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

Level 2 — Federal Court of Appeal

Level 1 — Tax Court of Canada

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.

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.


N
W
E
S
Alaska
Yukon
Northwest Territories
Nunavut
Labrador
Labrador Sea
Newfoundland
British Columbia
Hudson Bay
Alberta
Manitoba
Quebec
Prince Edward Island
Ontario
Nova Scotia
Pacific Ocean
Saskatchewan
New Brunswick
Atlantic Ocean
USA
©VRBO 2009

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 Owing
(tax credits)

Net Taxes Owing

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)	Canada Revenue Agency (CRA)	Department of Justice (Courts)
Creates the laws	Administer the laws Collect the taxes	Settle Disputes

fis·cal

/ˈfiskəl/

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?

Income from Office & Employment

To Be Covered

- Key Terms & General Information
- Taxation of Fringe Benefits
- Deduction of Employment Expenses

Employment Definitions

Wages - $10/hour

Salary - $30,000/year

Remuneration – broad enough to mean any benefit received, not just payments.

Employment Definitions

Employment Insurance (EI)

Canada Pension Plan (CPP)

Old Age Security (OAS)

Who is an Employee?

An individual in the service to some other person

- Control over work performed
- Ownership of tools
- Ability to subcontract
- Financial Risk
- Investment Capital & Management Duties
- Opportunity for Profit
- Integration

Alternative: Independent Contractor

Example – Who is an Employee?

Claire has just gotten a job with XYZ Company.

She works from 9am – 5pm Monday to Friday at XYZ's office.

XYZ provides her with her computer, pens, and paper needed for the job.

Claire is not allowed to work for XYZ's competitors

Retrieved September 16, 2014 from:
http://wellbeingmagazine.co.uk/article/exercise-posture

Example – Who is an Employee?

Retrieved September 16, 2014 from:
http://multics.co.tz/index.php/about

Claire has just gotten a contract with ABC Company.

She is working on a project called HeliumX and believes it will take 6-8 months to complete.

Claire charges $15,000 for her work on the project. She works from home but occasionally travels on site to check on progress.

Claire's business card says '*Claire McCormick – Construction Consultant*'

Employee Perspective

Deductions – greater deductions available to Independent Contractors (self-employed)

CPP & EI – Greater benefits available to employees to draw on, Contractors must pay employee and employer share of CPP

Fringe Benefits – Employees Receive better benefits

Tax Evasion – Contractors under less reporting and withholding.

Employer Perspective

CPP & EI – Cheaper to hire contractor, but will be liable if ‘accidentally’ an employee

Fringe Benefits – Cheaper to hire contractor, may need to increase pay to compensate

Contracts – Commitments to contractors are usually less stringent. Short term projects

Legal Liability – a Contractor is liable for their own work quality. Employer is liable for employee work.

Net Employment Income

Wages, Salary, & Remuneration (Income Inclusions)

Less:

Expenses incurred to earn employment income (Deductible Expenses)

Equal:

Net Employment Income

Income Inclusions

Employment Income

Salary, Wages, Bonuses, and Benefits received by being an Employee of an organization.

Includes signing bonus, severance pay, and non-compete clauses.

Includes tips- which can be self assessed, otherwise CRA will deny.

Generally on a cash basis

Timing – Ordinary Payroll

<u>Corporations use the accrual method</u>

Payroll liabilities are deductible to them when incurred, or earned, by employees.

<u>Individuals use the cash method</u>

Employment income is taxable to them when received.

Retrieved September 15, 2014 from: http://business.financialpost.com/2013/08/07/employees-pay-capitalism/

Timing – Ordinary Payroll

A Co. has a Dec 31, 2014 year end. They pay their payroll on the 1st and 16th day of the month. As of year end, they will have accrued payroll from December 17-31st available to deduct on their Dec 31, 2014 tax return.

Because their employees don't receive the payroll until Jan 1, 2015, they won't pay taxes until their Dec. 31, 2015 tax return.

Deduction------Pay Salary-------------Save Tax-----------------------------------
Dec 31, 2014 January 1, 2015 June 30, 2015

------------------Receive Pay---Pay Tax-----
January 1, 2015 April 30, 2016

Timing - Bonuses

Taxable to the individual when received

Deductible to the employer when accrued

IF:

Bonuses must be paid within 180 days (on the 179th day) for these rules to apply, otherwise deductible when paid.

Retrieved September 15, 2014 from:
http://www.talentbridgeusa.com/referral-bonus-program/

Timing – Bonuses

A Co. Decides to pay a bonus to Jill on December 31, 2014. A Co. gets a deduction on their Dec. 31, 2014 tax return.

Because Jill doesn't receive the bonus until 2015, she won't pay taxes until her Dec. 31, 2015 tax return.

Deduction---------------Pay Bonus--------------Save Tax---------------------------
Dec 31, 2014 March 31, 2015 June 30, 2015

-------------------------Receive Bonus--Pay Tax
March 31, 2015 April 30, 2016

Example

Sam is an employee at XYZ Limited. In 2014 he received an annual salary of $35,000. He also calculated that he collected $6,000 in tips and his employer gave him a bonus for coming in over the New Years holiday. He received this bonus on January 2, 2015.

Calculate Sam's taxable income for 2014.

$35,000 – Salary (assumed received in cash) is taxable
$6,000 - Tips are taxable as received
<u>$0</u> - Bonus is taxable in 2015, since that is when it was received
<u>$41,000</u> Taxable Income

Fringe (Taxable) Benefits

Non-cash compensation provided by an employer.

In some cases may be received tax free, but in other cases must be included in the income of the employee.

These are considered: Taxable Benefits

Retrieved September 16, 2014 from: http://www.personneltoday.com/blogs/workplace-advice/2007/07/do-employees-know-what-their/

Gifts

Expected to be taxable
CRA provides exceptions where non-cash (but not 'near cash')

Non-taxable if:

$500 or less/employee annually for special events
$500 or less/employee for long service awards (5 year increments)

Must be arm's length with employer, excess is taxable

Gifts - Examples

Q. $600 in gift cards on a birthday

A. $600 Taxable

Q. $600 Figurine given on their anniversary

A. $100 taxable ($600 - $500 annual special occasion allowance)

Q. $300 given to a spouse of sole shareholder at Christmas

A. $300 taxable

Gifts - Test

Q. $300 in watch for birthday

A. $0 Taxable

Q. $700 25 year service award & $200 cash bonus for Christmas. Last service award was for 20 years.

A. $400 taxable ($200 cash + $200 excess long service award)

Q. $100 picture for Wedding & $400 earrings for Birthday

A. $0 taxable

Loyalty Programs

Example: Airmiles

Earned because of employment, but owned personally.

No taxation if not converted into cash or near-cash. Otherwise taxable when converted at the fair market value received.

- Exemption removed if clearly to avoid tax.
- Taxable if company card with points used by employee
- Taxable if single employee builds points by paying for many employees

Tuition

1. Specific Employer Related Training – No Benefit
   CPA training in a CPA firm

2. General Employment Related Training – No Benefit
   MBA/First Aid in a CPA firm

3. Personal Interest Training – Taxable Benefit
   Knitting, Music (unless musician)

Employer deducts regardless
Benefit rules apply to meals, travel and accommodations required for the training.

Taxable Benefits - Example

Harry Simpson works at XYZ Nuclear Company. He earns an annual salary of $50,000 and his employer also paid for him to take jazz saxophone lessons which cost $2,000. Harry's job is as a safety technician.

Calculate Harry's Taxable Income.

$50,000 – salary assumed received is taxable
$2,000 - tuition is taxable benefit – not for benefit of employer
$52,000

Taxable Benefits - Example

Harry Simpson works at XYZ Nuclear Company. He earns an annual salary of $50,000 and his employer also paid for him to take pipe fitting lessons which cost $2,000. Harry's job is as a junior plumber.

Calculate Harry's Taxable Income.

$50,000 – salary assumed received is taxable
$0 - tuition is non-taxable –directly relates to Harry's work
$50,000

Board & Lodging

Retrieved September 16, 2014 from:
http://canada.phillipmartin.info/canada_oilrig.htm

Taxable Except:

Employment at a temporary special work site

- Unreasonable to expect employee to commute

Employment at a remote work site

- Unreasonable to expect employee to establish residence because of distance to a community

Other Benefits

Taxable:

- Flights & Holidays
- Income tax preparation
- Spouse Costs
- Life Insurance

Non-Taxable:

- Employee Discounts (not below cost)
- Required Uniforms or Safety Gear
- Employer Provided Recreational Facilities
- Counseling re Health, Re-Employment, Retirement.
- Professional Membership Fees
- Health & Dental

When in Doubt

Consider the economic benefit and government intentions

Planning – Use of Benefits

Tax Avoidance

- Deductible to Employer – Health Plans, Tuition
- Non-Taxable to Employees

Tax Deferral

- Deductible to Employer Immediately – RPP
- Taxable to Employees in future

Allowances vs. Reimbursements

Allowances

- If not based on a reasonable measure – per/km for travel, it will be taxable.
  - $0.55 per km
  - $17 per meal

- General allowances for other items are taxable (educational allowance where costs aren't tracked)

Reimbursements

- Reimbursement of food, lodging, registration fees paid by the employee on behalf of the employer are non-taxable.

Examples

- Jimbo receives a $600 allowance per month to pay for his vehicle which he uses for work.
- $600 x 12 = 7,200 income
- Not reasonable since not based on mileage

- Jimbo receives an allowance of $0.52 per km that he drives. In 2013 he drove 2,000 km.
  - $0 taxable
  - Not in excess of CRA rates. Appears reasonable

Examples

- Jimbo recently paid $1,500 for registration in a conference and $425 for a hotel. His employer reimbursed him $1,925 once he submitted receipts.
- $0 taxable
- Direct reimbursement based on receipts

- Jimbo's employer paid him $2,000 so that he could enroll in a conference. They did not require any support for his costs.
  - $2,000 taxable
  - No support required, not a direct reimbursement.

Cars

- When employee provided, can charge back \$0.55/km driven for the first 5,000 km and \$0.49/km after
- When employer provided, employee receives taxable benefit for personal use:
    - Standby Charge +
    - Operating Benefits

Standby Charge

- When owned by corp:
  - 2% x (original cost of vehicle x # of days available to employee/30)
  - Easiest to think of as 2% x cost x months
- When leased by corp:
  - 2/3 x (lease costs for period available to employee – insurance) x (# of days available to employee/30)
- Reduction if used mostly for business:
  - Multiple: personal km / (1,667 per month) by each formula (can't be used to increase the charge)
  - Only available if less than 50% is for personal use

Operating Benefit

- If the employer pays for the operating costs (fuel, maintenance), the lesser of:
  - Employee is charged $0.26/km for personal kms.
  - 50% of standby charge. This option available only if the car is used at least 50% for business.

- Reimbursements by employee to employer
  - Reduce the standby charge and the operating benefit

Stock Options

- <u>What they are:</u>
  - An option to purchase the shares of a company, at a certain price.
  - Example: I have the option to purchase 10 shares of ABC Co. for $10 each. If the shares are currently worth $12 on the open market, these options are worth $2 each ($12 FMV - $10 option price)
- <u>Purpose:</u>
  - To encourage performance that improves the company's value (increasing the value of the options)
- <u>Definitions:</u>
  - Exercise price : what the options give the right to purchase at.
  - In the Money: When the option price is less than FMV

Stock Options

Exercise price (strike price) - $10

FMV at date of grant - $8

FMV at date of exercise - $13

FMV at date of sale - $17

In the money-Strike<FMV grant
Not in the money – strike>FMV
Grant

	Public	CCPC
		Canadian controlled private corporation
Grant date	Nothing	Nothing
Exercise Date	$13-10=$3	$0
- Not in the money	($1.50)	
Sale Date	$17-$13=$4	$13-10=$3
	x 50% = $2	($1.50)
		$17-$13=$4
		x 50% = $2

Stock Options

Public	(Year of Exercise)	Year of Sale
Employment Income	$3	
Taxable Capital Gain		$2
Net income for tax purposes	$3	$2
Stock Option Deduction	(1.50)	$0
Taxable Income	1.50	$2
CCPC		
Employment Income		$3
Taxable Capital Gain		$2
Net income for tax purposes		$5
Stock Option Deduction		(1.50)
Taxable Income		3.50

Stock Options

Exercise price (strike price) - $10

FMV at date of grant - $12

FMV at date of exercise - $13 (in 2014)

FMV at date of sale - $17 (in 2017)

	Public	CCPC
Grant date	Nothing	Nothing
Exercise Date	$13-10=$3	$0
- IN the money	**($0)**	
Sale Date	$17-$13=$4	$13-10=$3
-**YES held for two yrs**	x 50% = $2	**($1.50)**
		$17-$13=$4
		x 50% = $2

Stock Options

Public	(Year of Exercise)	Year of Sale
Employment Income	$3	
Gain		$2
Net income for tax purposes	$3	$2
Stock Option Deduction	(0)	$0
Taxable Income	$3	$2

CCPC		Year of Sale
Employment Income		$3
Capital Gain		$2
Net income for tax purposes		$5
Stock Option Deduction		(1.50)
Taxable Income		3.50

Employee Loans

- Difference between loan rate and the prescribed rate is taxable benefit

- Exceptions – Relocation, Home Purchase, Share Purchase Loans

Retrieved Sept 17, 2014 from:
http://www.clipartbest.com/clipart-9cpEXdRcE

Employee Loans

Mr. Gilbert gives low interest loans to employees who want to take vacations. He charges 2% and thinks he has issued around $300,000 in loans this year and has yet to collect any (if fact some employees didn't come back). The prescribed rate is 5%.

$15,000 – interest calculated at prescribed rate ($300,000 at 5%)

(6,000) – interest collected ($300,000 at 2%)

$9,000 – interest to be included as benefit to employees

Deductions

Very Specific for Employees

- Legal Expenses to collect or defend salary
- Clergyman's residence
- Dues and Memberships
- RPP Contributions
- Travel Expenses – see next slide
- Automobile Expenses – see next slide
- Apprentice mechanic & Tradespersons Tools

Employee Travel Expenses

Must be:

- Required to pay their own expenses
- Ordinarily required to carry on duties away from employer's place of business
- Cannot be receiving a travel allowance unless it is included in income

Employees Expenses

<u>Can Deduct:</u>

- Meals & Entertainment (50%) – 12 hours out of town
- Lodging
- Vehicle (actual costs x kms drive for work/total km)
- Parking
- Home Office – special tests
- Training Costs
- Licenses
- Insurance

Retrieved Sept 17, 2014 from: http://www.uforgegallery.com/2013/09/assignment-inspiration-pop-culture/

Expenses

Jimbo earns a salary of $30,000 and is required to pay for certain expenses as part of his employment. He pays association dues of $1,000. He also supplies his own car. He drove 10,000 km total last year, of which 4,000 km were for business. He estimates he spent $3,000 on gas, insurance, and repairs for his vehicle (and has receipts to support this).

Calculate Jimbo's Taxable Income:

$30,000 Salary Income
(1,000) Association dues
(1,200) Vehicle costs ($3,000 x 4,000km / 10,000km)

<u>$27,800 </u>Total Taxable Income

Salespersons Expenses

Must be:

- Required to pay their own expenses
- Ordinarily required to carry on duties away from employer's place of business
- Cannot be receiving a travel allowance unless it is included in income
- **Must receive some income as commissions**

Salespersons Expenses

Can Deduct:

- **Advertising & Promotion**
- Meals & Entertainment (50%) – 12 hours out of town
- Lodging
- Vehicle
- Parking
- Home Office – special tests
- Training Costs
- Licenses
- Insurance

Total limited to the amount of commissions received

Home Office

Must be:

- Principle Place of Business (no other office); OR
- Regularly used solely for the purpose of meeting clients

What can be claimed:

- Employees – Maintenance, Hydro, Power
- Salesperson – Employee Expenses + Insurance and Property Tax
- Sole-Proprietor – Salesperson + CCA/Mortgage Interest

Based on percentage use of house (Sq footage)

Cannot be used to create or increase an employment loss

Home Office

Sam is employed as a marketing salesperson. He earns a salary of $60,000 and had commissions of $3,000 in 2014.

He works from home since he doesn't have another office. His office is 200 sq ft, and his total house is 2,000 sq ft.

He costs are outlined on the right:

- $500 Maintenance
- $600 Insurance
- $2,000 Power
- $300 Internet (full house)
- $6,000 Mortgage Interest
- $8,000 Mortgage Principle
- $2,500 Property Tax

Home Office

- $500 – yes for employees
- $600 yes since commissioned
- $2,000 – yes for employees
- $300 (yes –related to work)
- $0 – No Not self-employed
- $0 – Never, not a current expense
- $2,500 – Yes since commissioned

$5,900 x 200 / 2,000 sq ft

$590 Deduction (less than commission so ok)

- $500 Maintenance
- $600 Insurance
- $2,000 Power
- $300 Internet (full house)
- $6,000 Mortgage Interest
- $8,000 Mortgage Principle
- $2,500 Property Tax

When in Doubt

<u>Home Office</u>

Consider whether it is deductible…current or capital expense?

