explain any tax advantages of being a Small Business Corporation.
9.11 What is the Refundable Part IV tax and how is it determined? Why does it exist?
9.12 How do the various corporate tax rates tie into the concept of integration?
9.13 How are capital dividends treated for tax purposes? How does this tie into the concept of integration?
9.14 As an owner of a company, when is it beneficial to claim employment income (salary) rather than dividends (and vice versa)?

9.1 Explain the tax concept of "integration"

EVA VIERNES

The concept of integration is intended to eliminate any advantages and disadvantages in the application of tax between individuals, corporations and trusts. Thus, the after-tax cash received by an individual should be the same regardless if it was generated directly (as salary) or paid out as dividends from a corporation.

To achieve integration and to avoid double taxation on dividends received from a corporation, an individual must:

• gross-up dividends received to reflect the corporate pre-tax income

• receive a dividend tax credit (DTC) for the tax deducted at the corporate level

The DTC is the sum of federal and provincial dividend tax credits, and the calculation varies depending on whether the corporation is issuing eligible or non-eligible dividends. Typically, public corporations issue eligible dividends while Canadian-Controlled Private Corporations (CCPCs) issue non-eligible dividends.

Eligible dividends are paid from income that is taxed at a higher corporate rate, while non-eligible dividends are paid from income that is taxed at a lower corporate rate. To offset this inequity (and to create integration) eligible dividends receive more favourable tax treatment than non-eligible dividends.

Here is an illustration showing how integration works for both types of dividends. Notice that the tax paid by the corporation is equal to the DTC that can be claimed by the individual shareholder. The computed tax payable amount and the total after tax cash is the same irrespective of whether it is paid through eligible dividends, non-eligible dividends or received directly as salary.

Non-eligible dividends			**Eligible Dividends**		
Corporate Pre-Tax Income	1,000		*Corporate Pre-Tax Income*	1,000	
Tax @ 13% (assumed)	(130)		Tax @ 27.5% (assumed)	(275)	
Net earnings	870		Net earnings	725	
Individual Shareholder	*Cash*	*Taxable*	*Individual Shareholder*	*Cash*	*Taxable*
Cash dividend received	870		Cash dividend received	725	
Taxable dividend ($870 X 1.15)		1,000	Taxable dividend ($725 X 1.38)		1,000
Individual tax @40% (assumed)	(400)		Individual tax @40% (assumed)	(400)	
Plus DTC $130 (9/13 fed & 4/13 prov)	130		Plus DTC $275 (6/11 fed & 5/11 prov)	275	
Total After Tax Cash	**600**		**Total After Tax Cash**	**600**	
If Income is earned by Individual			*If Income is earned by Individual*		
Business Income Earned	1,000		Business Income Earned	1,000	
Tax payable ($1,000 X 40%)	(400)		Tax payable ($1,000 X 40%)	(400)	
Total After Tax Cash	**600**		**Total After Tax Cash**	**600**	
"DTC" is a Dividend Tax Credit. There is a federal and provincial portion of the credit.					
Integration works better as an academic concept as, in real life, provincial tax rates and credits will impact the actual result.					

Example of treatment of Non-eligible dividends and eligible dividends [Image Description]

References and Resources

- Video – "Integration" (authors: Abjeet Khatra and Gursimran Kohli) – uses 2017 rates
- Chartered Professional Accountants. (2022). The Chartered Professional Accountant Competency Map. Part 1: The CPA Competency Map: 6.1.1

Image Description

Example of treatment of Non-eligible dividends and eligible dividends: A spreadsheet comparing the tax consequences of non-eligible dividends and eligible dividends, as well as income earned by an individual.

Non-Eligible Dividends:

- Corporate Pre-Tax Income: $1,000
- Tax @ 13% (assumed): ($130)
- Net Earnings: $870

Individual Shareholder (Non-Eligible Dividends):

- Cash dividend received: $870
- Taxable dividend ($870 x 1.15): $1,000
- Individual tax @ 40% (assumed): ($400)

- Plus Dividend Tax Credit (DTC): $130 (9/13 federal & 4/13 provincial)
- Total After Tax Cash: $600

If Income is Earned by Individual (Non-Eligible Dividends):

- Business Income Earned: $1,000
- Tax payable ($1,000 x 40%): ($400)
- Total After Tax Cash: $600

Eligible Dividends:

- Corporate Pre-Tax Income: $1,000
- Tax @ 27.5% (assumed): ($275)
- Net Earnings: $725

Individual Shareholder (Eligible Dividends):

- Cash dividend received: $725
- Taxable dividend ($725 x 1.38): $1,000
- Individual tax @ 40% (assumed): ($400)
- Plus Dividend Tax Credit (DTC): $275 (6/11 federal & 5/11 provincial)
- Total After Tax Cash: $600

If Income is Earned by Individual (Eligible Dividends):

- Business Income Earned: $1,000
- Tax payable ($1,000 x 40%): ($400)
- Total After Tax Cash: $600

The footnote at the bottom states: "'DTC' is a Dividend Tax Credit. There is a federal and provincial portion of the credit. Integration works better as an academic concept as, in real life, provincial tax rates and credits will impact the actual result."

[Return to Example of treatment of Non-eligible dividends and eligible dividends]

9.2 What are the similarities and differences between how tax payable is determined for individuals and corporations? (Overview)

SAM NEWTON

What are the similarities and differences between how tax payable is determined for individuals and corporations?

Calculating Net Income For Tax Purposes (NITP) and, to some extent, Taxable Income is very similar for both individuals and corporations. The biggest differences show up in the way Taxable Income is actually taxed. We'll look into these similarities and differences in more detail below.

