

Intro to Income Tax

Popular Conception



**Canada Customs
and Revenue Agency**

**Agence des douanes
et du revenu du Canada**

1040 EZ 2 DO TAX FORM New Simplified Tax Form

1. How much money did you make? \$_____

2. Send it to us.

Canada



Forms of Taxation

- Income Tax
- Property Tax
- Consumption Tax
- Value Added Tax
- Tariffs or Customs Duties
- Transfer Tax
- User Tax
- Capital Tax
- Head Tax

Classifications of Taxation

Regressive

The HST is considered Regressive. As income rises, an individual spends less of their income on goods as a %. Therefore pays less HST.

Ex.

Mr. A earns \$300,000 and incurs \$10,000 in HST (3% of income paid).

Mr. B earns \$40,000 and incurs \$10,000 in HST (25% of income paid).

Classifications of Taxation

Progressive

The Income Tax is considered Progressive. As income increases, tax rates rise.

Example:

Up to \$43,000	24.1%
\$43,001 to \$87,000	34.1%
\$87,001 to \$135,000	38.4%
\$135,000 and up	43.3%



Pitfalls from Progressive

Complexity – splitting income to reduce rates

Income Fluctuations – high/low year over year

Family Unit Problems – one earner vs. two

Economic Growth – Disincentive to earn more

Tax Concessions – Ability for high income to plan

Tax Evasion – Discourages income reporting

History of Income Tax

‘Temporary’ war tax established to fund World War I in 1917.

Used for:

- Resource Allocation
- Distribution Effects
- Stabilization Effects
- Fiscal Federalism

Textbook quote on the ITA. “..running about 2,000 pages and which in our opinion, cannot be readily understood by most individuals.”



Why Study Tax?

Large Corporate Planning – Offshoring?

Entrepreneurs – Local sources of
employment

Individuals – Optimizing resources



Goals of Planning

Tax avoidance or reduction

Tax deferral

Income Splitting

The Income Tax Act (ITA)

6(1) “There shall be included in computing the income of a taxpayer for a taxation year as income from an office or employment such of the following amounts as are applicable:

(a) The value of board, lodging and other benefits of any kind whatever received or enjoyed by the taxpayer in the year in respect , in the course of, or by virtue of an office or employment, except any benefit...

The Income Regulations (ITR)

ITA

Elections available to be late filed are as prescribed.

ITR

For the purposes of subsection X(X) the following are prescribed elections:

Treaties

Example: US-Canada Income Tax Convention

If a taxpayer is liable for tax in both the US and Canada, the treaty will intervene so the taxpayer only pays tax in one country.

Uses: Avoiding Double Taxation OR Create Tax Avoidance

Bermuda does not tax capital gains. Gains that can be shifted into Bermuda instead of Canada will reduce overall taxes owing.

Interpretation Bulletins (Folios)

IT-533-- Interest Deductibility and Related Issues

Disappearing source rules 19. In general terms, the disappearing source rules in section 20.1 apply where borrowed money ceases to be used for the purpose of earning income (i.e., the borrowed money can no longer be traced to any income earning use). Generally, the borrowed money that is no longer linked to any income earning use is nonetheless deemed to be used for the purpose of earning income such that interest continues to be deductible for that portion of the borrowed money. Several specific conditions in section 20.1 must be met for that section to apply.

Example 6 Mr. O acquired property P with \$1,000 of borrowed money, the entire amount of which remains outstanding and the interest thereon is deductible. Mr. O subsequently disposed of property P for its fair market value of \$600 and used the \$600 to reduce the outstanding loan. If the conditions in section 20.1 apply, the remaining \$400 of borrowed money would be deemed to be used for the purpose of earning income and the interest thereon would continue to be deductible.

Others

Court Cases

Tax Court of Canada, Federal Court of Appeal, Supreme Court of Canada

CRA website

www.cra.gc.ca (old)

www.Canada.ca/en/revenue-agency.html (new)

Levels of Courts - Taxation

Level 3

Supreme Court

Tax cases are heard by lower courts first.