Consider whether it is related to the business and if so, by what %

Topics Covered

- Key Terms & General Information
- Taxation of Fringe Benefits
- Deduction of Employment Expenses

Extra Examples

Example:

Steve C. works at an office and sometimes take the office BMW to client meetings to impress clients, it also saves him money since the office pays all the costs. The office purchased the vehicle in 1990 for $25,000 so it's pretty much a classic. Steve has been working with the company for years so he didn't feel guilty about taking sick leave from May 1 until Sept 1. Other than that time he could take the car whenever he wanted. He actually borrowed it to drive to Toronto to watch a Jays game in September. He estimates the trip was around 2,700 km, but that's the only time he's ever used it personally. He estimates he drove 10,000km in total for the year.

Example:

Steve C. works at an office and sometimes take the office BMW to client meetings to impress clients, it also saves him money since the office pays all the costs. The office purchased the vehicle in 1990 for $25,000 so it's pretty much a classic. Steve has been working with the company for years so he didn't feel guilty about taking sick leave from May 1 until Sept 1. Other than that time he could take the car whenever he wanted. He actually borrowed it to drive to Toronto to watch a Jays game in September. He estimates the trip was around 2,700 km, but that's the only time he's ever used it personally. He estimates he drove 10,000km in total for the year.

Standby Charge

- 2% x (original cost of vehicle x # of days available to employee/30)
- Easiest to think of as 2% x cost x months

2% x $25,000 x 8 months (All but May-August) = $4,000 Standby Charge before reduction

Reduction if used mostly for business:

- Multiple: personal km / (1,667 per month) by each formula (can't be used to increase the charge)
- Only available if less than 50% is for personal use

$4,000 standby charge before reduction x 2,700 personal km / (1,667 x 8 months of use) = **$810 Reduced Standby Charge**

Standby Charge = $810

Operating Benefit

Personal use km x $0.24 = 2,700 x $0.26 = $702

OR

50% of Standby Charge if used less than 50% for personal = $810 Standby Charge x 50% = **$405**

Total Income

Standby Charge + Operating Benefit

$810 + $405 = $1,215

Retrieved September 16, 2014 from: http://www.mlmgenerationplan.com/

Stock Option Example A

- <u>Jan 1, 2009</u>
  - Stock options on A Co (Public) issued to Mr. X, an arm's length employee. 100 options, Exercise price $30, FMV $50
- <u>Jan 1, 2010</u>
  - Mr. X exercises his options and purchases 100 shares of A Co at $30. At that time the shares' FMV was $40 on the open market.
- <u>Jan 1, 2011</u>
  - Mr. X sells his shares of A Co for $50.
- <u>What is Mr. X's income inclusion and when does it occur?</u>

Stock Option Example A

- Public – No deferral
- Exercise Price $30 vs FMV $50 = YES in the money
- 1) Exercises option when shares are worth $40 - $30 exercise price = $10 income x 100 shares = $1,000 Total Income in 2010 (no 50% reduction since <u>was</u> in the money)
- 2) Sells 100 shares for $50 - $40 FMV at time of exercise = $10 income x 50% reduction = $5 income x 100 shares = $500 Total Income in 2011

Stock Option Example B

- Jan 1, 2009
  - Stock options on A Co (Private) issued to Mr. X, an arm's length employee. Exercise price $30, FMV $25
- Jan 1, 2010
  - Mr. X exercises his options and purchases 100 shares of A Co at $30. At that time the shares' FMV was $40 on the open market.
- Jan 1, 2013
  - Mr. X sells his shares of A Co for $50.
- What is Mr. X's income inclusion and when does it occur?

Stock Option Example A

- Private – Can Defer Income + Extra 2 Year Rule
- Exercise Price $30 vs FMV $25 = NOT in the money
- 1) Exercises option when shares are worth $40 - $30 exercise price = $10 income x 50% reduction since held for two years = $5 income x 100 shares = $500 Income in 2013
- 2) Sells 100 shares for $50 - $40 FMV at time of exercise = $10 income x 50% reduction = $5 income x 100 shares = $500 Income in 2013

Net Income to Taxable Income for Individuals

Net Income for Tax Purposes

- Net Employment Income
- Net Business Income
- Net Property Income
- Capital Gains and Losses
- Other Income
- Other Deductions
- <u>Current Year Losses – Capital or Non-Capital</u>

- = Net Income For Tax Purposes

From Where We Were:

Net Income for Tax Purposes		=
Less:	Allowable capital losses	-
	Employee Stock Options	-
	Deductions – sections 60 to 66.8	-
	Capital gains deduction	-
	Losses from an office or employment	-
	Losses from a business	-
	Losses from property	-
Taxable Income		=

Critical Thinking

- Why are there two totals?

  - Net Income For Tax Purposes – used to calculate eligibility for assistance programs and low income tax credits. (more inclusive)

  - Taxable Income – income actually intended to be taxed. (adjusted for losses & tax free income)

Tax Calculation and Credits

Calculation of Personal Tax

Marginal Tax Rates

Up to $43,000	24.1%	(+ $0)
$43,001 to $87,000	34.1%	(+ $10,363)
$87,001 to $135,000	38.4%	(+ $25,367)
$135,000 and up	43.3%	(+ $43,799)

Example:

Mr. X makes $93,000 in taxable income. How much tax will he pay before personal credits?

What about if he makes $148,000?

Example

Up to $43,000	24.1%	(+ $0)
$43,001 to $87,000	34.1%	(+ $10,363)
$87,001 to $135,000	38.4%	(+ $25,367)
$135,000 and up	43.3%	(+ $43,799)

Example:

Mr. X makes $93,000 in taxable income. How much tax will he pay before personal credits?

Longhand:

43,000 – 0 = 43,000 x 24.1% = $10,363
87,000-43,000 = 44,000 x 34.1% = $15,004
93,000 – 87,000 = 6,000 x 38.4% = $2,304

$10,363 + 15,004 + 2,304 = $27,671

Example

Up to \$43,000	24.1%	(+ \$0)
\$43,001 to \$87,000	34.1%	(+ \$10,363)
\$87,001 to \$135,000	38.4%	(+ \$25,367)
\$135,000 and up	43.3%	(+ \$43,799)

Example:

Mr. X makes \$93,000
in taxable income.
How much tax will he pay
before personal credits?

Shorthand:

93,000 – 87,000 = 6,000 x 38.4% = \$2,304

\$25,367 + 2,304 = \$27,671

Example

Up to $43,000	24.1%	(+ $0)
$43,001 to $87,000	34.1%	(+ $10,363)
$87,001 to $135,000	38.4%	(+ $25,367)
$135,000 and up	43.3%	(+ $43,799)

Example:

Mr. X makes $148,000
in taxable income.
How much tax will he pay
before personal credits?

Longhand:

43,000 – 0 = 43,000 x 24.1% = $10,363
87,000-43,000 = 44,000 x 34.1% = $15,004
135,000 – 87,000 = 48,000 x 38.4% = $18,432
148,000 – 135,000 = 13,000 x 43.3% = $5,629

$10,363 + 15,004 + 18,432 + 5,629 = $49,428

Example

Up to $43,000	24.1%	(+ $0)
$43,001 to $87,000	34.1%	(+ $10,363)
$87,001 to $135,000	38.4%	(+ $25,367)
$135,000 and up	43.3%	(+ $43,799)

Example:

Mr. X makes $148,000 in taxable income. How much tax will he pay before personal credits?

Shorthand:

148,000 – 135,000 = 13,000 x 43.3% = $5,629

$43,799 + 5,629 = $49,428

Example – Knowledge Check

Up to $43,000	24.1%	(+ $0)
$43,001 to $87,000	34.1%	(+ $10,363)
$87,001 to $135,000	38.4%	(+ $25,367)
$135,000 and up	43.3%	(+ $43,799)

Example:

Mr. X makes $57,000
in taxable income.
How much tax will he pay
before personal credits?

Choose an Answer

A. $19,437

B. $4,774

C. $15,137

D. $42

Retrieved September 23, 2014 from:
http://wall.alphacoders.com/by_sub_category.php?id=212731

Credit vs. Deduction

- Deduction
  - Income – Deduction = Taxable Income (reduces tax by highest marginal rate)
- Credit
  - Taxes Owing – (Credit x lowest rate) = Net Taxes Owing. (reduces tax by lowest marginal rates).
  - Credits may be refundable or non-refundable.

Tax Savings Example

Deductions

$146,000 Income before

(11,000) Deduction is a reduction of income.

<u>$135,000 </u>Income After

*Income over and above $135,000 taxed at 43.3% so…

$11,000 x 43.3% = $4,763 tax savings

Credits

$146,000 Income before

-

$146,000 Income After

*Credits reduce tax at lowest marginal tax rate of 24.1% so…

$11,000 x 24.1% = $2,651 tax savings

Provincial vs. Federal

- Rates
  - Varying rates with varying cutoff levels (federal at $43,000, provincial at $37,000)

  We use combined federal & provincial rates with rough cutoff levels for this class to simplify this concept.

- Credits
  - Credit amounts may vary between Federal and Provincial.
  - Some credits may be only available provincially or federally.

Where there is a difference we use Federal credits as will future courses.

Personal Tax Credits

Family Based Credits

Family Based Credits

- Definition: Common Law
  - Cohabited in a conjugal relationship for a continuous period for at least one year; or
  - Is the parent of a child of whom the taxpayer is also a parent.

No requirement they be of the opposite sex

Possible to have both

Family Based Credits

- <u>Definition: Child</u>
  - Natural or adopted children of the individual or of their spouse/common law partner.

Family Based Credits

- Personal Credits - $11,000
  - For yourself

- Spousal Credits - $11,000
  - For your spouse if they can't use
  - Reduced by your spouses Net Income For Tax Purposes.

Family Based Credits

- Eligible Dependant Credit - $11,000
  - If you have no spouse or common-law partner
  - have a dependant minor child, disabled adult child, parent, or grandparent
  - Must be dependant on you for food, clothing, shelter & living with you.
  - Reduced by dependants Net Income for Tax Purposes

Key to remember – these three are all the same.

Family Based Credits

Example

George and Marie are married. George earns $50,000 from interest and Marie does not work. Calculate the reduction of George's taxes based what you know about him.

$11,000 Personal Credit

$11,000 Spousal Credit

$22,000 x 24.1% = $5,302 Reduction in Taxes.

Family Based Credits Cont'd.

- <u>Age Credit</u>
  - Taxpayers 65 and over - $6,900
  - Reduced if they earn too much income. ($38,000 starts, eliminated by $89,000)
  - Transferable to a spouse

Retrieved September 23, 2014 from:
http://kristiholl.net/writers-blog/2011/11/age-are-you-too-old-to-write/

Family Based Credits Cont'd

<u>Disability Tax Credit - $8,000 (T2201)</u>

- Available to individuals with an impairment that results in a "marked" restriction in a basic activity of daily living, that has lasted or is expected to last for at least 12 months
- Mental or physical infirmity must be certified by a medical doctor or similar professional.

- A $4,732 supplement is added on for disabled children under the age of 18

- The credit may be transferred to:
  - a spouse, or
  - A supporting person who claimed the caregiver credit, or eligible dependent credit on behalf of the impaired individual.

Family Based Credits

<u>Example</u>

George is 70 years old, unmarried, and has 3 children age 6, 7 and 8. George earns $30,000 annually. Not enough to reduce any of his credits. Calculate the reduction of George's taxes based what you know about him.

$11,000 Personal Credit

$11,000 Eligible Dependant Credit

$6,900 Age Credit

$28,900 x 24.1% = $6,964.90 Reduction in Taxes.

Family Based Credits

<u>Example</u>

George is 73 years old and married. His spouse has a registered disability certified by a doctor, and is 66 years old. Their combined income for the year is $30,000, all of which is George's. Calculate George's Personal Credits.

$11,000 Personal Credit

$11,000 Spousal Credit

$6,900 Age Credit

$6,900 Age Credit from spouse

$8,000 disability credit transferred from spouse

$43,800 x 24.1% = $10,555.80 Reduction in Taxes.

Family Based Credits Cont'd.

- Canada Caregiver Amount. – 6,900
  - For supporting an infirm adult relative, including a child, grandchild, parent, grandparent, brother, sister, aunt, uncle, niece, or nephew
  - Must be dependent because of mental or physical infirmity
  - Relative need not live with the taxpayer
  - Credit is reduced by 15% of the relative's net income in excess of $16,163

- If eligible for dependant credit, can't claim Canada Caregiver amount.

Family Based Credits Cont’d.

- Family caregiver amount for infirm dependent. – 2,150
  - One family caregiver amount is allowed for each infirm dependent, for which the spousal or equivalent to spouse is claimed.
  - Also available on a standalone basis for an infirm child under 18 for the 2017 year and onward.

Family Based Credits Cont'd

Home Accessibility Amount - $10,000

- Available to taxpayers 65 years of age or older, or who are eligible for the disability tax credit.
- For eligible renovations to improve safety and accessibility of a home.
- The basis for the credit is the lesser of the cost of the eligible renovations and $10,000.

Family Based Credits

<u>Example</u>

George is 45 years old and unmarried. He supports his 23 year old niece, since his brother (her father) passed away. She has an registered disability. Calculate George's Personal Credits.

$11,000 Personal Credit

$6,900 Canada Caregiver

$8,000 disability credit transferred from niece since George claimed the caregiver credit for her.

$25,900 x 24.1% = $6,241.90 Reduction in Taxes.

Family Based Credits Cont'd

- First Time Homebuyers Tax Credit
  - $5,000 – where individual or spouse hasn't purchased a home or lived in one they owned in the last 4 years.

- Adoption Expenses Tax Credit
  - $15,000 in Eligible Adoption Expenses
  - For the adoption of a child under 18
  - Must be claimed in the year adoption finalized
  - Includes agency fees, court costs, travel & living expenses of child & adoptive parents, etc.

Income Based Credits

Income Based Credits

- EI/CPP Credits
  - Credit for amounts paid up to annual max
  - EI Max is $891, CPP Max is $2,356
  - Remainder deducted from pay is refunded

- Employment Credit
  - $1,117 for having employment income (at least $1,117 of it)

Income Based Credits

- Pension Credit
  - $2,000 for having pension income (at least $2,000 of it)
  - Not available on OAS, CPP, or Death Benefit Income
  - Transferable to a spouse if unused

Retrieved September 23, 2014 from:
http://pensionsatwork.ca/

Income Based Credits

Example

George is 34 and earns $500 in employment income in 2012. Calculate the reduction of his income tax from credits.

$11,000 Personal Credit

$500 Employment Credit (lesser of emp income or $1,117)

$11,500 x 24.1% = $2,771.50 (potential) Reduction in Taxes.

Income Based Credits

Example

George is 34 and earns $25,000 in pension income in 2012. Calculate the reduction of his income tax from credits.

$11,000 Personal Credit

$2,000 Pension Credit (Lesser of pension income or $2,000)

$13,000 x 24.1% = $3,133 Reduction in Taxes.

Income Based Credits

<u>Example</u>

George is 34 and earns $25,000 in employment income in 2012. George contributed $1,000 to EI from his employment income. Calculate the reduction of his income tax from credits.

$11,000 Personal Credit

$1,117 Employment Credit (Lesser of employ income or $1,117)

$891 EI Credit

$13,008 x 24.1% = $3,135 + ($1,000 – 891) = $3,244 Reduction in Taxes.

Miscellaneous Credits

Miscellaneous Credits

- Tuition Tax Credits
  - Tuition paid at university, college, post-secondary institution
  - Unused credits can be carried forward
  - Can be transferred up to $5,000 in the current year to parents – not mandatory – balance with unlimited carry-forward
  - Not claimable if reimbursed by employer unless it was a taxable benefit

- Exam Fees
  - Exam fees $100 or more

Miscellaneous Credits

- Student Loan Interest
  - Credit available for interest paid on government student loans. Lines of credit generally not applicable. 5 yrs forward

Tuition Credits

<u>Example</u>

George is 23 attends the University of New Brunswick for 4 full time months in 2012. His tuition costs $6,000. Calculate the reduction of his income tax from credits.

$11,000 Personal Credit

$6,000 Tuition Credit

$17,000 x 24.1% = $4,097 Reduction in Taxes.

*If unable to use the tuition amount, George can carry them forward to a future year.

Miscellaneous Credits

- Volunteer Firefighters Credit
  - $3,000
  - Individuals volunteering 200 hours a year
  - Cannot use volunteering hours from a fire department the individual also works for.