Similarities

NITP – Corporations and individuals both follow the Section 3 ordering rules. The only real difference when calculating NITP is that some types of income and expenses really only relate to individuals (spousal support, employment income, child care expenses) and we wouldn't expect them to be part of a corporate tax return.

Taxable Income – Division 'C' deductions, which get us from NITP to Taxable Income, are also very similar although there are a few key differences as follows:

Item	Personal tax treatment	Corporate tax treatment
Charitable donations	Personal tax credit (ITA 118.1)	Division 'C' deduction (ITA 110.1(1))
Capital Gains Deduction	Division 'C' Deduction (ITA 110.6)	Not available to corporations
Dividends from Canadian Corporations (other than capital dividends)	Included in property income (NITP) and receive dividend tax credit	Division 'C' deduction (ITA 112), then dividends are taxed under Part IV of the ITA

Tax Rates and Process

The key difference between corporate and individual tax returns is how taxable income is actually taxed. For individuals, taxable income (regardless of the type of income) is grouped together and taxed using the progressive tax brackets. For corporations, the type and amount of items included in taxable income matters and is taxed as follows:

Taxable Income Element	Corporate Tax Process
Active Business Income (ABI) <= the Small Business Deduction Threshold	Taxed at a very low rate to encourage small businesses.
Active Business Income (ABI) > the Small Business Deduction Threshold	Taxed at a moderate rate
Passive income (interest, some rental income etc.)	Taxed at an extremely high rate to discourage having passive income in a corporation. The intention is for corporations to focus on active business and flow any extra cash/ passive items out to shareholders.

Note, the above elements apply primarily to Canadian Controlled Private Corporation (CCPC's). Public corporations (and non-CCPC's) are not eligible for some of these items (like the Small Business Deduction)

Here are the corporate tax rates based on the type and amount of income. These specific elements will be addressed in more detail later on in the book.

	CCPC ABI<= SBD	CCPC ABI > SBD	CCPC Passive income	Non CCPC	ITA
Basic Rate	38%	38%	38%	38%	123(1)(a)
Provincial Abatement	(10%)	(10%)	(10%)	(10%)	124(1)
Small Business Deduction	(19%)	NA	NA	NA	125(1) & 125(1.1)
General Rate Reduction	NA	(13%)	NA	(13%)	123.4(2)
Additional Refundable Tax	NA	NA	10.7%	NA	123.3
Total federal tax rate	**9%**	**15%**	**38.7%**	**15%**	

As you can see, for CCPC's, Active Business Income below the Small Business Deduction limit is taxed at a very low rate (9%), passive income is taxed at a very high rate (38.7%), and all other income is taxed at 15%. This stratification and different tax treatment of the various types of income is the main difference between the taxation of corporations and individuals.

References and Resources

FITAC > Tax Rates and Tools > Corporate Income Tax Rates – Federal Components (Author: Canada Revenue Agency)

9.3 What are the similarities and differences between the various types of corporations (private, CCPC, public). (6.2.1)

JESSICA THAO

The status of a corporation, whether it's private, public, or a Canadian-controlled private corporation (CCPC), will affect the tax treatment of its shareholders and the corporation itself. The similarities and differences are shown below:

<table>
<tr><th></th><th>CCPC</th><th>Other Private corporation</th><th>Public corporation</th></tr>
<tr><td>Definition</td><td>Private corporation
Not controlled by a non-resident</td><td>Private corporation
May be controlled by a non-resident</td><td>Corporation listed on a public stock exchange</td></tr>
<tr><td>Net tax rate

(corporate tax rates)</td><td>9% Active Business Income (ABI) <= Small Business Deduction (SBD)
15% for other ABI
38.67% for investment income</td><td>15%</td><td>15%</td></tr>
<tr><td>Eligible for RDTOH</td><td colspan="2">Yes (CRA ‘refundable dividend tax on hand)</td><td>No</td></tr>
<tr><td>Additional refundable tax</td><td>Yes, on passive income</td><td>No</td><td>No</td></tr>
<tr><td>Small business deduction</td><td>Yes, for ABI up to the $500K SBD threshold.</td><td>No</td><td>No</td></tr>
<tr><td>Other tax benefit</td><td>– Enhanced investment tax credits

– Capital gain exemption for shareholders on the sale of shares

– Research & development tax credit</td><td>No</td><td>No</td></tr>
</table>

References and Resources

- Article – “Small business deduction rules” (Author: Goverment of Canada)
- Article “T2 corporation income tax guide chaoter 6″ (Author: Government of Canada)
- Article “Corporations” (Author: Government of Canada)

9.4 What are some significant differences for the treatment of Division 'C' deductions for individuals and corporations?

PRABPREET BADYAL

There are several differences for the treatment of division ‘C’ deductions for individuals and corporation. Some of the major differences are listed in the table below:

<table>
<tr><th colspan="2">Division ‘C’ Deductions</th></tr>
<tr><td>INDIVIDUALS</td><td>CORPORATIONS</td></tr>
<tr><td>Lifetime Capital Gain Deduction
• Capital gains deductions available is the lifetime maximum for the capital gains deduction, less any amounts that have been used in preceding years. ITA 110.6</td><td>Lifetime Capital Gain Deduction
N/A</td></tr>
<tr><td>Donations
• Individuals receive a credit for donations.
• ITA 118.1</td><td>Donations
• Corporations receive a deduction for a donation under Division ‘C’ rather than receiving a credit.
• Deduction cannot be greater than 75% of division B income
• Can be carried forward for 5 years.
• ITA 110.1(1)</td></tr>
<tr><td>Dividends
• Individuals receive a dividends credit for a gross up of 38% for eligible dividends and 15% for non-eligible dividends.
• ITA 82 and 121</td><td>Dividends
• From Canadian corporations and foreign affiliates – Division ‘C’ deduction (ITA 112), then dividends are taxed under Part IV of the ITA
• Other foreign dividends are included in Taxable income and taxed as Passive income.</td></tr>
<tr><td colspan="2">Loss carryovers
• Net Capital Loss for individuals and corporations are carried forward indefinitely and carried back 3 years. ITA 111(1)
• Non-Capital Loss for individuals and corporation are carried forward 20 years and carried back 3 years. ITA 111(5.4)</td></tr>
</table>

Refer to ITA 110- 114.2, as well as ITA sections listed above for an in-depth explanation on Division ‘C’ deductions.

References and Resources

- Article – "T2 Corporation – Income Tax Guide – Chapter 3: Page 3 of the T2 return" (Author: Government of Canada)
- Article – "T2 Corporation – Income Tax Guide – Chapter 8: Page 8 of the T2 return" (Author: Government of Canada)

9.5 What is Active Business Income and Aggregate Investment Income?

SAM NEWTON

Corporate tax rates are based upon the type of income rather than focussing on the amount of income (as we see with the progressive tax rates used on individuals). In general, the Canadian government would like to see corporations used for active business activities (like manufacturing, processing, selling things etc.) rather than passive income activities (like receiving interest revenue or dividends). To achieve this goal, the government taxes Active Business Income (ABI) at a very low rate and Aggregate Investment Income (AII) at a very high rate (albeit some of this amount is refundable).

Here is a brief definition of ABI and AII

Active Business Income

Per ITA 125(7), active business income "means any business carried on by the corporation other than a specified investment business or a personal services business…". For purposes of achieving the most favourable Canadian tax rates (see 'Small Business Deduction" later in this book), this Active Business Income must be generated in Canada.

Aggregate Investment Income

AII is basically all your passive income that isn't being taxed under Part IV. ITA 129(4) "Aggregate Investment Income" has the details of the AII calculation, but the basic formula is as follows:

- Taxable capital gains net of allowable capital losses for the year. I.e. the amount in 3(b) when calculating NITP – 129(4)(a)(i) & (ii)
  - Less: Net capital losses deducted under Division 'C' – 129(4)(a)(iii)
- Property income for the year (Canadian and Foreign) – 129(4)(b)
  - Less: Dividends deducted under Division 'C' – 129(4)(b)(iii)

- Less: Property losses for the year – 129(4)(b)

This Aggregate Investment Income will be used in calculating the Additional Refundable Tax discussed later in this book.

9.6 How is tax payable calculated for a corporation and why is the source of the income (ABI, AII, Specified Investment Business Income etc.) important?

AMER BASSI

Public corporations are not impacted by the Additional Refundable Tax or the Small Business Deduction.   Assuming a public corporations income is earned in Canada it is taxed at 15%. The calculation for a CCPC is a bit more complex.

Tax payable calculation for a CCPC

Basic Part I tax – ITA 123(1)	(38%)(Taxable income)
Less: Federal abatement for provincial tax, ITA 124(1) Income earned outside of Canada is not eligible for the abatement	(10%)(Taxable income earned in Canada)
Add: Additional refundable tax (ART) on CCPC Aggregate Investment Income (AII), ITA 123.3	10 2/3% * Passive income
Less: General rate reduction, ITA 123.4 General rate reduction applies to active business income not eligible for SBD	(13%)(Taxable income not impacted by SBD or AII)
Less: Small business deduction, ITA 125(1). Available for ABI eligible for the SBD	(19%)(Taxable Income eligible for SBD)
Part I tax payable	$ ___________

As you can see, clearly identifying the different types of income (ABI <= SBD, ABI > SBD, passive income) is imperative when calculating a corporation's tax payable. Each source of income determines what should be applied when calculating the tax payable for a corporation.

References and Resources

- *Income Tax Act*, RSC 1985, c1, (5th Supp.) ss 123(1), 124(1), 123.3, 123.4, 125(1), 125(7), 129(1)
- “Taxation Primer”, 2019 edition, author: CPA Canada, p.39-41.

9.7 What is the General tax rate and the General rate reduction?

JERRED FLYNN

What is the Basic Corporate Rate?

The Basic Corporate Rate is the base tax rate that applies to businesses in Canada. This is a permanent rate, which is then altered by other devices: the Small Business Deduction, the Additional Refundable Tax, and the General Rate Reduction to get your overall corporate tax rate for each type of income. The Basic Corporate Rate is 38%, as of 2022 (ITA 123. (1)(a)).

What is the General Rate Reduction?

The General Rate Reduction (GRR) is applied to Active Business Income not eligible for either the Small Business Deduction or the Additional Refundable Tax. At its core, it is designed to incentivize businesses to focus on generating Active Business Income rather than Investment Income, since the GRR does not apply to Aggregate Investment Income.

How Does It Work?

In short, income that is neither Aggregate Investment Income (which has the Additional Refundable Tax applied to it) nor claimed under the SBD is eligible for the GRR. As of 2022, the GRR is a 13% reduction of the Basic Corporate Rate (ITA 123.4). This is a number that is subject to change periodically, to increase or decrease the income tax that corporations pay.