The decision of a lower court can be “appealed” to a higher court for a new answer.

The higher court does not have to agree to the appeal.

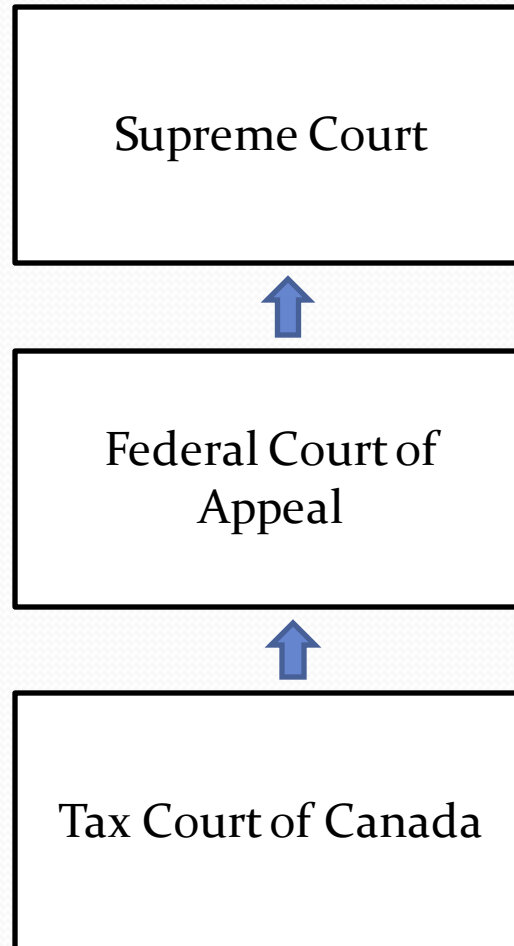
Higher court decisions have greater precedence.

Level 2

Federal Court of
Appeal

Level 1

Tax Court of Canada



Liability for Taxes

Persons

Include:

- Individuals (Natural persons)
- Corporations (Limited, Ltd, Incorporated, Inc.)
- Trusts

But not:

- Partnerships



Provincial and Federal Taxation

- Separate Tax Acts.
- Federal is more comprehensive, provinces tend to mimic
- Combined Reporting (except QC)

Credits used in this course will be the Federal, where possible I will use combined tax rates assuming residence in NB.



Residency in Canada (Federal)

Corporations

- Incorporated in Canada
- Shareholders or directors reside in Canada

Individuals

- House
- Spouse
- Children
- Employment
- Investments/bank accounts
- Assets and licenses
- Time and duration of visits

Residency in a Province

Corporations

- Wages paid in the province
- Revenues earned in the province

Individuals

- Location of residency on December 31st.

Basic Tax Concept

+ Earnings

- Expenditures to earn income (deductions)

Taxable Income

x Applicable Rate (provincial + federal)

Taxes Owning

(tax credits)

Net Taxes Owning

Net Income for Tax Purposes

- Net Employment Income
- Net Business Income
- Net Property Income
- Capital Gains and Losses
- Other Income
- Other Deductions
- Losses – Capital or Non-Capital

Administration

Who is in Charge of Tax?

Department of
Finance (Government)

Creates the laws

Canada Revenue
Agency (CRA)

Administer the laws
Collect the taxes

Department of Justice
(Courts)

Settle Disputes

fis·cal

/ˈfɪskəl/ 

adjective

1. of or relating to government revenue, especially taxes.
"monetary and fiscal policy"
synonyms: budgetary; [More](#)

noun archaic

1. a legal or treasury official in some countries.



Fiscal

- Wrong
 - This information you gave me is very **fiscally**
- Right
 - The match-making industry is subject to special **fiscal** conditions.

Important Individual Dates

- Individual Fiscal Year Ends
 - December 31 if alive
 - Date of death if died in the year
- Individual Tax Return Due Dates
 - April 30 if alive and no Business Income
 - June 15 if alive with Business Income
 - The later of regular due date or 6 months after death.