Retrieved September 23, 2014 from: http://www.clipartlord.com/category/people-clip-art/men-in-uniform-clip-art/fireman-clip-art/

Miscellaneous Credits Cont'd

- Medical Expense Credits

  - Total expenses for the family (spouses, minors, adult children with disabilities)
  - Reduced by: 3% of net income or $2,152 (lesser of).
  - Includes: Prescriptions, glasses, premiums, dentistry, etc.
  - Federal Doesn't include: Cosmetic surgery
  - NB Doesn't include: acupuncture, natural remedies
  - Any 12 month period ending in the year & 24 months at death.

Miscellaneous Credits Cont'd

- Medical Expense Credits Continued...

  - Can include spouse & minor children with no reduction, and
  - Adult children less 3% of their income or $2,152 (lesser of)
  - Does not include any amounts reimbursed by medical insurance.

Medical Credits

<u>Example</u>

George is married to Marie. George spent $6,000 and Marie spent $8,000 in medical expenses from November 2011 to October 2012. George estimates that $2,000 was reimbursed by Blue Cross Insurance. He earns $50,000 annually and she earns $8,500. Calculate his tax reduction JUST from medical.

$6,000 George's Medical

$8,000 Marie's Medical

(2,000) Less: reimbursement

(1,500) Less: 3% of $50,000 (less than $2,152)

$10,500 x 24.1% = $2,530.50 Reduction in Taxes.

Miscellaneous Credits Cont'd

- Charitable Donations
  - Preferential treatment. First $200 at lowest bracket – afterwards at highest tax bracket.
  - Limited to 75% of net income for tax purposes
  - Able to be carried forward for 5 years
  - Better to lump spousal donations together.

First-time Donors Super Credit (new in 2013)

- Extra 25% on donations up to $1,000
- Available to individuals (or couples) who haven't donated since 2007.

Donation Credits

<u>Example</u>

George contributes $10,000 in donations in 2012. Calculate his tax reduction from donations only.

$200 x 24.1% = $48.20

$9,800 x 43.3% = $4,243.40

Total Tax Reduction: 48.20 + 4,243.40 = $4,291.60

Donation Credits

Example

George contributes $10,000 in donations in 2014. Calculate his tax reduction from donations only, assuming he has never donated before.

$200 x 24.1% = $48.20

$9,800 x 43.3% = $4,243.40

$1,000 x 25% = $250 ($25% of the first $1000)

Total Tax Reduction: 48.20 + 4,243.40 + 250 = $4,541.60

Changing Province of Residence

In general, provincial tax credits are lower than federal. This results in a faster use of the provincial portion of your tuition credits than your federal (you will run out of provincial sooner).

However, when changing provinces of residences, some provinces allow you to “reset” your provincial tuition credit carry forward to the federal amount. Watch for this potential benefit if you move.

Miscellaneous Income and Deductions

Income Inclusions

Income that isn’t:

Employment Income

Business/Property Income

Capital Gains

Pension Income

- <u>Canada Pension Plan (CPP) & Other Pensions</u>
  - Registered Pension Plans (RPP)
  - Old Age Security (OAS), Guaranteed Income Supplement (automatic)
  - Canada Pension Plan (CPP) (separate from death benefits)
  - Provincial Pension plans

Retiring Allowances

- Retiring Allowances
  - An amount received on retirement from employment in recognition of long service; or
  - On loss of employment as damages.
  - Unused Sick Pay
  - NOT unused vacation.

Special transfer available to RPP or RRSP which can be deducted from income.

Retiring Allowances - Transfer

Contribution Room

- $2,000/yr employed prior to 1996

  Plus
- $1,500/yr employed prior to 1989 where NOT a member of an RPP or DPSP.

Transferred amount does not decrease RRSP contribution room.

Example:

Jim receives a retirement allowance worth $80,000 From Aco Ltd.

Jim began working at Aco Ltd. in 1975 and he was never part of a retirement plan.

Jim has $10,000 in RRSP contribution room available.

How much of his allowance can he transfer to his RRSP and how much contribution room will be left afterwards?

retirement allowance worth $80,000
began working at Aco Ltd. in 1975
never part of a retirement plan.
$10,000 in RRSP contribution room available.

How much of his allowance can he transfer to his RRSP

1989-1975 = 14 years before 1989 x $1,500 per year = $21,000
1996-1975 = 21 years before 1996 x $2,000 per year = $42,000

$21,000 + $42,000 = $63,000 can be rolled over without RRSP room

how much contribution room will be left afterwards?

$80,000 allowance ordinarily taxable - $63,000 into RRSP without reducing room
= $17,000 taxable allowance remaining - $10,000 RRSP room = $7,000 taxable allowance

$10,000 original RRSP contribution room - $10,000 deduction taken = $0 RRSP room

Example:

Jim receives a retirement allowance worth \$40,000 From Aco Ltd.

Jim began working at Aco Ltd. in 1980 and he was never part of a retirement plan.

Jim has \$20,000 in RRSP contribution room available.

How much of his allowance can he transfer to his RRSP and how much contribution room will be left afterwards?

retirement allowance worth $40,000
began working at Aco Ltd. in 1980
never part of a retirement plan.
$20,000 in RRSP contribution room available.

How much of his allowance can he transfer to his RRSP

1989-1980 = 9 years before 1989 x $1,500 per year = $13,500
1996-1980 = 16 years before 1996 x $2,000 per year = $32,000

$13,500 + $32,000 = $45,500 can be rolled over without RRSP room

how much contribution room will be left afterwards?

$40,000 allowance ordinarily taxable - $40,000 into RRSP without reducing room
= $0 taxable allowance remaining (cannot roll over more into RRSP than received)

$20,000 original RRSP contribution room - $0 deduction taken = $20,000 RRSP room

Death Benefits

- On the death of an employee, $10,000 can be given tax free.
- Can be to one or several beneficiaries, but a max of $10,000 will be tax free.
- Consider: who gets it? Who gets it tax free?
- Any excess is taxable

http://thecareercafe.co.uk/blog/?attachment_id=1945
Obtained August 31, 2012

Death Benefits

- If just to a spouse – first $10,000 non taxable
- If just to non spouse – first $10,000 non taxable

- If to a spouse and non-spouse
  - spouse gets first $10,000 tax free,
  - non-spouses share any remainder of 10,000 exemption, in proportion to the FMV of their benefit

- If to two spouses
  - $10,000 exemption split in proportion to the FMV of their benefit

http://thecareercafe.co.uk/blog/?attachment_id=1945
Obtained August 31, 2012

Death Benefits

Dave and his mother in law, Kerry, each receive \$6,000 in death benefits on the death of Dave's wife, Sandra.

What should Dave and Kerry report as income from the death benefit?

Dave will report \$0 of income, as he receives a tax free benefit up to either the amount paid, or the \$10,000 limit.

Kerry is a non-spouse, and so would receive any residual benefit

\$6,000 – (\$10,000 tax free - \$6,000 used by dave) = \$2,000 taxable.

Death Benefits

Dave and his mother in law, Kerry, each receive $20,000 in death benefits on the death of Dave's wife, Sandra.

What should Dave and Kerry report as income from the death benefit?

Dave - $10,000 income ($20,000 received – $10,000 exemption)

Kerry - $20,000 income ($20,000 received – $0 exemption)

Various Minor Items:

- Employment Insurance
  - Taxable when received & deductible if repaid.
- Social Assistance Received – tax exempt but must be included in income and then removed
- Workers Compensation – tax exempt but must be included in income and then removed

Various Minor Items:

- Pension Splitting
  - Eligible pension included in the income of recipient
  - Deduction from income for pension split with spouse
  - Proportionate share of tax withheld is also transferred
  - CPP & OAS cannot be split

Retrieved September 30, 2014 from: http://www.retirementcommunications.com/the-employer-does-not-offer-a-pension-you-can-build-your-own/

Pension Splitting - Example

Michelle and Jon are each 75 years old and are married.

- Michelle earns the following income: OAS $5,000, RPP Pension Income $70,000, Interest $16,000
- Total Income $91,000
- Jon earns no income.

What is Jon's optimum income level?

- Jon's optimum income is $35,000. ($0 + $35)
- Jon not using credits, Michelle has higher income
- Maximum is 50% of eligible pension income or $35,000 ($70,000 x 50%).

Pension Splitting - Example

Michelle and Jon are each 75 years old and are married.

- Michelle earns the following income: OAS $5,000, RPP Pension Income $70,000, Interest $16,000
- Total Income $91,000
- Jon earns no income.

What is Michelle's optimum income level?

- Michelle's optimum income is $56,000. ($91 - $35)
- Jon not using credits, Michelle has higher income
- Maximum is 50% of eligible pension income or $35,000 ($70,000 x 50%).

Support Payments

- Recipient must have discretion over its use
- Periodic Payments
- Receivable under a court order or separation agreement
- If agreement doesn't specify, and there is a child, we assume it is Child Support

- Spousal – Deductible to payer, Taxable to recipient
  - Must be living separate and apart at the time the payment is made.

- Child – Non-Deductible to payer, Non-Taxable to recipient

Support Payment - Example

Jane and Nick sign a divorce agreement on May 1, 2013 stipulating that Nick will pay Jane $2,000 per month beginning immediately. They do have a child who continues to live with Jane.

What must Jane include in her 2013 income?

- Nothing
- As not specified whether child or spousal support, we assume it is child support.
- Child support non-taxable to recipient

Support Payment - Example

Jane and Nick sign a divorce agreement on May 1, 2013 stipulating that Nick will pay Jane $2,000 per month in spousal support beginning immediately.

What must Jane include in her 2013 income?

- $16,000 (May – December x $2,000 per month)
- Periodic spousal support based on an agreement
- Spousal support taxable to recipient

Annuities

- Periodic Payments (monthly, annually, etc.)
- Types:
  - Life Annuity – Guaranteed payments for life of the annuitant (or minimum 10 years for example)
  - Term Annuity – Payments for 25 years
- Tax Treatment
  - RRSP/RRIF withdrawals- 100% taxable
  - Non-Registered - Some portion is a return of capital and the rest income. An information sheet will be provided by investment provider (T3).

Life Insurance Proceeds

<u>Tax-free</u> if paid as a consequence of death

Because you pay the premiums yourself they haven't been deducted for tax purposes.

This is an important principle. Paid in after tax dollar – typically tax free benefits.

Retrieved September 30, 2014 from: http://www.abouttermlifeinsurance.com/term-life-insurance-riders.html

Scholarships

- Fully exempt if you get the tuition tax credit (college diplomas, bachelor, masters, or doctoral degree costs)
- Grants for artists & research projects are taxable only where they exceed the expenses to complete the project
- $500 base exemption applies even where the two above criteria aren't met
- $500 exemption doesn't apply where the prize is a benefit of employment (ie, your employer gives you a scholarship)

Scholarships

Craig attends the University of Waterloo. He is taking a Bachelor in Computer Science and received $35,000 in scholarships in 2014. Craig also had a part time job at Tim Hortons where he earned $6,000.

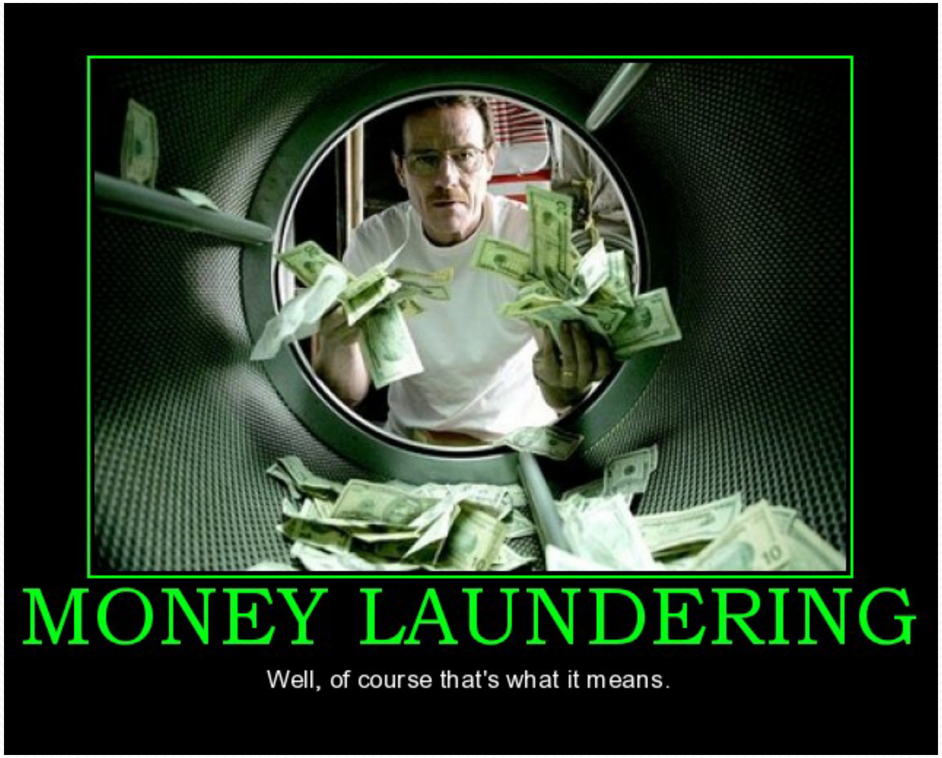
Calculate his taxable income in 2014.

$0	Scholarship not taxable
$6,000	Employment Income

$6,000	Total Taxable Income

Indirect Payments

- Payments made to a third party at the request or direction of someone else, are included in the requestor's income.
- Example: A husband receives a bonus but asks his company to pay it to his wife. It's still his income for tax purposes.
- Example: an employee receives a bonus but asks his company to pay it to his bookie. It's still his income for tax purposes



http://hustedia.com/blog/2011/05/16/hiding-money/
Obtained August 31, 2012

Deductions

Various Minor Items:

- Support Payments
  - Spousal – Deductible to payer, Taxable to recipient
  - Child – Non-Deductible to payer, Non-Taxable to recipient

- CPP
  - Credit up to annual max, refund of remainder ($2,356)
  - Self-employed can deduct ½ of CPP contributions (the employer's half of $2,356)

- RRSPs
  - Contributions to an RRSP are deductible
  - Contributions to RPP by employer are deducted from your contribution room. Because not included in income, no deduction

Various Minor Items:

- Legal Payments
  - To object or appeal a tax assessment
  - Remember that also to obtain or defend employment income
- Pension Splitting
  - Those receiving pension income can split up to 50% of it with a spouse if it is advantageous. The amount split is a deduction.
- OAS
  - Clawback - important to know they may take it back if you make too much money. Starts around $65,000. Deductible.

Moving Expenses

- 40km closer to employment or school
- Reduced by any allowances paid by your employer
- Limited to the income after the move, from the new place (scholarships/Empl. $)
- Remainder can be carried forward (but must be used if able)

Obtained from Spruce Island
August 31, 2012

Moving Expenses

- Travel Costs – Actual Meals/Lodging or simple method. $0.59/km $21/meal/person
- Transportation & Storage Costs for Household Items
- Costs of Meals & Lodging near either residence for 15 days.
- Lease Cancellation Costs
- Selling costs of old home:
  - Advertising, legal, real estate, mortgage fees.
  - Excludes renovations/repairs.
- Legal & land transfer fees for new residence
- Mortgage interest, property tax, insurance, maintenance on old home while vacant (Max $5,000)

Moving Expenses

- Revision of personal documents: driver's license, car permits, utility hookups.
- House or job hunting costs are not deductible.

Obtained from Spruce Island
August 31, 2012

Moving Expenses

- Loss on old residence is not deductible from income.
- However, only ½ of employer reimbursement in excess of $15,000 for this loss is a taxable benefit.
- Effective tax planning strategy.

- Example: $40,000 Reimbursement on $60,000 loss.
- (40,000 – 15,000) x ½ = $12,500 taxable

Moving Expenses

Example:

- 2 people travel for 3 days from BC to PEI (3,000 km)
- Old home didn't sell for 2 months. Estimate power, hydro, and maintenance while waiting to sell was $6,000.
- Storage at new place to hold household effects $2,000
- Cost to hire a moving company $1,500

Income in new location:

- Scholarships $15,000 from BBA
- Employment Income of $3,000

Moving Expenses

- Simplified KM = 3,000km x $0.59 = $1,770
- Simplified Meals = 2 people x 3 days x $21/meal x 3 meals per day = $378
- Maximum reached on old home maintenance $5,000
- Storage is deductible = $2,000
- Moving Company Costs are deductible $1,500
- **Total Moving Expenses: $10,648**

Income in new location:

- Scholarships $15,000 from BBA
- **Employment Income of $3,000 (limited to income)**

Child Care Expenses

Retrieved September 30, 2014 from: http://www.little-u.com/

- For children under 16 <u>or</u> who have a disability
- Must be a child of the individual, their spouse, or a legal dependant with income less than the basic personal credit (around $11k).
- Can't be paid to the mother, father, or a person under 18 related to the individual.