For example, a new board game design and development company, Game Heretics Designs, has Taxable Income of $50,000. Contained in that Taxable Income is $7,500 of investment income. Additionally, only $20,000 of the income earned is eligible for the Small Business Deduction, as their associated manufacturing company claimed most of the Business Limit. With these conditions, their tax formula would look like the following (assuming all their income was earned in Canada):

	Passive Investment Income	Active Business Income eligible for SBD	Active Business Income Ineligible for SBD	Total Tax Owing
Basic Tax Rate	38% * $7,500	38% * $20,000	38% * $22,500	$19,000
Provincial Abatement	(10%) * $7,500	(10%) * $20,000	(10%) * $22,500	($5,000)
SBD	N/A	(19%) * $20,000	N/A	($3,800)
ART	10.7% * $7,500	N/A	N/A	$802.50
GRR	N/A	N/A	(13%) * $22,500	($2,925)
Effective Tax Rate/Tax Owing	38.7% * $7,500 =$2,902.50	9% * $20,000 =$1,800	15% * $22,500 =$3,375	$2,902.50 +1,800 +3,375 $8,077.50

As this example illustrates, the ability of the government to adjust the functional tax rate by adjusting the General Rate Reduction is much more effective than adjusting the Basic Tax Rate, since doing so would require them to adjust the Small Business Deduction, Provincial Abatements, Additional Refundable Tax, *and* the General Rate Reduction to ensure that the preference given to Active Business Income earned in Canada remains intact. This is also important for public corporations, as their **entire** income earned in Canada is taxed at the same functional rate as a CCPC's active business income which is ineligible for SBD (i.e. the 15% GRR rate as of 2022).

Note that as the M&P deduction rate (13%) is the same as the GRR (13%) we typically don't worry about the M&P rate in this course as the tax payable amount would be the same under either method.

References and Resources

Income Tax Act, RSC 1985, c1, (5th Supp.) 123.4(1), 123.4(2)

9.8 What is the Small Business Deduction and how is it determined?

PUNEET BERING

Small Business Deduction ITA 125

Small business deduction (SBD) ITA 125 (1.1) refers to a reduction in tax which is payable by a Canadian-controlled private corporation in a taxation year.

SBD is equal to SBD rate of (19%) for the taxation year multiplied by lessor of:

1. active business income of the corporation in Canada (excluding certain income and exceeding certain losses) – **ITA 125(1)(a)(i)**
2. taxable income of the corporation for the year less estimated foreign income (see below for details) – ITA 125(1)(b)
3. business limit of the corporation for the year – ITA 125(1)(c)

Taxable income less foreign income ITA 125 (1)(b) **–** The foreign income calculation in this formula is based on the foreign tax credit rather than the actual foreign income and changes depending on whether the foreign income is business related as follows:

- – foreign income is estimated at 100/28 of the foreign tax credit for foreign non-business income
- – foreign income is estimated at 4 X the foreign tax credit for foreign business income

Business Limit

Business limit ITA 125(2) for a corporation is $500,000 for a taxation year unless it is associated with another CCPC. If a CCPC is associated with one or more corporations in a taxation year, then the business limit can be split amongst the associated corporations. CCPC's can assign all or a part of their business limit to another CCPC for a taxation year.

Business Limit Reduction ITA 125 (5.1)

A CCPC's business limit is reduced by the greater of taxable capital business limit reduction and passive income business limit reduction.

- *Taxable capital business limit reduction* – Large CCPC's with more than $15M do not qualify for SBD. The business limit is reduced on a straight-line basis for corporations that have taxable capital between $10M to $15M in previous years.
- *Passive income business limit reduction* – A CCPC's business limit is reduced if the corporation or any other associated corporation combined earn $50,000 to $150,000 from passive investments.

References and Resources

- *Income Tax Act*, RSC 1985, c1, (5th Supp.) s 125
- Article – "Small business deduction rules" (Author: Government of Canada)
- Article – "T2 Corporation – Income Tax Guide – Chapter 4: Page 4 of the T2 return" (Author: Government of Canada)

9.9 What are the associated company rules? How do they impact the small business deduction? Why do they exist?

AMANEET DHUDWAL

Associated Companies

The $500,000 business limit must be shared amongst associated CCPC's. If this rule did not exist, then corporations would max their small business deduction (SBD) limit at $500,000 then open and transfer excess active business income into another corporation and max their SBD deduction there.

One corporation is associated with another in a taxation year if: (ITA 256(1))

- One of the corporations is controlled indirectly or directly by the other corporation – ITA 256(1)(a)
- Both of the corporations were controlled indirectly or directly by the same person or group of persons – ITA 256(1)(b)
- Each of the corporations were controlled indirectly or directly by a person; and the person who controlled one of the corporations was related to the person who controlled the other; and one of them has to own at least 25% of the shares of each corporation – ITA 256(1)(c)
- One of the corporations were controlled indirectly or directly by a person; and that person was related to each member of a group of persons that controlled the other corporation; and that person owns at least 25% of the shares of the other corporation – ITA 256(1)(d)
- Each of the corporations was controlled indirectly or directly by a related group; and each member of one of the groups was related to all the other members of the other group; and one or more persons who are members of both related groups (either alone or together) own at least 25% of the shares of each corporation – ITA 256(1)(e)

These rules are put into place to prevent companies from taking advantage of the small business deduction.

Example 9.9.1

If associated company rules did not exist:

Corporation X has $1,000,000. They would be able to use the maximum business limit of $500,000 with Corporation X and then set up a subsidiary corporation (ex. Corporation Y) and transfer up to half of their business ($500,000) to the subsidiary corporation to double-dip on the Small Business Deduction.