Important Individual Dates

- Individual Tax Payment Due Date
 - April 30th if alive
 - April 30th (!!) if alive with Business Income
 - The later of April 30th or 6 months after death.**

Important Individual Dates

- Example:

- Sam has business income, and hasn't passed away in 2014
- Tax Return due June 15, 2015
- Tax Payment due April 30, 2015

- Example:

- Sam has business income, and passes away Sept 15, 2014
- Tax Return due June 15, 2015 (later of 6 mo & reg due date)
- Tax Payment due April 30, 2015

Important Individual Dates

- Example:

- Sam has no business income, and hasn't passed away in 2014
- Tax Return due April 30, 2015
- Tax Payment due April 30, 2015

- Example:

- Sam has no business income, and passes away Dec 25, 2014
- Tax Return due June 25, 2015 (later of 6 mo & reg due date)
- Tax Payment due June 25, 2015

Individuals – How Taxes Are Paid

- **By Employers**

- Payroll taxes are withheld by an employer before salary or wages are paid to an employee.

- **By Banks**

- Lump sum payments such as: Retiring allowances, RRSP withdrawals, and RESP withdrawals typically also have withholding tax on them.

Individuals – How Taxes Are Paid

- **Self-Employed**

- No withholdings for self-employed individuals or contractors. These individuals may end up owing tax on their tax returns.

- **Quarterly Instalments**

- Where taxes owed on filing an individual tax return are \$3,000 or higher in the current year, and in one of the two preceding years, instalments will be required in the next fiscal year.

Individuals - How Taxes Are Paid

- **Instalments - Example**

- \$3,000 taxes owing on tax return in 2012, \$1,000 owing in 2011, and \$4,000 owing in 2010. Instalments required for 2012.

- **Final Calculation on T1**

- After taxes are withheld or instalments are made, the personal tax return calculates final taxes owing. Any shortfall is owed to CRA and any excess is refunded.

Individual Interest & Penalties

- Prescribed Amount – 2% currently
- + 2% = what CRA pays on refunds owing (4% total)
- + 4% = what CRA charges on balances due (6% total)
- Compounded Daily
- Interest is charged on top of penalties. Late filing penalty for personal tax returns is 5% of the balance owing plus 1% for each month to a maximum of 12 months (17%).
- For second offenses or where negligence exists, late filing penalties can be higher.

Reference

- T1 Personal Income Tax and Benefit Return
- T2 Corporate Income Tax Return
- T3 Trust Return (beneficiaries receive T3 Slips)
- T4 Statement of Remuneration Paid (employees receive T4 Slips)
- T5 Statement of Investment Income (investors receive T5 Slips)
- Other information forms exist. T3010 for charities, T1044 for Not-for-Profits, T2057 for Reorganization Transactions, etc, but these five are the basics.

Definition: Statute Barred

- Statute Barred is a term that means that a tax year is no longer eligible for review by the CRA or for requests by a taxpayer.
- In ordinary circumstances, 3 years after a tax return is assessed it becomes statute barred and CRA cannot open it for investigation unless fraud or negligence can be proven.
- In the case of fraud or gross negligence, an additional 3 year period is granted.

Tax Evasion

- **Definition**

- Willful intent to mislead the government and misrepresent taxable income.

- **Example**

- contractors paid in cash – CRA is clever at finding ways to identify these individuals.

- **Impact**

- Ability to impose fines and jail time where evasion is identified.

Tax Avoidance/Planning

- **Definition:**

- Does not involve breaking the law
- May circumvent the concept of fairness or the “spirit” of the law.

- **Where we come in**

- To be effective, tax planning should achieve the most positive result for taxpayers while agreeing with the intent of the law.

- **General Anti-Avoidance Rule (GAAR)**

- A ‘smell test’ provision to assist where the spirit of the act is violated but not the wording of the act.



Questions?