Child Care Expenses

- Amounts paid must be to allow the individual to earn employment income or go to school. Ie. No tuition or no employment income = no deduction.

- Must be deducted from lower income spouse EXCEPT…

- Deductible from higher income spouse when:
  - Lower earner is in school
  - Lower earner is infirm for at least two weeks (broken leg) or has a long term infirmity (blind)
  - Lower earner is in Jail
  - Spouses are separated for 90 days

Child Care Expenses

- Babysitting, Daycare, or Day Camps (no weekly limit)
- Boarding school or camp:
  - $275/week per disabled child.
  - $200/week for under 7 yrs
  - $125/week for 7-16 yrs

- **Limit 1:**
  - $11,000/child with disability
  - $8,000/child under 7 yrs
  - $5,000/child 7-16 yrs
- **Limit 2:**
  - Actual expenses
- **Limit 3:**
  - 2/3 of earned income of the individual.

Child Care Expenses

Aaron and Miranda have three children, Bruce, Bob, and Bambi aged 5, 8, and 10, respectively.

Aaron earned $25,000 and Miranda earned $15,000 in employment income in 2012.

The couple paid for a babysitter for the full year costing $8,200.

The couple also enrolled Bambi in an seven day overnight summer camp that cost $5,000.

Calculate the maximum amount that can be claimed for Child Care and who claims it.

Child Care Expenses

- Miranda is lower income earner – no exceptions present

  - **Limit 1**: 2/3 of her income is: $10,000 maximum

  - **Limit 2**: Total annual limit $5,000 + $5,000 + 8,000 = $18,000 (two children age 7-16 and one under 7)

  - **Limit 3**: Actual expenses
    Babysitting - $8,200
    Overnight camp = (1 week x $125 per week maximum)=$125
    Total Expenditures = **$8,325.00**

Capital Cost Allowance (CCA)

Capital Cost Allowance (CCA)

CCA

A method of reporting a decline in value

Retrieved October 6, 2014 from:
http://uygarr.blogspot.ca/2012/10/new-ford-mondeo-release-date.html

Retrieved October 6, 2014 from:
http://myfinancialjourney.com/archive/my-financial-journeys-pimp-ride

Accounting Vs. Tax

Amortization vs. CCA

Cost vs. Capital Cost

Net Book Value vs. Un-depreciated Capital Cost (UCC)

Individual Assets vs. Asset Pools by Class

Accounting Amortization:

$100,000	Purchased equipment with 5 year useful life (Cost)
(20,000)	Amortization in Year 1 (1/5)
80,000	Remaining useful life after year 1 (NBV)
(20,000)	Amortization in Year 2 (1/5)
60,000	Remaining useful life after year 2 (NBV)
(20,000)	Amortization in Year 3 (1/5)
40,000	Remaining useful life after year 3 (NBV)

Tax Depreciation:

$50,000	Equipment A purchased (Cost)
$50,000	Equipment B purchased (Cost)
100,000	Total Equipment
(20,000)	Depreciation (CCA) in Yr 1 (20%)
80,000	Remaining tax cost after year 1 (UCC)
(16,000)	Depreciation (CCA) in Yr 2 (20%)
64,000	Remaining tax cost after year 2 (UCC)
(12,800)	Depreciation (CCA) in Yr 3 (20%)
51,200	Remaining tax cost after year 3 (UCC)

Additions of Property

<u>For Tax Purposes:</u>

An addition to the capital cost of a property includes everything required to bring it to it's useable state:

Legal, Accounting, and Appraisal fees to acquire

Realtor Fees

Shipping, Duties, Installation

Ie. Mr. Smallman purchased a $15,000 tractor. He incurred a $2,000 legal fee and it cost $1,500 to ship it to his home.

The Capital Addition is: $18,500 added to CCA Class.

Additions of Property

Restrictions

Government assistance received is deducted from the cost of an asset for tax.

Mr. Smallman purchased a manufacturing plant for $1.5 million. The government gave him a grant for $500,000 to use towards the purchase.

Total addition to manufacturing assets: $1,000,000 ($1,500,000 cost - $500,000 reimbursed grant)

What is Capital?

Remember our test for Rental/Home Office Deduction Purposes?

	Capital	**Current**
Does it add to the value of a property	New Roof	Fix 1 Shingle
Is it expected to have a useful life longer than a year	New Siding	Paint
Is it material	Freezer	Frying Pan

What is Depreciable Property?

Can’t be Inventory

- What is inventory depends on nature of the business
- Printers are inventory to a company that sells and distributes printers
- Printers are capital to a legal firm

Can’t be Land

- Land is a non-depreciable asset
- It’s value lasts forever

CCA Terminology

- Capital Cost Allowance “Classes”
  - All assets of a particular class are lumped together

Example: Vehicles – Class 10,

Equipment – Class 8,

Software – Class 12, etc

Class 10

Retrieved Oct 1, 2014 from: http://www.homepower.com/articles/vehicles/basics/what-types-vehicles

Class 8

Retrieved Oct 1, 2014 from: http://www.oaklease.co.uk/Office-Equipment-Leasing

Class 12

Retrieved Oct 1, 2014 from: http://www.webopedia.com/DidYouKnow/Hardware_Soft
are/types_of_software.asp

CCA Terminology

- <u>Capital Cost Allowance "Pools"</u>
  - The particular balance of a CCA Class is called it's "Pool". When you purchase an addition to a CCA Class you are adding to that Class's pool of UCC to depreciate.

WHOO HOO!!!

Retrieved Oct 1, 2014 from: http://www.vehiclepassion.com/2012/11/15/watch-2013-ford-fusion-jumping-off-a-cliff-in-commercial-video/

Retrieved Oct 1, 2014 from: http://www.forbes.com/fdc/welcome_mjx.shtml

Retrieved Oct 1, 2014 from: http://www.commentarymagazine.com/2009/05/01/an-inconsistent-car-company-goes-bankrupt/

Exceptions

- <u>Separate Pools of the same “Class” of asset when:</u>

  Multiple businesses. Example: a knitting supplies business and a legal advice business. Equipment related to each should be kept separate even though it is all equipment

  Rental Properties in excess of $50,000

  Luxury vehicles (Class 10.1) costing more than $30,000

Calculating CCA

- Capital Cost Allowance (CCA)
  - Annual CCA reduces the capital cost of a property and the remaining balance is UCC.

    - Opening UCC Pool
      - Add in additions
      - Subtract disposals (lesser of cost or proceeds)
      - Less: CCA
    - Closing UCC Pool

- Methods
  - Declining Balance – Most Classes
  - Straight Line – Leaseholds (Class 13)

Declining Balance - Example

- <u>Stats</u>
  - Original Cost = 500,000
  - Opening UCC Pool = 100,000
  - Rate 10%

Declining Balance Year 1: 100,000 x 10% = 10,000.
100,000 opening UCC – 10,000 CCA = 90,000 Ending UCC

Declining Balance Year 2: 90,000 x 10% = 9,000.
90,000 opening UCC – 9,000 CCA = 81,000 Ending UCC

Declining Balance - Practice

- Stats
  - Original Cost = 100,000
  - Opening UCC Pool = 60,000
  - Rate 30%

Declining Balance Year 1: 60,000 UCC x 30% = 18,000 CCA

60,000 opening UCC – 18,000 CCA = 42,000 Ending UCC

Declining Balance Year 2: 42,000 UCC x 30% = 12,600 CCA

42,000 opening UCC – 12,600 CCA = 29,400 Ending UCC

Straight Line - Example

- <u>Stats</u>
  - Original Cost = 500,000
  - Opening UCC Pool = 200,000
  - Straight line over 5 years.

Straight Line Year 1: 500,000 / 5 years = 100,000 each year
200,000 opening UCC – 100,000 CCA = 100,000 Ending UCC

Straight Line Year 2: 500,000 / 5 years = 100,000 each year
100,000 opening UCC – 100,000 CCA = 0 Ending UCC

Straight Line - Practice

- Stats
  - Original Cost = 400,000
  - Opening UCC Pool = 250,000
  - Straight line over 8 years.

Straight Line Year 1: 400,000 / 8 years = 50,000 each year

250,000 opening UCC – 50,000 CCA = 200,000 Ending UCC

Straight Line Year 2: 400,000 / 8 years = 50,000 each year

200,000 opening UCC – 50,000 CCA = 150,000 Ending UCC

Accelerated First Year Rule

In the Year of Acquisition (purchase), 150% of the CCA on the additions can be taken

Declining Balance Example:

Opening UCC	\$10,000 x 10% =	1,000
Additions	\$5,000 x 10% x 150% =	750
Rate 10%	---------	------
Total Pool:	<u>15,000</u>	<u>1,750</u> Total CCA

10,000 Opening UCC + 5,000 Additions – 1,750 CCA = 13,250 Ending UCC

First Year Rule - Practice

Steve purchased a $15,000 vehicle during the year for his business. The balance in his vehicle UCC pool at the beginning of this year is $30,000 and the declining balance rate of CCA is 30%. Calculate his current year CCA and Closing UCC Balance.

Opening UCC	$30,000 x 30% =	9,000
Additions	$15,000 x 30% x 150% =	6,750
Rate 10%	---------	------
Total Pool:	45,000	15,750 Total CCA

30,000 Opening UCC + 15,000 Additions – 15,750 CCA = 29,250 Ending UCC

Short Fiscal Periods

- When a fiscal year is short you prorate the CCA
- Suppose the business only started in December CCA is 1/12 what it normally would be.

- <u>Application</u>
  - First or last year of the business
  - 150% first year rule still applies if it is the year of purchase
  - Length of business year determines proration, not length of ownership of the asset
  - Only applicable to business income. No proration on property income producing assets.

Short Fiscal Periods

When a fiscal year is short (suppose the business only started in December) you prorate the CCA

Facts: 10% Class, Cost $100,000, Year of purchase

Declining Balance Year 1: 100,000 x 10% x 150% = 15,000 x 1/12 (1 month out of 12 months) = 1,250.

100,000 opening UCC – 1,250 CCA = 98,750 Ending UCC

Declining Balance Year 2: 98,750 x 10% = 9,875

98,750 opening UCC – 9,875 CCA = 88,875 Ending UCC

Short Fiscal Periods - Practice

Clovis decided to start a business September 1, 2012 and his fiscal year end will be Dec 31, 2012. He purchased a small office building for $90,000 in October in order to open a Quiznos franchise. Calculate his CCA in year 1 and 2 assuming a 6% rate.

Declining Balance Year 1: 90,000 x 6% x 150% = $8,100 CCA x 4/12 (4 months out of 12 months) = $2,700 Prorated CCA

90,000 opening UCC – 2,700 CCA = 87,300 Ending UCC

Declining Balance Year 2: 87,300 x 6% = 5,238

87,300 opening UCC – 5,238 CCA = 82,062 Ending UCC

Important Rates

- Class 1 - Buildings
  - 4% - If not included in one of the other %'s.
  - 6% - After 2007 >90% Non-residential buildings (offices, malls)
  - 10% - After 2007 >90% Buildings used in Manufacturing & Processing (M&P)

Cannot use CCA to create or increase a rental loss

Important Rates

- <u>Class 8 – Miscellaneous/Equipment</u>
  - 20%
  - Furniture
  - Equipment
  - Machinery
  - Photocopiers
  - Telephone Equipment
  - If something doesn't have a prescribed class, it usually goes here.

Important Rates

- Class 10 - Vehicles
  - 30% - Non-luxury cars, motorcycles, trucks, trailers, or special purpose vehicles like a cube van to fill with tools for a contractor

- Class 10.1 – Luxury Vehicles
  - 30% - But limited to a CCA addition of $30,000 regardless of the vehicles cost.
  - Each luxury vehicles gets it's own Class 10.1
  - When you dispose of it, you still get a half year's CCA and then there is no terminal loss or recapture.

Important Rates

- Class 12 – Small Items & Software
  - 100%
  - Computer Software (no systems software -Microsoft 10)
  - Various Tools.
  - Books to be lent
  - Cutlery/China
  - Uniforms
  - Kitchen Utensils under $500

Important Rates

- <u>Class 13 – Leasehold Improvements</u>
  - Straight line – over the lease term + first renewal period. (minimum of 5 years if short term)
  - What is a Leasehold: you rent a unit in an office building but improve it with new walls, painting, electrical, plumbing. Pretty much anything not part of the structure that a renter adds.
  - Ex: Purchased leaseholds worth $70,000 in the second year of a 5 year lease (so 4 remaining). There is a renewal option on the lease of 3 years.

70,000 / (4 + 3) = 10,000 depreciated per year with 150% = $15,000 first year depreciation, 10k each year after

Important Rates

- <u>Class 53 – Manufacturing & Processing Equipment</u>
  - 50%
  - Purchased after 2015 and before 2026
  - Only for M&P Equipment, not general purpose

M&P includes the creation of things – food, other machinery, vehicles, medication, etc.

Important Rates

- <u>Class 50– Computers</u>
  - 55%
  - Computer Hardware – laptops/Desktops
  - System Software – Not Class 12 assets like Microsoft Office, more like what a computer needs to operate. (Think Microsoft 10)
  - Computer Classes change a lot. In recent years has been 45, 52, 55. Current additions go to 50, but older ones may not (purchased in 2007 for example)

Know Your Rates

- For each of the following depreciable assets, indicate the appropriate CCA Class.

• Printer	8
• Machine for cutting out vehicle parts	53
• BMW Costing $50,000	10.1
• New dividing wall in a rented office	13
• Manufacturing Plant	1 (10%)
• Microsoft excel	12

Leaseholds

150% first Year Rule Applies

Straight Line

Remainder of the lease term + first renewal period.

Leasehold improvements purchased in 2008 for $400,000.
Lease term is 7 years + two 3 year renewal periods.

CCA in 2008 is 400,000 / (7+3) x 150% = **$60,000**
400,000 / 5 x 150% = $120,000

CCA in 2012 is 400,000 / (7+3) = $40,000

Leaseholds

60,000
40,000
40,000
40,000
40,000
40,000
40,000
40,000
40,000
20,000

Leasehold improvements purchased in 2008 for $400,000. Lease term is 7 years + two 3 year renewal periods.

CCA in 2008 is 400,000 / (7+3) x 150% = $60,000
CCA in 2013 is 400,000 / (7+3) = $40,000

Leasehold improvements purchased in 2010 for $60,000 on the same building. (2 years have passed since lease started)

CCA in 2010 is 60,000 / (5+3) x 150% = **$11,250**
60,000 / 5 x 150% = 18,000

CCA in 2012 is 60,000 / (5+3) = $7,500

Class 10.1

Each one goes in a separate CCA pool

Additions are capped at $30,000 + tax:

- $40,000 car purchase = $30,000 added to UCC
- $20,000 car purchase = goes in Class 10.
- $60,000 car purchase = $30,000 added to UCC

Class 10.1

<u>On Sale</u>

-No Terminal Losses

-No Recapture

-1/2 year's CCA

10,000 UCC x 30% = \$3,000 x 50% = \$1,500 CCA deduction
10,000 UCC – 1,500 CCA = \$0 Ending UCC.

Class 10.1

Sold the car for $12,000. UCC pool of $15,000

$15,000 Opening UCC
- No impact for sale proceeds

$15,000 Remaining UCC in a class with no assets
($2,250) $15,000 x 30% x ½ Half year's CCA claimed.
- Resets UCC - No tax impact

CCA is based on UCC before disposals.

Class 10.1

Sold the car for $19,000. UCC pool of $15,000

$15,000 Opening UCC
 -           No impact for sale proceeds

15,000 Negative UCC in a class with no assets
($2,250) $15,000 x 30% x ½ Half year's CCA claimed.
-                    Resets UCC - No tax impact

CCA is based on UCC before disposals.

Disposing of Depreciable Property

- Accounting (Not tax)
  - Proceeds less Net Book Value (NBV) (original cost less amortization) = Gain or Loss

Example:

Gerald operates a business and owns several delivery trucks which are capital assets. He purchased them for $40,000 and has taken $25,000 in amortization since purchase. He sold them during the year for $60,000.

40,000 Cost – 25,000 Amort. = 15,000 NBV

60,000 Proceeds – 15,000 NBV = 45,000 Gain on Disposal

Accounting Disposition:

$100,000	Purchased equipment with 5 year useful life (Cost)
<u>(20,000)</u>	Amortization in Year 1 (1/5)
80,000	Remaining useful life after year 1 (NBV)

Equipment sold in year two for $120,000

$120,000	Proceeds
<u>(80,000)</u>	Net Book Value (Cost less Amortization)
40,000	Gain on Disposition

Disposing of Depreciable Property

Key to Know: No Capital Losses on Depreciable Property

- <u>Tax Treatment</u>
  - Lesser of: original cost or proceeds deducted from the pool.
    - IF: Still assets in the pool <u>and</u> a balance of UCC in the pool, then nothing special happens – CCA as normal.
    - IF: No assets in the pool <u>and</u> a UCC balance remaining, then terminal loss (less CCA taken than should have been)
    - IF: UCC is negative, then recapture results (more CCA taken than should have been)

Disposing of Depreciable Property

Proceeds in excess of cost trigger capital gains.