Illustration 1:

CORPORATION X
Amount: $1,000,000

Corporation X	Corporation Y
$500,000	$500,000

With the association rules, Corporation X and Y are associated (as Corp X directly control Corp Y) and must decide how they want to allocate the $500,000 Small Business Deduction limit. i.e. Corporation X could take $300,000 and Corporation Y could take $200,000. This can be shared however they like, but the total amount amongst the associated companies cannot exceed $500,000.

References and Resources

- *Income Tax Act*, RSC 1985, c1, (5th Supp.) s 256(1)

9.10 What is a Small Business Corporation? Explain any tax advantages of being a Small Business Corporation.

MORGAN CAMPBELL

What is a Small Business Corporation?

According to ITA 248(1) a small business corporation (SBC) is essentially a corporation that is a Canadian Controlled Private Company (CCPC) that has all or substantially all (90% or more) of the fair market value of its assets engaged in:

- Being used to carry on active business (primarily) in Canada or by a related corporation
- Shares or debts of related corporations that used to be small business corporations
- A combination of the two

What is a Qualified Small Business Corporation?

It is important to note that while all Qualified Small Business Corporations (QSBC's) are SBC's not all SBC's are QSBC's. In order for small business corporation shares to be a QSBC they must satisfy all of the following criteria according to ITA 110.6(1):

- At the time the shares are sold, it was a share of the capital stock of a small business corporation and owned by the taxpayer or their spouse or common-law partner, or a partnership of which the taxpayer is a member.
- For 24 months before the share was sold it remained a share of a CCPC with primarily (50% or more) in active Canadian business and satisfies the requirements of being a Small Business Corporation.
- For 24 months before the share was sold, no one owned the share other than the taxpayer, or member of a partnership

What are the tax implications of being a Small Business Corporation (particularly how does it tie into Business Investment Losses and the Lifetime Capital Gains Exemption)?

Having a business that meets the criteria of a small business corporation can present several desirable tax advantages.

One of the most apparent is the Lifetime Capital Gains Exemption. This permits the sale of shares in an applicable company tax free, for up to $850,000. However, it is important to note that according to ITA 80.03(8) a corporation MUST meet the criteria of a qualified small business corporation in order to receive this exemption.

Another advantage for owners of small business corporation is business investment losses. For example, if an owner sells shares of his small business corporation at a loss (at arm's length) a business investment loss is created. Half of that loss qualifies as an allowable business investment loss (ABIL). As opposed to an allowable capital loss an ABIL can be deducted against ANY sources of income, for the taxpayer.

References and Resources

- *Income Tax Act*, RSC 1985, c1, (5th Supp.) ss 80.03(8), 248(1), 110.6(1)
- "Definitions for capital gains deduction" (Author: Government of Canada)
- "Canada: Qualified Small Business Corporation and Lifetime Capital Gains Exemption" (Author: Mondaq)
- "Income Tax Folio S4-F8-C1, Business Investment Losses" (Author: Government of Canada)

9.11 What is the Refundable Part IV tax and how is it determined? Why does it exist?

PAUL JHAJJ

Refundable Part IV tax applies to certain dividends received by private corporations in Canada. It is intended to prevent some corporate tax deferral opportunities as well as addressing double taxation problems that might occur when dividends are paid from corporation to corporation. It even ties into the overall tax concept of integration. The refundable part IV tax is calculated as follows ITA 186(1):

- Dividends Received from "portfolio dividends" from non-connected corporations (own less than 10% of voting shares): Part IV tax equals 38 1/3% of the total dividend received.
- Dividends received from connected corporations (own more than 10% of voting shares): Part IV tax equals the recipient's ownership % of the payor corporation × the dividend refund received by the payor corporations.

Example 9.11.1

Opal Ltd., a Canadian controlled private corporation, received the following amounts of dividends during the year ending December 31, 2020

- Dividends on Various Portfolio Investments: $14,000
- Dividends on Emerald Inc: $41,500
- Dividends From Ruby Inc: $18,000

Opal Ltd. Owns 100 percent of the voting shares of Emerald Inc. and 30 percent of the voting shares of Ruby Inc. (which approximates the fair value of Opal's ownership as well). As a result of paying the $60,000 dividend, Ruby Inc. received a dividend refund of $15,000. Emerald Inc. received no dividend refund for its dividend payment.

How much Part IV Tax must Opal Ltd. pay as a result of receiving these dividends?

Solution

The amount of Part IV Tax Payable would be calculated as follows:

- Tax On Portfolio Investments [38 1/3%) ($14,000)] $5,367
- Tax on Emerald Inc. Dividends $Nil
- Tax On Ruby Inc. Dividends [(30%) (15,000)] $4,500
- Part IV Tax Payable $9,867

9.12 How do the various corporate tax rates tie into the concept of integration?

CHANPREET KANG

The idea behind integration is that regardless of how you earn your income (through a corporation or directly) the ultimate amount of after tax cash should be the same. This should be true regardless of whether a corporation earns active or passive income or pays out eligible, non-eligible or capital dividends. This is illustrated below:

Eligible Dividend		**Non-Eligible Dividend**		**Capital Dividend**	
Income	$2,000.0	Income	$2,000.0	Income	$2,000.0
Tax Rate (27.54%)	$550.8	Tax Rate (13.79%)	$275.8	Tax Rate (0%)	
Net Income	$1,449.2	Net Income	$1,724.2	Net Income	$2,000.0
Cash Dividend Received	$1,449.2	Cash Dividend Received	$1,724.2	Cash Dividend Received	$2,000.0
Gross Up (138%)	$2,000.0	Gross Up (116%)	$2,000.0	Gross Up (0%)	
Personal Tax Rate (15%)	$300.0	Personal Tax Rate (15%)	$300.0	Personal Tax Rate (0%)	$ –
Dividend Tax Credit	$550.8	Dividend Tax Credit	$275.8	Dividend Tax Credit	$ –
Cash After Tax	$1,700.0	Cash After Tax	$1,700.0	Cash After Tax	$2,000.0
Employment Income					
Income	$2,000.0				
Personal Tax Rate (15%)	$300.0				
Cash After Tax	$1,700.0				

Note: There is a minor mathematical issue in the non-eligible dividend portion of the table above. The corporate tax rate should be slightly lower, the gross up should be 115% rather than 116% and the dividend tax credit would be slightly lower.