Original Cost

Proceeds in excess of UCC trigger recapture of negative UCC created.

UCC Balance of Pool

Proceeds less than UCC do nothing special if other assets left in the pool – CCA as normal.

Proceeds less than UCC trigger terminal loss of remaining UCC balance if no assets are left.

Example A – No Special Tax Impact

Mr. Sykes bought a piece of equipment for 100,000 and claimed CCA over time. His opening UCC balance for the current year was $150,000 and he sold the equipment for $60,000. He has several pieces of equipment left.

UCC Opening Balance	$150,000
Disposals	(60,000) (less of 100k and 60k)

UCC Ending Balance	$90,000
	x 20%
	(18,000) CCA deduction
	72,000 Ending UCC

Reduces the pool, but does not deplete it (less than zero) and there are still assets to depreciate. Therefore, no special tax impact (terminal loss or recapture, etc).

Example B – Terminal Loss

Mr. Sykes bought a piece of equipment for 100,000 and claimed CCA over time. His opening UCC balance for the current year was $150,000 and he sold the equipment for $60,000. He has no equipment left.

UCC Opening Balance	$150,000
Disposals	(60,000) (less of 100k and 60k)

Terminal Loss	$90,000 Reduction of Income

Reduces the pool, but does not deplete it (less than zero) but no assets left to depreciate. Should have depreciated faster.

Example C - Recapture

Mr. Sykes bought equipment for 100,000 and claimed CCA over time. His opening UCC balance for the current year was $50,000 and he sold the equipment for $60,000.

UCC Opening Balance	$50,000
Disposals	(60,000) (less of 100k and 60k)

Recapture of CCA	(10,000) Included in income

Reduces the pool to less than zero. Assets were depreciated too quickly. Need to recover some CCA taken by reporting income.

Example D - Gain

Mr. Sykes bought equipment for 100,000 and claimed CCA over time. His opening UCC balance for the current year was $50,000 and he sold the equipment for $120,000.

UCC Opening Balance	$50,000
Disposals	(100,000) (less of 100k and 120k)

Recapture of CCA	(50,000) Included in income

Reduces the pool to less than zero. Assets were depreciated too quickly. Need to recover some CCA taken by reporting income.

Proceeds also more than cost. An absolute gain has occurred. Must treat as a capital gain.

$120,000 Proceeds – 100,000 Cost = 20,000 Capital Gain 50% taxable = $10,000 included into income.

Practice - A

Mr. Sykes bought a piece of equipment for 80,000 and claimed CCA over time. His opening UCC balance for the current year was $170,000 and he sold the equipment for $90,000. He has one other piece of equipment left.

UCC Opening Balance	$170,000	
Disposals	(80,000)	(less of cost and proceeds)
UCC Ending Balance	$90,000	Assets left to depreciate

- Reduces the pool, but does not deplete it (less than zero) and there are still assets left to depreciate. No Income Impacts
- Capital gain triggered as proceeds exceed cost

$90,000-80,000 = $10,000 capital gain 50% taxable = $5,000 inclusion

Practice - B

Mr. Sykes bought a piece of equipment for 150,000 and claimed CCA over time. His opening UCC balance for the current year was $60,000 and he sold the equipment for $120,000. He has no other equipment left

UCC Opening Balance	$60,000	
Disposals	(120,000)	(less of cost and proceeds)
UCC Ending Balance	$(60,000)	Recapture (100% income)

Reduces the pool to less than zero. Assets were depreciated too quickly. Need to recover some CCA taken by reporting income.

Next year's Opening UCC Balance will be zero. Recapture resets the UCC to zero.

Income from Business

What is Business Income?

Net Income for Tax Purposes

- Net Employment Income
- Net Business Income
- Net Property Income
- Capital Gains and Losses
- Other Income
- Other Deductions
- <u>Current Year Losses – Capital or Non-Capital</u>

- = Net Income For Tax Purposes

Differences so far

- Net Employment Income
  - Can only be earned by individuals
  - Taxed on the cash basis

- Net Business Income
- Net Property Income

- Capital Gains and Losses
  - Can be reported by any taxable entity (corporation, trust, individual)
  - Taxed on the accrual basis

Income Over Time

- Important Reminder:
  - This determination occurs on the income that is earned over time. Business vs. Property income on property that is held.
- Why is this important?
  - Individuals – Only important in determining what deductions are available against the income.
  - Corporations – Property income is taxed as a significantly higher rate within a corporation.

Business vs. Property

- Property Income
  - Less effort to earn
  - “Passive” income
  - No large commitment of time, labour or attention
- Business Income
  - Actively Earned
  - “An adventure in the nature of trade”
  - Not employment income

Business vs. Property

- Property Income
  - Interest
  - Dividends
  - Rental Income
  - Royalties
- Business Income
  - Plumbing business
  - Starbucks Franchise
  - Providing legal consultations

Business vs. Property - Example

- An individual operates a 2 unit rental building (duplex) and has no employees. Would these rents be considered business or property income?

This income would be considered property, no significant commitment of time is required to earn income from a duplex unit.

- An individual operates a 50 unit rental building (complex) and has 8 employees to do bookkeeping, perform maintenance, and sit at reception. Would these rents be considered business or property income?

This income would be considered business income. Managing 8 employees for this number of units would require active work

Business vs. Property - Example

- An individual investments $20,000 in GIC's which bear interest at 6% annually. Is this interest business or property income?

This income would be considered property. Passive income that Involves only holding the GIC until interest is paid.

- An individual invests $300,000 in a McDonald's franchise and regularly checks in on the progress of the manager to make sure things are on track. Would income earned be business or property income?

This income would be considered business income. The individual Is monitoring and regularly managing their business. (Management Fees)

Gain on Sale

(business/cap gains)
(inventory/capital property)

- Important Reminder:
  - This determination occurs when an asset is sold.
- Why is this important?
  - Because capital gains are only 50% taxable, can be incentive to argue that income is capital and not business income.
  - Because capital losses are restricted and only 50% claimable, can be incentive to argue that losses are business losses and not capital

Business vs. Capital Gains

- Tests for Capital vs. Inventory
  - Did you buy the item to resell?
  - Length of ownership period (2 weeks vs. 5 years)
  - Is your normal business buying & reselling?
  - Number & frequency of transactions
  - Supplemental work on the property

- Capital Assets - Acquired to earn income through their use. Capital Gain on sale
- Inventory – Acquired to be resold for profit. Business Income on sale

Business vs. Capital Gains

- Inclusion Rate
  - **Business income** included in taxable income 100%
    - Dispose of an investment:
    - $10 FMV - $5 cost = $5 gain x 100% = $5.00 taxable
  - **Capital Gains** included in income 50%
    - Dispose of an investment:
    - $10 FMV – $5 cost = $5 gain x 50% = $2.50 taxable
- Application
  - Capital losses only deductible against capital gains

Business vs. Capital Gains

- Regularly performing an activity with a view to profit can result in business income, where it might otherwise be considered property income.

- Example:
- House Flippers Vs. Selling the Family Cottage

Ordinarily, the sale of a cottage is considered capital gains. It is Not purchased to earn income and occurs over a long period of time. However, house flippers buy homes with the intent to improve and Resell them. The trades occur frequently. This recharacterizes the Gains on sale as busines income.

Business vs. Capital Gains

- Regularly performing an activity with a view to profit can result in business income, where it might otherwise be considered property income.

- Example:
- Day Trading Vs. Passing Investing

Ordinarily, the sale of investments is considered capital gains. Generally, investments are purchased with the intent that their Value will increase over time. However, day traders intend to make Profits over a very short period of time. They purchase stocks with The intent to resell them shortly at a profit. This changes their nature To Business income.

Examples:

Ostrich Producers of Ontario, 2012

Business Income Calculation

Calculation of Business Income

START	Income for Accounting Purposes	$100,000
	Adjust for items restricted in the act	
	Adjust for items permitted in the act	
	<u>Example:</u>	
	Amortization (not deductible for tax)	$20,000
	CCA (not included in accounting income)	<u>(16,000)</u>
	Business Income for Tax	$104,000

Calculating Business Income

- <u>Start with Accounting Income (Financial Statements)</u>
  - Add Items Back
    - Accounting Depreciation
    - Accounting losses
    - Taxable Capital Gains
    - Income Tax Expense
    - Interest & Penalties on Taxes
    - 50% of meals & entertainment
    - Current year financing fees
    - Non-deductibles (Yacht, Golf)
    - Unreasonable expenses (high income to spouse)

Calculating Business Income

- Less Items
  - Capital Cost Allowance (CCA-Tax depreciation)
  - Financing Costs (over 5 years)
  - Accounting Gains
  - Landscaping Costs (if capitalized for accounting)

=Net Income for Tax Purposes

Calculating Business Income

- Adjusting Items
  - Accounting Gains removed, Capital Gains added
    - Example, sale of land purchased for $10, sold for $30.
    - Accounting gain = $20 ($30-$10)
    - Taxable Capital Gain = $10 ((30-10) x 50%)

Adjusting accounting income to taxable income

Deduct: accounting gain	(20)
Add: taxable capital gain	10
Adjusted Income	(10)

Calculating Business Income

- Adjusting Items
  - Unreasonable Expenses
    - Amounts paid to related entities must be reasonable to be deductible
    - Salary for wife who does bookkeeping $150,000
    - Arms length individual would be paid $40,000

Adjusting accounting income to taxable income

Add: unreasonable amount	150,000
Deduct: reasonable amount	(40,000)
Adjusted Income	110,000

Calculating Business Income

<u>Meals & Entertainment</u>

- 50% Deductible in ordinary circumstances
- 80% Deductible for long haul truck drivers traveling away from home at least 24 hours.
- <u>No restriction if:</u>
  - Meals provided to customers (hotels, airlines)
  - Meals for a charitable fundraising event
  - When reported as a taxable benefit
  - When for meals in a remote work site
  - **When made available to all employees (office meetings or Holiday parties).**
  - Meals billed to clients who reimburse

Calculating Business Income

- Adjusting Items
  - Meals
    - Example assumes ordinary 50% meals of $1,000

Adjusting accounting income to taxable income	
Add: 50% of meals	500
Deduct: no offset	0
Adjusted Income	500

Calculating Business Income

- Adjusting Items
  - <u>Financing Fees</u>
    - Costs of refinancing debt.
    - Deductible over 5 years – straight line
    - Assume current year fee paid of $1,000

Adjusting accounting income to taxable income	
Add: any current year fee	1,000
Deduct: 1/5 of current year	<u>(200)</u>
Adjusted Income	800

Income reduction in year 2, 3, 4, 5 = $200 in each year

Calculating Business Income

- Adjusting Items
  - Reorganization Fees
    - Legal and accounting fees paid to perform a reorganization or incorporation
    - Non-deductible but then added to Class 14.1

Adjusting accounting income to taxable income	
Add: accounting deduction	1,500
Deduct: no offset	(0)
Adjusted Income	1,500

CCA deduction calculated separately. And CCA deduction taken.

Calculating Business Income

- Adjusting Items
  - <u>Landscaping Fees</u>
    - Landscaping fees are capitalized to the cost of land for accounting purposes
    - They are deductible for tax purposes

Adjusting accounting income to taxable income

Add: no offset	0
Deduct: landscaping fees	(2,000)
Adjusted Income	(2,000)

Calculating Business Income

- Adjusting Items
  - <u>Interest & Penalties</u>
    - Can't deduct interest and penalties owing because of the tax act (on late filing, late payment, late installments, etc.)
    - Must add it back to calculate business income
  - <u>Taxes Owing per Financial Statements</u>
    - Financial Statement income is ordinarily shown net of tax (tax already deducted).
    - Must add it back to calculate the business income we want to apply tax to.

Business Income Inclusions

Business Income Inclusions

- Damages
  - For example, a subcontractor defaults on the contract and you are awarded damages
- Gambling Profits
  - Only when earning it constitutes a business (a professional gambler). Otherwise, gambling and lottery winnings are tax free.
- Inducement Payments
  - For example, receipt of a lease inducement from tenant who wants special terms included in a lease.

Business Income Inclusions

- Profits from Illegal Businesses
  - Drugs, Bribery, and Prostitution Income is Taxable
- Government Assistance
  - When received to purchase capital assets, it reduces the cost of the assets.
  - When received for an income earning purpose, it is included in taxable income.
- Restrictive Covenants
  - Includes non-compete clauses received other than by employment. Example, from the person who purchases your business

Restrictions on Business Deductions

Business Deduction Restrictions

- Capital Costs
  - Non-deductible, only CCA can be taken.
  - If deducted for accounting, must be added back.

- Personal or living expenses
  - Personal housing, travel, meals, clothing, etc.

- Must be Incurred to Earn Taxable Income
  - Expenses to earn exempt income aren't deductible
  - Must be incurred with the intent to earn income

Business Deduction Restrictions

- Interest & Property Taxes on Vacant Land
  - Since not technically incurred to earn income it isn't deductible. These amounts are capitalized to the cost of the land.
- Illegal Payments
  - Bribes, Fines, Tickets
- Political Donations
  - Not deductible but able to receive a credit for them.

Business Deduction Restrictions

- Yacht, Camp, Lodge, or Golf Dues
  - Never deductible to businesses

- Expenses of Personal Services Business
  - What is a PSB? Acting as an employee through a corp.
  - Restricted to employment expenses

Business Deduction Restrictions

- <u>Life Insurance</u>
  - Cannot be deducted unless:
    - Required by the lender
    - Lender is a financial institution (bank)
    - Used as collateral for a loan
    - Interest on that loan is deductible

Life Insurance Example:

Andy borrows $50,000 from the bank to buy new vending machines for his snack business. He's getting on in years so the bank asks for life insurance against the balance of the loan. Andy thought he'd probably like extra life insurance too so bought a policy for $150,000.

The annual premiums were $6,000

Can Andy deduct the life insurance against business income?

Yes – it is a requirement of lending

How much can he deduct?

$2,000 the proportion the premiums are to the required insurance
$6,000 premiums x ($50,000 required / $150,000 obtained)

Comprehensive Examples

Example A:

Financial Statements of Harpco:

Revenues from sale of widgets	$60,000
Salaries	$10,000
Depreciation/Amortization (CCA $10k)	$6,000
Legal fees	$2,000
Accounting fees	$2,000
Meals & Entertainment	$1,800
Interest ($100 from CRA)	$1,500
Parking Tickets	$200
Net Income before tax	$36,500
Tax Expense	$5,840
Net Income	$30,660

Example A: Solution

Accounting Income	**30,660**
Tax Expense for Accounting	5,840
Salary (no adjust if reasonable)	-
Accounting Amortization	6,000
CCA (assumed)	(10,000)
Legal (no adjust if not reorg/finance)	-
Accounting (no adjust if not reorg/finance)	-
Meals (50% deductible)	900
Interest & penalties from CRA	100
Parking Tickets (illegal)	200
Net income for tax purposes:	**33,700**

Example B:

Financial Statements of Harpco:

Revenues from sale of widgets	$500,000
Salaries	$170,000
Depreciation	4,000
Financing Fees	2,000
Life Insurance (no debt)	3,000
Net Income before tax	$321,000
Tax Expense	$50,000
Net Income	$271,000

CCA $6,000 & Bribes accepted $3,000 (unreported)
Plays the lottery once a week at work, and won $50,000 (unreported)
Husband earns $130,000 as bookkeeper, would cost $40,000 to replace.

Example B: Solution

Accounting Income	**$271,000**
Tax Expense (Added back to calc pre-tax income)	50,000
Salaries (add unreasonable)	$130,000
Salaries (deduct reasonable)	(40,000)
Depreciation (add accounting)	4,000
CCA (deduct for tax)	(6,000)
Financing Fees (deductible over 5 yrs)	2000
Financing Fees (Deduct year 1)	(400)
Life Insurance (deductible if required for debt)	3,000
Bribes not included in accounting income	3,000
Lottery winnings (not business income)	-
Net income for tax purposes:	**416,600**

Example C:

Jim operates a welding business. He doesn't maintain records but wants you to calculate his taxable income. He believes he earned \$50,000 from sale of his services and received \$15,000 in government grants to get started. He paid his employees \$7,000 in salaries (unrelated to Jim) and paid for \$400 in meals while they were on the job. He used some welding profits to pay for a new lawn mower which cost \$500.

Calculate Jim's Net Income for Tax Purposes from Business Income.

Example C: Solution

Accounting Income (N/A)	**0**
Revenue	50,000
Government Assistance	15,000
Salaries (all reasonable)	(7,000)
Meals (no exceptions-50% deductible)	(200)
Lawn mower (personal)	-
Net income for tax purposes:	**57,800**

Income from Property

What is Property Income?

Net Income for Tax Purposes

- Net Employment Income
- Net Business Income
- Net Property Income
- Capital Gains and Losses
- Other Income
- Other Deductions
- <u>Current Year Losses – Capital or Non-Capital</u>

- = Net Income For Tax Purposes

Differences so far

- Net Employment Income
  - Can only be earned by individuals
  - Taxed on the cash basis

- Net Business Income

  Net Property Income

  Capital Gains and Losses
  - Can be reported by any taxable entity (corporation, trust, individual)
  - Taxed on the accrual basis (some exceptions)

Business vs. Property

- <u>Property Income</u>
  - Less effort to earn
  - Interest
  - Dividends
  - Rental
  - Royalties

- <u>Business Income</u>
  - Actively Earned
  - “An adventure in the nature of trade”
  - Not employment income

Definition

- Difference from Business Income covered in great detail in Session 6.
- Return on invested capital where little or no effort is required by the investor to produce the return.
- Doesn’t include capital gains, as these are included elsewhere as income under the tax act.

Important Because

- CCA cannot be used to increase or create a loss on property income.
- No requirement to prorate CCA on assets used to produce property income for short year ends.
- Limited deductions for property income – No CEC, convention expenses,

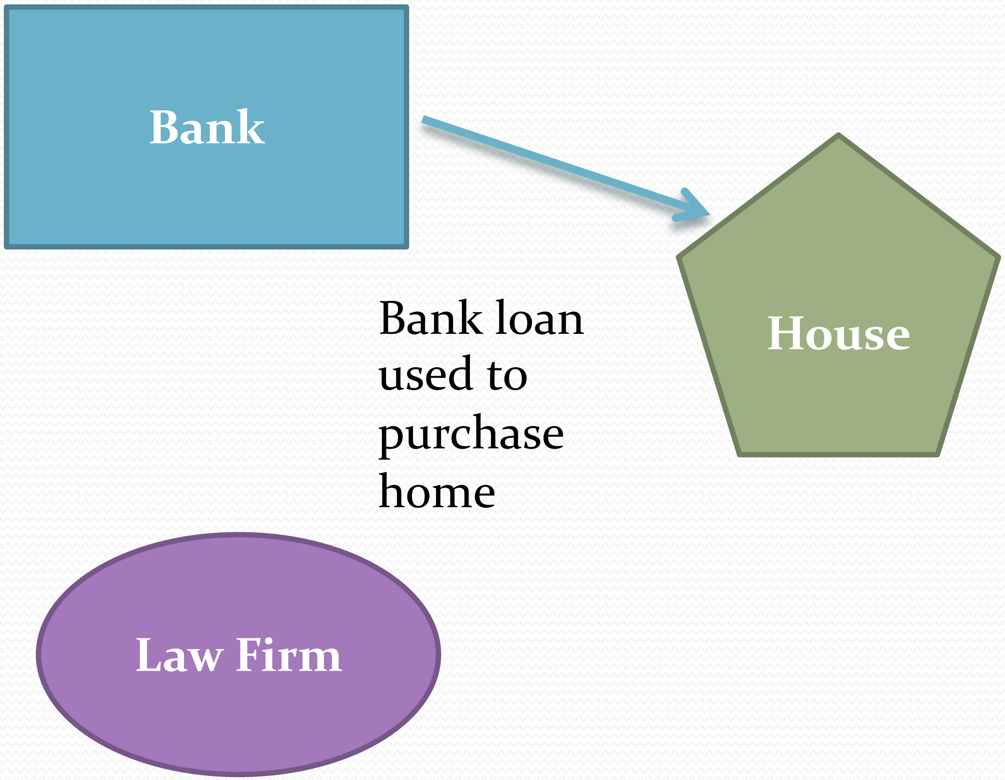
Interest Deductibility

Restrictions

- Deductible only to the extent it is incurred to earn business or property income.
  - Capital gains do not qualify
  - Employment Income does not qualify
  - Cannot be interest for personal purchases

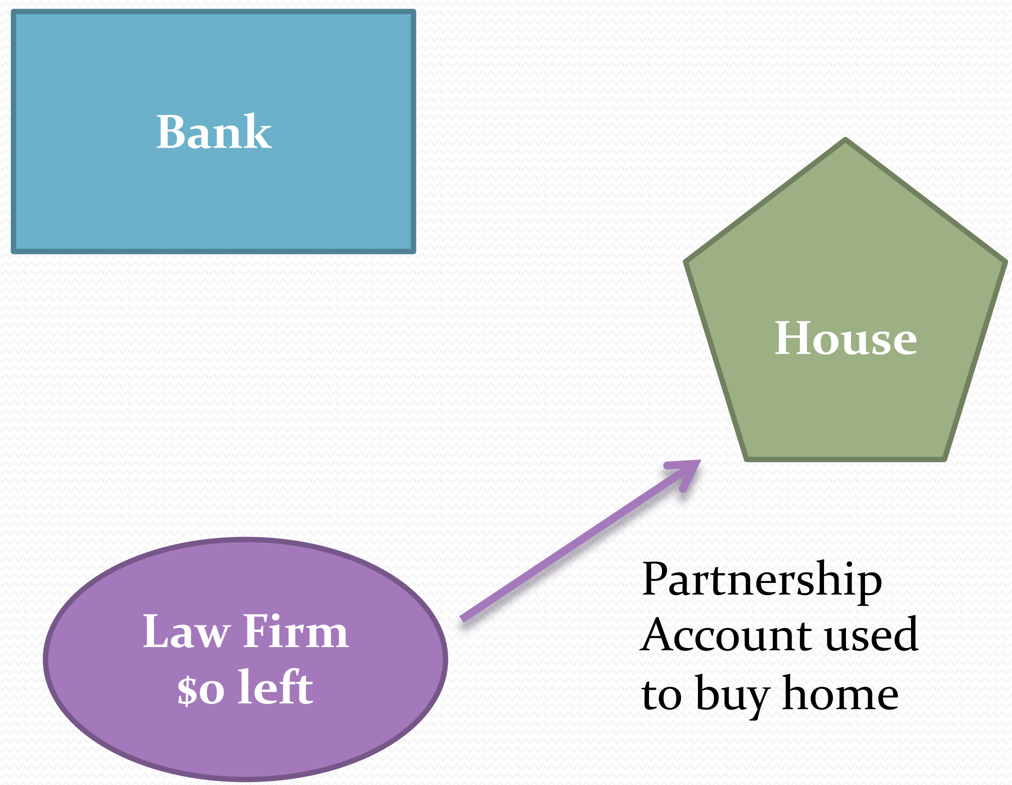
Typical Home Buying Transaction

- Ordinarily a taxpayer will loan funds from a bank to buy a home.
  - Personal Transaction
  - No deduction if there is interest paid



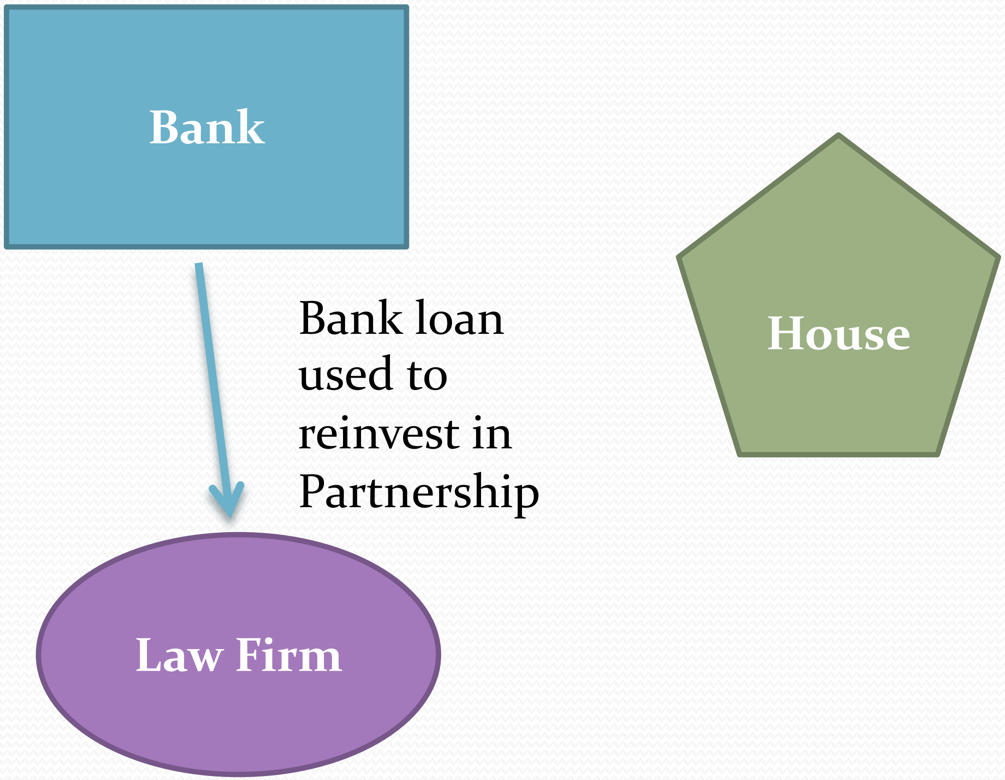
Singleton Case – Step 1

- Withdrew funds from his law firm to purchase a personal home.
    - Personal Transaction
    - No deduction if there is interest paid



Singleton Case – Step 2

- THEN, received a commercial loan and reinvested in the law firm.
  - Interest on this debt, used to invest in business income earning asset, is deductible.

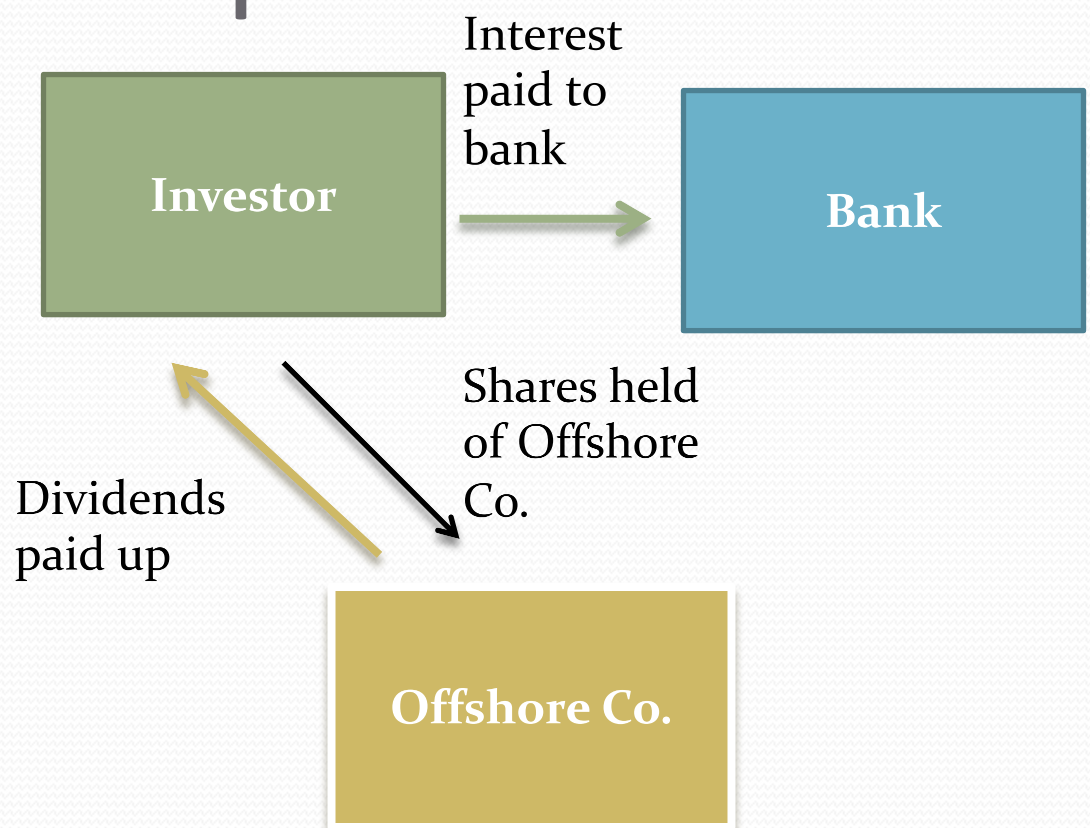


Singleton - Result

- The "<u>shuffle of cheques</u>" created legal relationships.
- The interest paid by the taxpayer was on debt used to earn income (by being contributed to the law firm)
- Therefore, the interest was deductible. (ie. Taxpayer WIN!)
- No debt existed for the purchase of the home, therefore the structure is the most tax advantageous (no lost deduction for interest paid)

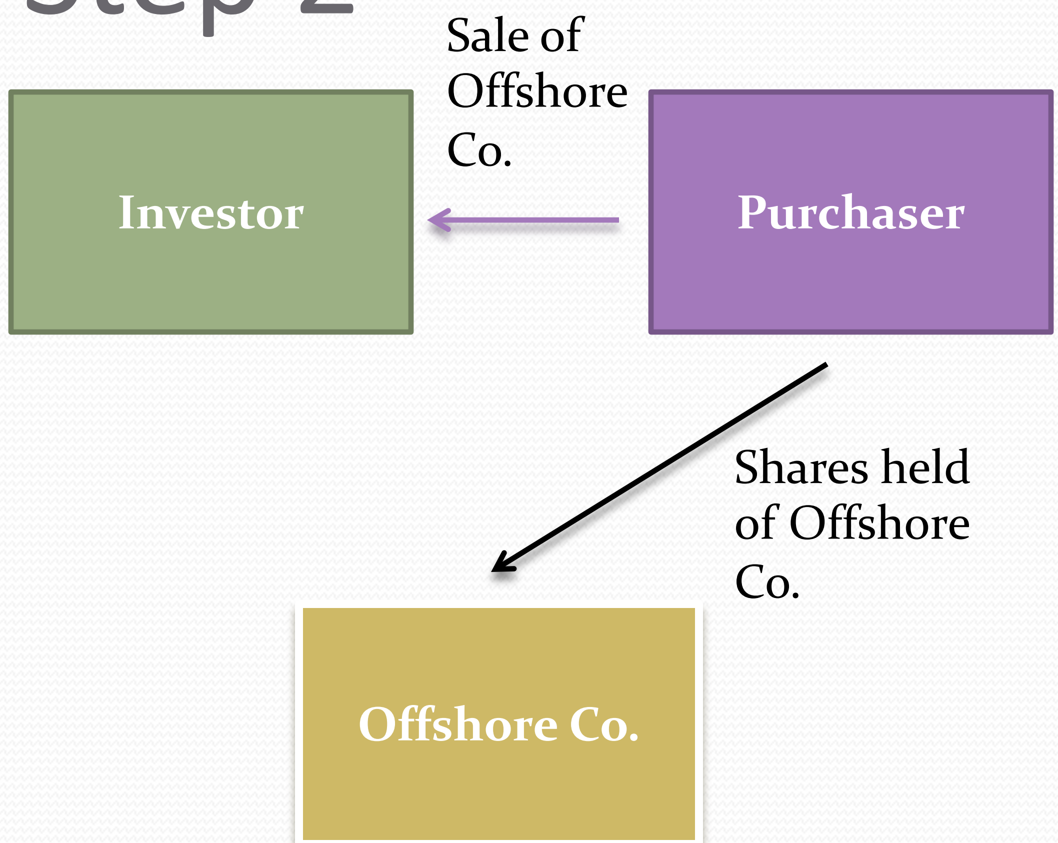
Ludco Case – Step 1

- Borrowed funds to invest in an offshore company
  - $6,000,000 in interest paid
  - $600,000 in dividends received



Ludco Case – Step 2

- Shares of Offshore Co. sold to a purchaser
  - $9,200,000 capital gain incurred.
  - CRA's position that purchase was to earn gains, not income.



Ludco - Result

- Earning business or property income doesn't have to be the ONLY purpose of the transaction.

- An investment can have multiple purposes.

- Therefore, the interest was deductible. (ie. Taxpayer WIN!)

- This case is further complicated by the size of income ($600,000) to interest paid ($6 million). Although approved in this case, there is some dispute over whether it would fall prey to the proposed Reasonable Expectation of Profit Rules (REOP)

Interest

- What is interest?
  - It must be accrued on a continuous basis (able to be calculated at any point in time)
  - It must be calculated based on a principal amount
  - It must be compensation for the use of the principal amount.

Direct or In-Direct Use

Requirement is that the funds borrowed must be used to earn income from Business or Property.

- Remember Singleton – The use of the loan on which the interest is paid is the important one. Economically was to purchase a home, directly was to invest in law firm.