This figure shows that you end up with the same amount of after tax cash (for a given income type) regardless of whether it was earned directly or received through corporate dividends. This applies to capital dividends as well as they are flowed through tax free to the shareholder (to represent the tax free portion of capital gains).

Passive or aggregate investment income is taxed very differently compared to the other forms of income. It is taxed at a very high rate and a large amount of this tax goes into the non-eligible RDTOH account. Ultimately this amount is refunded to the corporation when they subsequently pay out non-eligible dividends. The tax rate on aggregate investment income less the dividend refund (when dividends are subsequently paid out) bring the net amount of tax paid on AII to an amount similar to Active Business Income eligible for the Small Business Deduction. For this reason, AII creates non-eligible dividends even though it is initially taxed at a very high rate.

References and Resources

- Article – taxable amount of dividends (eligible and other than eligible) from taxable Canadian corporations, (Author: Government of Canada)
- Article – Income Tax Folio S3-F2-C1, Capital Dividends, (Author: Government of Canada)
- Article – Federal Dividend Tax Credit, (Author: Government of Canada)
- Article – T2 Corporation – Income Tax Guide – Chapter 7: Page 8 of the T2 return (Author: Government of Canada)

9.13 How are capital dividends treated for tax purposes? How does this tie into the concept of integration?

GURLEEN KAUR

The Capital Dividends are tax-free dividends that are paid out to the shareholders of the corporation as a form of return on investment. The tax-free surpluses of the corporations are accumulated in the capital dividend account (CDA). The balance in CDA is also increased by Capital dividends received.

A corporation can issue capital dividends up to the amount in the capital dividend account. For example, Breeze Co. has a capital gain of $52,000. One-half of this gain would be a taxable capital gain i.e. $52,000 x 50%= $26,000, and the other half ($26,000) is the non-taxable portion of the capital gain which goes into the CDA account.

Capital Dividends and Integration

The goal of tax integration is that an individual should have the same amount of after-tax cash regardless of whether the income was earned directly or through a corporation. Since capital dividends are tax-free dividends, the tax rate at the corporate level and individual level is the same (i.e. they are tax free).

The table below illustrates the concept of tax-free dividends tied with integration. For Breeze Co., half of the capital gain i.e. the non-taxable portion, is paid out to the corporation's shareholders tax-free resulting in the pre-tax earnings amount to be the same as the post-tax amount (at Corporate level). Similarly, at the individual level, since the capital dividends are paid out tax-free, when the dividends are received by the shareholders, both the pre-tax and post-tax amounts are the same. Hence, the net earnings paid out at the corporate level and individual level is the same, eliminating the problem of double taxation.

• Capital Dividends- Non-taxable portion of the capital gains which are paid out to the shareholders tax-free.	$52,000 X 50% =$26,000
CORPORATION	
Capital Dividend paid-out	$26,000
Less: Corporate Tax (Capital dividends are Tax-free)	$ –
Net earnings	$26,000
INDIVIDUAL SHAREHOLDER	
Capital Dividends received	$26,000
Less: Individual Income Tax (Capital dividends are Tax-free)	$ –
Net earnings	$26,000

So, in the example above, the shareholder would receive a capital dividend and after tax cash of $26,000 (on the non-taxable portion of the capital gain). This is the same amount of after tax cash the individual would have received if the taxable capital gain was taxed directly (and not through a corporation).

References and Resources

- Article- "Income Tax Folio S3-F2-C1, Capital Dividends" (Author: Government of Canada)
- *Income Tax Act*, RSC 1985, c1, (5th Supp.) s 89(1)(a)

9.14 As an owner of a company, when is it beneficial to claim employment income (salary) rather than dividends (and vice versa)?

NAVJOT LALLI

In chapter 2, we learned the theory of integration. However, perfect integration rarely exists due to different provincial personal and corporate tax rates as well as differing tax credits. Therefore, as an owner of a company you can choose the most tax-efficient type of remuneration for you and your company. To determine which remuneration is most beneficial, calculate both the corporation's and owner-manager's after-tax position using the appropriate provincial tax rates and credits and compare the two accordingly.

Note, the tax rates and dividend tax credits for BC and Ontario – in the following examples – are intended to be illustrative (to show how the various provincial tax rates can impact salary vs. dividend decisions) and are not necessarily intended to accurately reflect the actual tax rates in those provinces. Also, we are ignoring some elements (like CPP and most personal tax credits) to focus on the key salary vs dividend concepts.

Table 1 illustrates the outcome of paying an owner-manager a salary or dividend income of $100,000 from a small CCPC that generated $300,000 in active business income.

Table 1: Corporation's after-tax position (2019 rates)

	British Columbia		Ontario	
	Salary	**Dividend**	**Salary**	**Dividend**
Active business income	$300,000	$300,000	$300,000	$300,000
Less: Salary & CPP	(100,000)	–	(100,000)	–
Corporate taxable income	200,000	300,000	200,000	300,000
Less: Corporate tax (11% in BC and 12.5% in Ontario)	(22,000)	(33,000)	(25,000)	(37,500)
Less: Dividend to shareholder (Non-eligible dividend)	–	(100,000)	–	(100,000)
Retained earnings	$178,000	$167,000	$175,000	$162,500

Table 2 illustrates the owner-manager's after-tax position from the scenario above. Here, dividend income results in greater net income for the owner-manager but receiving dividend income does not allow the owner to contribute into CPP or build RRSP contribution room.

Table 2: Owner-manager's after-tax position (2019 rates)

	British Columbia		Ontario	
	Salary	**Dividend**	**Salary**	**Dividend**
Salary	$100,000	–	$100,000	–
Non-eligible dividends	–	$100,000	–	$100,000
Non-eligible dividend gross-up (1.15)	–	15,000	–	15,000
Taxable income	100,000	115,000	100,000	115,000
Less: Income tax (22.6% avg in BC and 23.6% avg in Ont)	(22,600)	(25,990)	(23,600)	(27,140)
Dividend Tax Credit – In this example Ontario has a better DTC than BC. Note, other personal tax credits have been ignored.		14,500		15,500
After tax cash (Cash dividend – tax + dividend tax credit)	$77,400	$88,510	$76,400	$88,360

Table 3 illustrates a summary of both the corporation's and owner-manager's after-tax position. Ultimately, receiving employment income provides slightly greater total earnings than dividend income in both provinces, but this will not always be the case due to differing provincial tax rates and credits.

Table 3: Summary of corporation's and owner-manager's after-tax position

	British Columbia		Ontario	
	Salary	**Dividend**	**Salary**	**Dividend**
Corporate retained earnings	$178,000	$167,000	$175,000	$162,500
Owner-manager's after tax cash	77,400	88,510	76,400	88,360
Total earning and after tax cash	$255,400	$255,510	$251,400	$250,860

So, in these examples there are more retained earnings (and cash) within the corporation by paying out salaries and more after tax cash in the hands of the individual by paying out dividends. This is a very simplified example, if you were doing tax planning with your client you would need to consider the specific after tax cash needs, the specific tax rates and dividend tax credits for your province, personal tax credits available etc.

ADDITIONAL RESOURCES

Chapter Overview

Describe scholarships and how they are treated for tax purposes
What are the key rules related to an RESP?
What is GST? What is the difference between GST and HST? Who pays and who charges GST? (6.7.1)
How are fully taxable, zero-rated and exempt supplies treated for GST purposes? (6.7.2)
In your own words how would you differentiate the kinds of items that are categorized as taxable, zero-rated or exempt supplies? Provide some examples of each. (6.7.2)
Who is required to register for GST? When are you required to register for GST? (6.7.2)
How is the GST payable/receivable calculated? What is the 'quick method' and when might it be relevant? (6.7.3)
What are the GST filing deadlines? What are the GST instalment and final payment deadlines? (6.7.4)
What are the penalties and interest for late filing of GST return? What are the penalties and interest for late instalments and final payments of GST? (6.7.4)
What are the GST implications on taxable benefits? (6.7.5)
What are some GST considerations when transacting with non-residents? (6.7.6)

Describe scholarships and how they are treated for tax purposes

BOBINPREET SINGH

Definition of Scholarships under ITA

Effectively, scholarships are amounts received by the taxpayer in the year for scholastic pursuits. Under ITA 56(1)(n) the amount of scholarships received that exceed the scholarship exemption for the year are included in "Other Income" for purposes of calculating Net Income for Tax Purposes. Luckily the "scholarship exemption" (as defined in ITA 56(3)) is very broad and, usually, as long as the student meets the following criteria the scholarship will not be taxable.

- Enrolled as a full-time student in a qualifying educational program at a designated educational institution, or
- Enrolled at a designated educational institution in a specified educational program that requires at least 12 hours of course work (student effort) per month."

The definition of 'full-time student', 'qualifying educational program', 'designated educational institution' etc. can be found in ITA 118.6(1)

Example

Basant Motors, an auto dealership located in Surrey, provides a scholarship of $1,400 every year to two students in the region. After carefully screening the transcript of various students who applied for the scholarship, they have decided to move forward with the following students:

1) Bobinpreet Singh- A full time student, pursuing an accounting degree at Kwantlen Polytechnic University

2) Jagdeep Singh- A part time student, pursuing a diploma in Ecological Restoration at Kwantlen Polytechnic University. Due to work demands, he is only taking 1 course at this time and the duration of the course is 2 weeks.

The impact of this scholarship on their Net Income for Tax Purposes (NITP) will be as follows:

Bobinpreet Singh	Jagdeep Singh
Bobinpreet is a qualifying student (full-time student) taking a qualifying educational program (accounting degree) at a designated educational institution (Kwantlen). Therefore his scholarship is exempt and will not be included in his NITP.	As Jagdeep is a part-time student in a course that is less than 3 weeks long, this is not a 'qualifying educational program' and the scholarship is not exempt (other than the basic $500 exemption). He must include $900 as "Other Income" after taking the $500 basic scholarship exemption (ITA 56(1)(n)(ii))

Interactive content

Author: Bobinpreet Singh, March 2019

Interactive content

Author: Opraj Purewal, June 2019

References and Resources:

- *Income Tax Act*, RSC 1985, c 1 (5th Supp.), ss 56(1)(n), 118.6(1)
- "Income Tax Folio S1-F2-C3, Scholarships, Research Grants and Other Education Assistance" (Author: Government of Canada)
- Chartered Professional Accountants. (2022). The Chartered Professional Accountant Competency Map. Part 1: The CPA Competency Map: 6.3.2

What are the key rules related to an RESP?