Direct or In-Direct Use

Direct Use is the general use, with Two Exceptions

- Exception 1: FILLING THE HOLE

  Interest on loans made to Pay Dividends, Redeem Shares, or Return Capital can be deductible where:

  The loan takes the place of capital already invested in the company

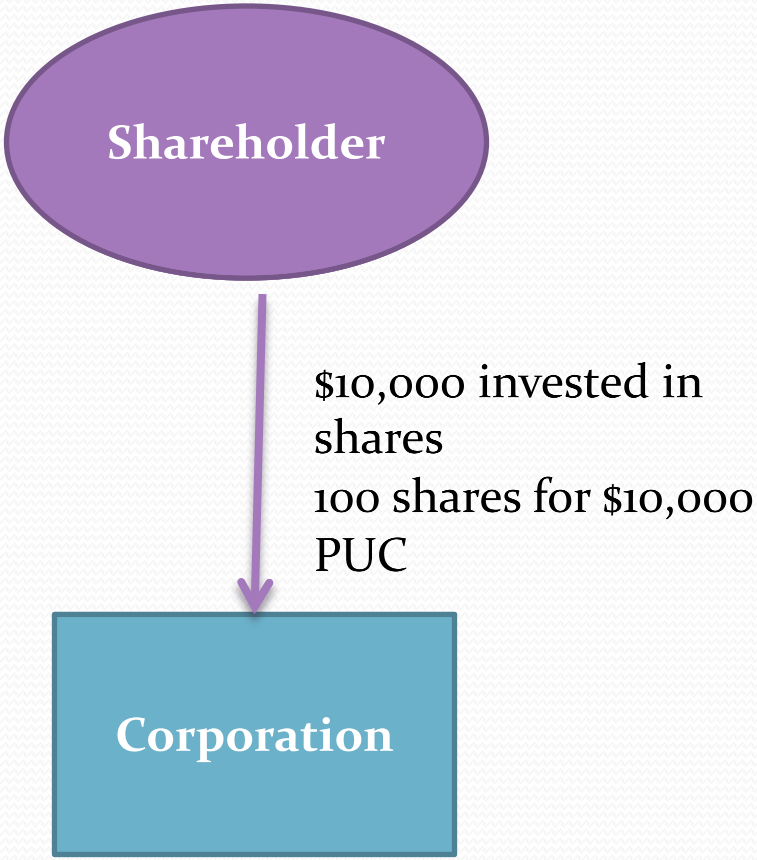
  - Return of capital limited to paid up capital of shares.
  - Redemptions and dividends limited to retained earnings left in the company

Filling the Hole – ROC Step 1

- Step 1 :

  Individual invests $10,000 of his own money in a company.

  Invested capital is $10,000



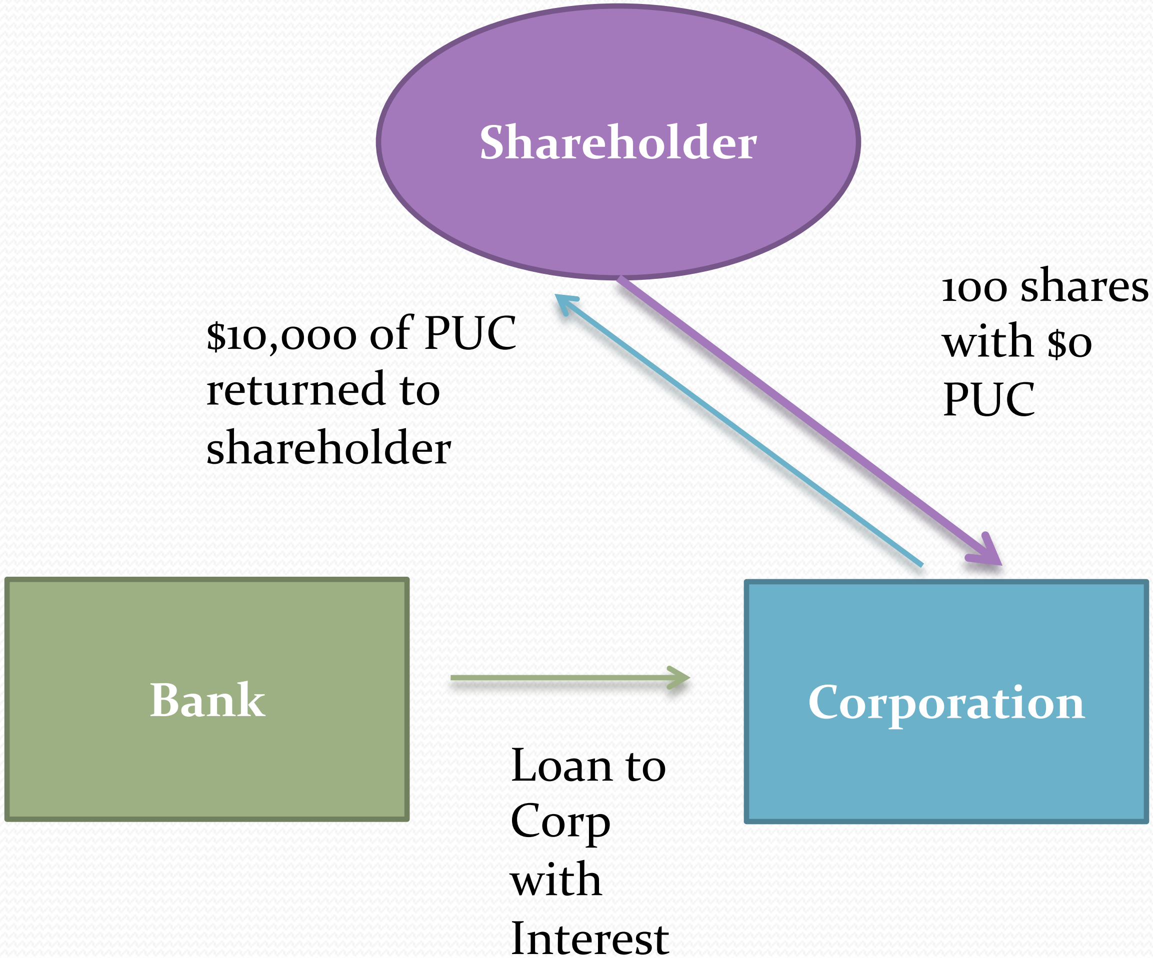
Filling the Hole – ROC Step 2

- Step 2 :

  Corporation borrows $10,000 from the bank and repays the Shareholder

  Invested capital remaining is $0

  Corporation pays interest to bank



Filling the Hole – ROC Result

- Direct use of the money was to return capital to the shareholder.

- In-direct use of money was to replace money the shareholder invested to earn income from business or property.

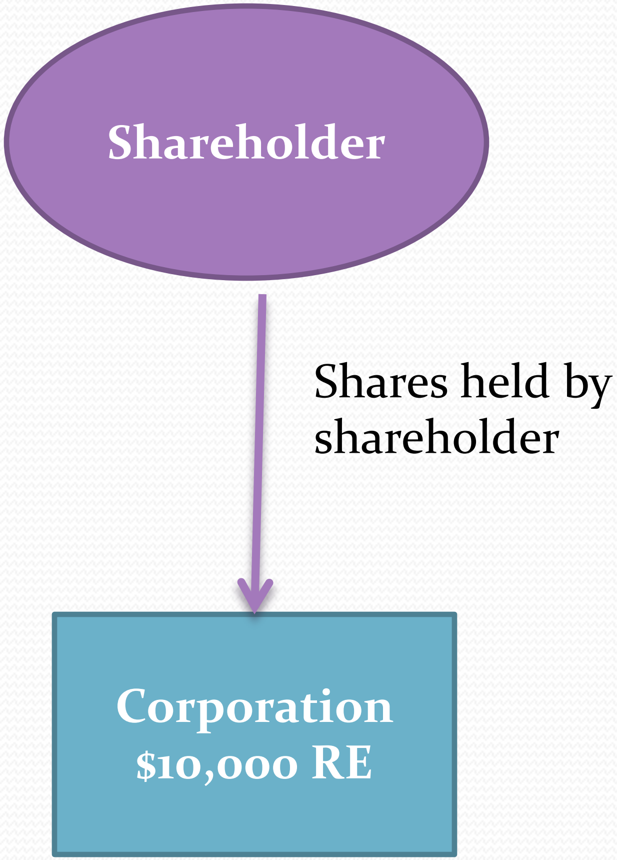
- Hence why it is called the "Fill the hole" concept. Based on replacing money, that was originally used for purposes that would cause interest to be deductible.

Filling the Hole – Dividend Step 1

- Step 1 :

  Corporation earns $10,000 after tax and never pays a dividend.

  Retained Earnings of company is $10,000



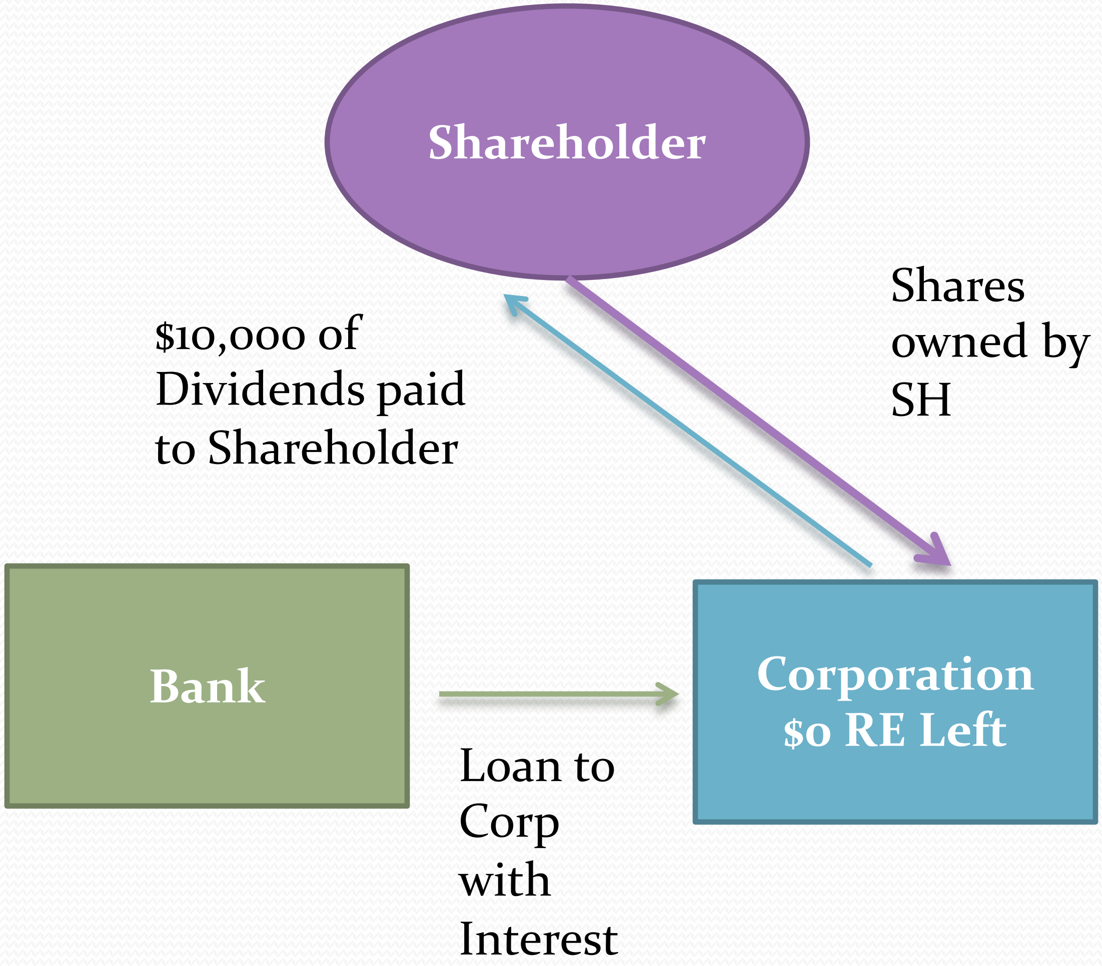
Filling the Hole – Dividend Step 2

- Step 2 :

  Corporation borrows $10,000 from the bank and pays a dividend to the shareholder

  Retained Earnings is $0

  Corporation pays interest to bank



Filling the Hole – Dividend Result

- Direct use of the money was to pay a dividend to the shareholder.
- In-direct use of money was to replace money the shareholder invested to earn income from business or property.
  - shareholder "invested" the retained earnings of the corporation, by not distributing them previously.
  - By leaving them within the corporation the shareholder made the choice to invest them.
- Hence why it is called the "Fill the hole" concept. Based on replacing money, that was originally used for purposes that would cause interest to be deductible.

Interest Free Loans

Interest paid on loans used to make interest free loans are not deductible

- Exception 1: INTEREST FREE LOANS

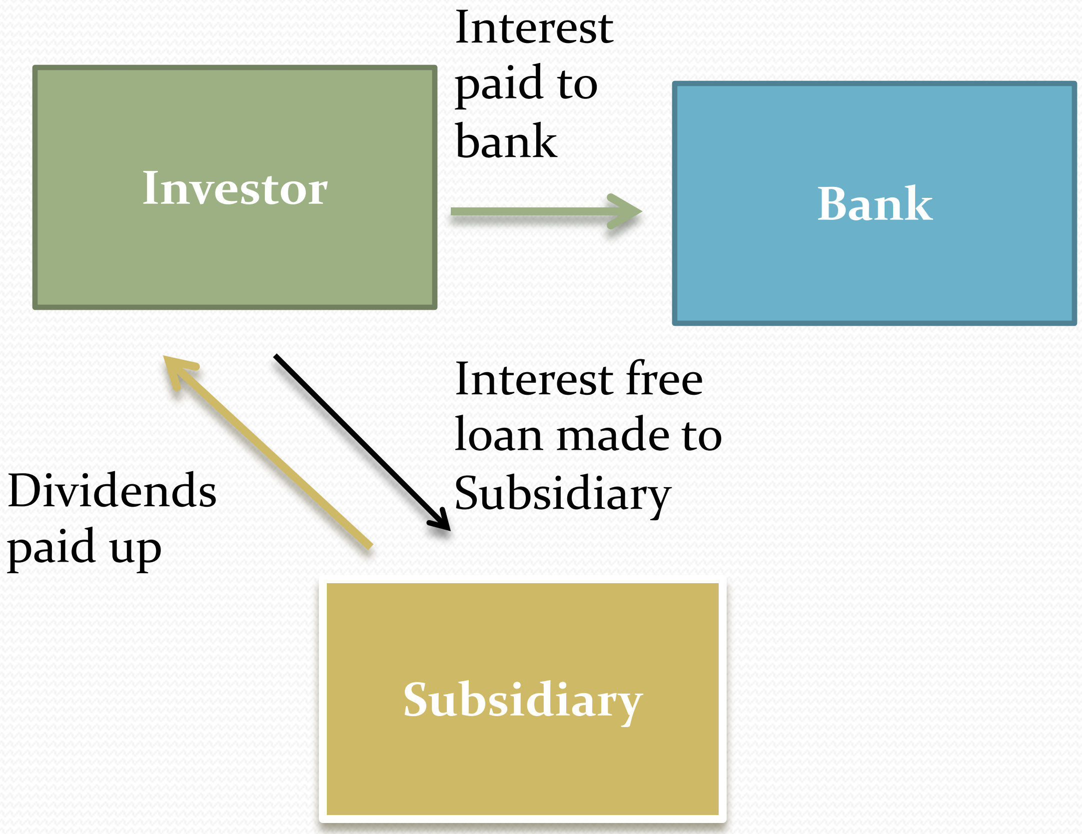
  Interest on money borrowed to make interest free loans can be deductible if income is expected to be earned another way than by interest because that loan was made

  Example:

  - Interest free loan to a corporate subsidiary, who then pays dividends to the lender.

Interest Free Loans

- Borrowed funds to invest in a subsidiary
  - Loan to sub allows them to earn income, which they distribute as dividends
  - Investor has earned dividend income (property) from the loan



Linking to Current Use

The current use of the borrowed funds must be to earn income.

- <u>Step 1:</u> An individual borrows $100,000 to buy shares of a corporation that pays dividends.
  - Interest on the loan is deductible.
- <u>Step 2:</u> The individual sells the shares of the corporation for $100,000 and uses those funds to buy a yacht. The loan is still outstanding
  - The interest on the loan is no longer deductible. The current use of funds is to buy a yacht

Linking to Current Use

The current use of the borrowed funds must be to earn income.

- Step 1: An individual borrows $100,000 to buy shares of a corporation that pays dividends.
  - Interest on the loan is deductible.
- Step 2: The individual sells the shares of the corporation for $100,000 and uses those funds to invest in a copyright that earns royalties. The loan is still outstanding
  - The interest on the loan remains deductible. The new use is to earn royalties, which is property income.

Linking to Current Use

What happens if sold for more or less than the purchase price?