H. KHOSA

A Registered Education Savings Plan (RESP) is a contract between the Subscriber and the Promoter for the Beneficiary to have a chance at attaining higher education. The Subscriber is the person who set up the RESP and is usually the primary caregiver (often the parent) of the Beneficiary. The Beneficiary is the child who will use the RESP for education costs.

There are two types of promoters for RESP's: financial institutions (ex. RBC or Credit unions) and group scholarship providers (ex. Canadian Scholarship Foundation). The Promoter is the one who organizes all the detail and manages the RESP. They are also the ones who pay the contributions to the Beneficiary. The Beneficiary must be a resident of Canada.   Unlike an RRSP, Subscribers cannot deduct the contributions to an RESP from their income on their income tax return.

How do you contribute to an RESP?

It depends on your RESP promoter. For example, you may have entered a plan where your provider requires a certain amount of contributions monthly or annually each year. Others let the Subscriber contribute to the plan whenever the Subscriber wants. As of 2019 the maximum amount for a Subscriber to contribute to an individual's RESP is $50,000 during their lifetime.

There is also a federal government grant that is called the Canada Education Savings Grant (CESG).   As of 2019, the maximum lifetime amount that the CESG can provide is $7,200. The CESG is 20% on the first $2,500 or less per year of contributions made by the Subscriber to an RESP. There are additional CESG amounts available to help out lower income families as follows:

> "10% on the first $500 of annual personal contributions for children from families with an adjusted family net income between $46,605 and $93,208." (CRA)

> "20% on the first $500 of yearly personal contributions for children from families with an adjusted family net income of $46,605 or less." (CRA)

How do you optimally withdraw $ from an RESP?

The best way to withdraw money from an RESP is by having the Beneficiary pursue post-secondary education. The Subscriber's contribution, the CESG, and accumulated earnings are paid out to the Beneficiary as Educational Assistance Payments (EAP). The Subscriber's contribution is not taxable to the Beneficiary or Subscriber, but the CESG and accumulated earnings are taxable income to the Beneficiary.

If the Beneficiary does not use the RESP, the Subscriber has a few options. Firstly, the RESP can be transferred to another Beneficiary, or the RESP can be refunded. The original Subscriber contribution can be returned to the Subscriber tax-free. For the accumulated earnings it depends on what kind of plan the Subscriber has. Some plans forfeit the earning or they can be paid out as Accumulated Income Payments (AIP) to the Subscriber. AIP is subject to regular income tax plus an additional 20% tax, or 12% for residents of Quebec. In general it is much better to have the Beneficiary withdraw amounts while they are attending school because usually, the Beneficiary's income level is low at that time.

Example: RESP amounts		**On Withdrawal**
Subscriber's contribution	$24,000	Not taxable
CESG grant	$7,200	Taxable
Accumulated earnings (5% rate of return)	$10,005	Taxable
Total in RESP	$41,205	

Interactive content

Author: H Khosa, March 2019

Interactive content

Author: Saijal Arora, June 2019

References and Resources:

- *Income Tax Act*, RSC 1985, c 1 (5th Supp.), s 146.1(1)
- Article-"Registered Education Savings Plans"(Author: Government of Canada)
- Article-"What is a Registered Education Savings Plans (RESPs)?"(Author:TaxTips.ca)
- Chartered Professional Accountants. (2022). The Chartered Professional Accountant Competency Map. Part 1: The CPA Competency Map: 6.3.3

What is GST? What is the difference between GST and HST? Who pays and who charges GST? (6.7.1)

Interactive content

Author: Parveen Kaur, January 2020

Interactive content

Author: Parveen Kaur, January 2020

How are fully taxable, zero-rated and exempt supplies treated for GST purposes? (6.7.2)

Interactive content

Author: Stone Lacroix, January 2020

Interactive content

Author: Ramanpreet Kaur, January 2020

Interactive content

Author: Ramanpreet Kaur, January 2020

In your own words how would you differentiate the kinds of items that are categorized as taxable, zero-rated or exempt supplies? Provide some examples of each. (6.7.2)

Interactive content

Author: Harpreet Lehal, January 2020

Interactive content

Author: Serena Manhas, January 2020

Who is required to register for GST? When are you required to register for GST? (6.7.2)

Interactive content

Author: Chandani Pasricha, January 2020

How is the GST payable/receivable calculated? What is the 'quick method' and when might it be relevant? (6.7.3)

Interactive content

Author: Teodora Pirvu, January 2020

Interactive content

Author: Lashmen Sandhu, January 2020

What are the GST filing deadlines? What are the GST instalment and final payment deadlines? (6.7.4)

Interactive content

Author: Praksha Sharma, January 2020

Interactive content

Author: Manpreet Sanghra, January 2020

What are the penalties and interest for late filing of GST return? What are the penalties and interest for late instalments and final payments of GST? (6.7.4)

Interactive content

Author: Harkirat Singh, January 2020

Interactive content

Author: Michael Stegar, January 2020

What are some GST considerations when transacting with non-residents? (6.7.6)

Interactive content

Author: Mallika Verma, January 2020

Interactive content

Author: Matthew Yee, January 2020

Version History

This page provides a record of changes made to the open textbook since its initial publication. If the change is minor, the version number increases by 0.1. If the change involves substantial updates, the version number increases to the next full number.

Version	Date	Change	Affected Web Rage
1.0	August 8, 2024	Publication	N/A