- Step 1: An individual borrows $100,000 to buy shares of a corporation that pays dividends.
    - Interest on the loan is deductible.
- Step 2: The individual sells the shares of the corporation for $60,000 (less) and uses $20,000 to invest in a new car and $40,000 to invest in another corporation.
    - The interest on the loan is prorated. 2/3 will be deductible, 1/3 will not be.
    - This is the ratio of the current use of the funds ($40,000 income earning/$60,000 total proceeds = 2/3 deductible)

Linking to Current Use

What happens if sold for more or less than the purchase price?

- Step 1: An individual borrows $100,000 to buy shares of a corporation that pays dividends.
  - Interest on the loan is deductible.
- Step 2: The individual sells the shares of the corporation for $120,000 (More) and uses $20,000 to invest in a new car and $100,000 to invest in another corporation.
  - Option 1 – the interest on the loan is allocated 100% to the most beneficial use ($100,000 of loan allocated to $100,000 investment)
  - Option 2 – the interest is prorated based on the % of the proceeds is used to earn income
    - $20,000 / $120,000 = 16.67% of the interest will be non-deductible.

Disappearing Source Rules

If loan proceeds disappear, borrower isn't penalized.

- Step 1: An individual borrows $100,000 to buy shares of a corporation that pays dividends.
  - Interest on the loan is deductible.
- Step 2: The individual sells the shares of the corporation for $60,000 and uses those funds to repay the loan. $40,000 of the loan is outstanding
  - The interest on the loan is still deductible.
  - The asset's decline in value shouldn't unfairly penalize the taxpayer

Common vs. Preferred Shares

- Preferred shares typically have set dividend rates (ex. 5% per year)
  - Purpose of earning income is easy to observe. Dividends received regularly
- Common shares do not ordinarily have a mandatory dividend on them. They are "participating" in that they can share in the growth of the company by receiving dividends when and if there is income in the company.
  - Purpose of earning income is still present, if it could be expected that dividends will be paid.
  - Not there if explicitly state in their terms that no dividends will be paid.

Interest Income

Interest

- Taxed when earned by corporations and trusts (Accrual method)
- Taxed on the anniversary date for individuals or when cash is received if earlier.

Bond Cash Flow

This is a $10,000 5% bond

Date	Cash Flow	Income
Feb 1, 2016	($10,000) Issued	-
Dec 31, 2016	Year end	-
Feb 1, 2017	$0	$500 Accrued
March 15, 2017	$700	$200 (Cash is taxable, less accrued amount already reported
Dec 31, 2017	Year End	-
Feb 1, 2018	$0	$300 2nd year accrual (2 years x $500 per year, less excess cash already reported)

Taxation of Dividends

Definition

- Dividends are payments of corporate earnings to shareholders.
- Paid out of after tax retained earnings
- Not deductible to the corporation

Example:

\$100,000 Revenue

(\$20,000) Supplies Expense

\$80,000 Net Income

(12,400) Tax on Net Income

\$67,600 After Tax Income

\$30,000 Opening RE

\$67,600 Current Year Income

(40,000) Dividends Paid

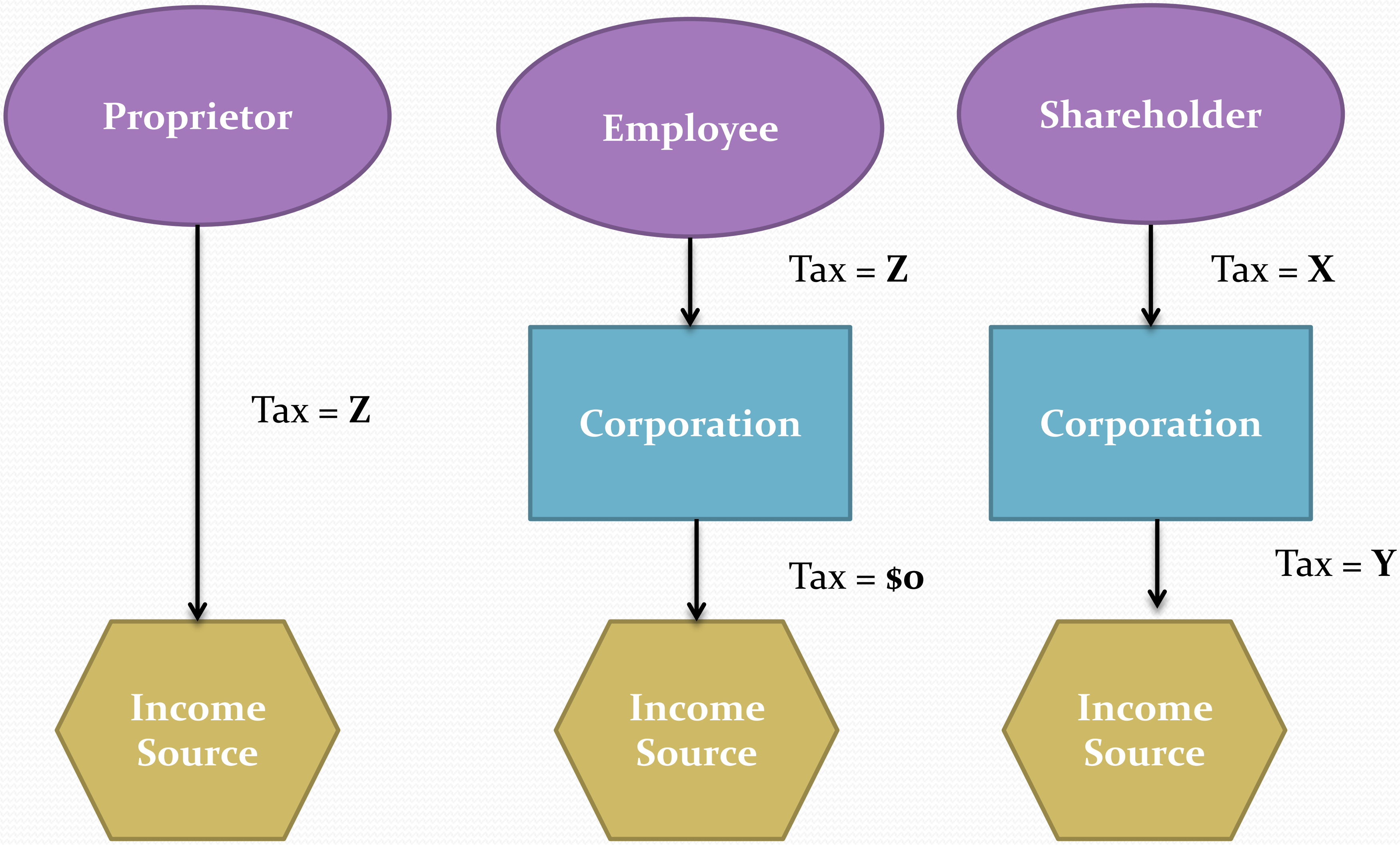
\$57,600 Ending RE

Concept of Integration

- Theory that regardless of how a specific type of income is earned, the same overall tax should be levied.
  - Ie. earned through corporation, partnership, sole-proprietor, etc.
  - Eligible and Non-Eligible Dividends help create this "integration"
  - Will be covered more thoroughly in ECON3205 when discussing corporate taxation.

Integration

X + Y = Z



Dividends – Non-Eligible

- Non-Eligible
  - Grossed up 1.25 x Actual
  - Credit 16 2/3% of Actual
  - Applies to dividends from small corporations who pay the low rate of tax.

Example

$1,000 non-eligible dividend.

$1,250 Taxable Dividend included in income ($1k x 1.25)

$167 Dividend Tax Credit ($1,000 actual dividend x 16.67%)

Dividends – Non-Eligible

Calculate Tax Assuming $50,000 in salary as well as this $1,000 non-eligible dividend.

$51,250 Taxable Income

$13,176 Tax on income (10,363 + ((51,250-43,000)x.341))

$11,000 Personal Credit

(2,651) Reduces Tax ($11k x .241)

(167) Dividend Tax Credit

(2,818) Total Credits

$10,358 Net Tax (13176 – 2818)

Example

$1,000 non-eligible dividend.

$1,250 Taxable Dividend included in income ($10k x 1.25)

$167 Dividend Tax Credit ($1,000 actual dividend x 16.67%)

Dividends - Eligible

- Eligible
  - Grossed up 1.38 x Actual
  - Credit 20.75 of Actual
  - Applies to dividends from big corporations who pay a high rate of tax

Example

$1,000 eligible dividend.

$1,380 Taxable Dividend included in income ($1k x 1.38)

$207.5 Dividend Tax Credit ($1,000 actual dividend x 20.75%)

Dividends – Eligible

Calculate Tax Assuming $50,000 in salary as well as this $1,000 eligible dividend.

$51,380 Taxable Income

$13,221 Tax on income (10,363 + ((51,380-43,000)x.341))

$11,000 Personal Credit

(2,651) Reduces Tax ($11k x .241)

(207.5) Dividend Tax Credit

(2,858.5) Total Credits

$10,362.5 Net Tax (13221 – 2858.5)

Example

$1,000 eligible dividend.

$1,380 Taxable Dividend included in income ($10k x 1.38)

$207.5 Dividend Tax Credit ($1,000 actual dividend x 20.75%)

Dividend Example A

Murray received a dividend on his shares of TD Bank of $25,000. He wants to know how much tax he will pay.

Type:

Gross up:

Credit:

Tax Calculation:

Dividend Example A

Murray received a dividend on his shares of TD Bank of $25,000. He wants to know how much tax he will pay.

Type: From large public corp - Eligible

Taxable Income: $25,000 x 1.38 = $34,500 Taxable

Credit: $25,000 x 20.75% = $5,187.50 reduction of income tax

Tax Calc:
$34,500 x 24.1% (first bracket) = $8,314.50 Tax
$11,000 (personal credit) x 24.1% = $2,651 + $5,187.50
DTC = $7,838.50 Reduction of Tax
$8,314.50 - $7,838.50 = $476 Net Tax Owing

Can't be negative tax owing

Dividend Example B

Murray received a dividend on his shares of Murray Co., which he owns, of \$25,000. Murray Co. makes \$250,000 in taxable income per year. He wants to know how much tax he will pay.

Type:

Gross up:

Credit:

Tax Calculation:

Dividend Example B

Murray received a dividend on his shares of Murray Co., which he owns, of $25,000. Murray Co. makes $250,000 in taxable income per year. He wants to know how much tax he will pay.

Type: From small corp & under $500,000 – Non-eligible

Taxable Income: $25,000 x 1.25 = $31,250 Taxable

Credit: $25,000 x 16.67% = $4,167.50
reduction of income tax

Tax Calc: $31,250 x 24.1% (first bracket) = $7,531.25 Tax
$11,000 (personal credit) x 24.1% = $2,651 + $4,167.50
DTC = $6,818.50 Reduction of Tax
$7,531.25 - $6,818.50 = $712.75 Net Tax Owing

Dividends Cont'd

- Capital Dividends
  - Non-taxable
  - Must be paid from a company's "Capital Dividend Account".
  - Will be covered in corporate tax.

Obtained Oct 22, 2013 from: http://www.etftrends.com/2010/09/how-etfs-pay-dividends/

Dividends Cont'd

- Stock Dividends
  - A distribution of corporate stock to an individual.
  - Actual dividend is the "paid up capital" amount of the stock.
  - Can have a set FMV or be a common share with floating value.

- Example
  - B Co. issues a stock dividend to its shareholder of 1,000 Class B preferred shares.
  - The shares have a PUC of $20 and a FMV of $1 million
  - Actual Dividend is $20. FMV has no impact until shares are sold or redeemed.
  - Eligible or non-eligible treatment applied to the $20

Other Property

Royalties

- Defined as: Payments based on production or use

- Calculated using the accrual method – royalties earned but not received during the year must be included in income.

Example: Jim purchases the right to a Post Malone song which earns $30,000 in the year after the date of his purchase. $5,000 of that amount was not received until the next year. How much must Jim include in income?

Royalties

- Defined as: Payments based on production or use

- Calculated using the accrual method – royalties earned but not received during the year must be included in income.

Example: Jim purchases the right to a Post Malone song which earns $30,000 in the year after the date of his purchase. $5,000 of that amount was not received until the next year. How much must Jim include in income?

Jim must include $30,000 in income; the amount earned.

Rental Property

- Calculated using the accrual method – can use cash method if net income would be effectively the same. It is rare for this method to be used.

- CCA can be claimed on rental properties.
  - Remember that each rental property costing more than $50,000 receives it's own CCA "pool".
  - CCA cannot be used to create or increase a rental loss that is property.

Rental Property - Example

Example:

Jerry has rental income of $40,000 in 2012. He calculates that his rental expenses are $36,000. His opening UCC balance on his rental building is $200,000 (4%). Calculate the maximum CCA Jerry can take.

Rental Property - Example

Example:

Jerry has rental income of $40,000 in 2012. He calculates that his rental expenses other than CCA are $36,000. His opening UCC balance on his rental building is $200,000 (4%). Calculate the maximum CCA Jerry can take.

$200,000 Opening UCC x 4% = $8,000 maximum CCA claim.

However, net income is currently $4,000 before CCA ($40,000 income - $36,000 expenses). Cannot use CCA to create or increase a loss.

Therefore, max CCA claimable is $4,000. Enough to bring income to zero.

Rental Property - Example

Example:

Jerry has rental income of $40,000 in 2012. He calculates that his rental expenses other than CCA are $36,000. His opening UCC balance on his rental building is $50,000 (4%). Calculate the maximum CCA Jerry can take.

Rental Property - Example

Example:

Jerry has rental income of $40,000 in 2012. He calculates that his rental expenses other than CCA are $36,000. His opening UCC balance on his rental building is $50,000 (4%). Calculate the maximum CCA Jerry can take.

$50,000 Opening UCC x 4% = $2,000 maximum CCA claim.

Jerry's net income is currently $4,000 before CCA ($40,000 income - $36,000 expenses). Cannot use CCA to create or increase a loss.

Therefore, max CCA claimable is $2,000. Net income after CCA is $2,000 ($4,000 before CCA less $2,000 CCA = $2,000). Not negative, so no reason to adjust CCA claimed.

Rental Property

- Rental Income
- Less:
  - Utilities
  - Repairs
  - Maintenance
  - Interest
  - Insurance
  - Property Taxes
  - CCA if not in your home

If in home:

Current expenses are pro-rata based on space used.

Always remember to separate out the current and capital expenses.

All expense deductible. This isn't employment income, which limits what can be deducted.

Mutual Funds

Teco Rodrigues/For the Toronto Star

- A “trust” where you pool your money with many other investors to buy a pool of investments

- Income of the pool gets flows out to you as:
  - Dividends
  - Capital Gains
  - Interest,
  - Foreign Income
  - Return of Capital (ROC)

Foreign Source Income

- Taxed as regular income regardless of type (US interest, dividends, etc.)
- Taxes withheld by foreign authorities (like the IRS) is used as a tax credit to reduce Canadian taxes paid.

- <u>Example:</u>

John received US dividends of $15,000. $1,000 in US taxes was withheld from the dividends so he received $14,000 in cash.

John includes $15,000 in his taxable income. His total taxes owing will be reduced by $1,000.

Deferred Income Plans

Non-Deductible Contribution Types

Types

Registered Education Savings Plans (RESPs)

Registered Disability Savings Plans (RDSPs)

Tax Free Savings Accounts (TFSAs)

Benefits

Growth of Investment Earnings Tax Free

Tax Reduction – RESP/RDSP - Use of a low income individual's tax brackets

Tax Avoidance – TFSA Only – No tax on income earned within the account.

Structure

Time

Non-Deductible
Contributions

Investment Account
Contributions
& Income
Grow Tax Free

TFSAs
Contributions & Earnings
paid out tax free

RESPs & RDSPs
Contributions paid out
tax free
Earnings taxable to recipient

RESPs

Registered Education Savings Plans

Image obtained November 1, 2013 from:
http://www.yummymummyclub.ca/life/money/your-resp-rulebook

Registered Education Savings Plans (RESPs) - Overview

- Intended to assist in saving for the education of a beneficiary (generally a child or grandchild)
- Contributions are made by the adult relative.
- Taxable withdrawals are taxed to the beneficiary (the child) if the beneficiary is in post-secondary study at the time of withdrawal.
- Otherwise taxable to the contributor.

Registered Education Savings Plans (RESPs) - CESGs

- CESGs – Canada Education Savings Grants
- 20% government grant deposited to the RESP
- Maximum of $500 per year on contributions of $2,500.
- If beneficiary not in post-secondary study when RESP withdrawn, the CESG and income on it is removed from RESP account.
- Can catch up if did not contribute or open a plan – max of $1,000 in any one year.

Registered Education Savings Plans (RESPs) – CESGs +

- For low income families, extra grant (on top of ordinary 20%) is available.

- On first $500
  - 20% if family income is $43,953 or less
  - 10% if family income is between 43,953 and 87,907
  - 0% if family income is greater than 87,907

Registered Education Savings Plans (RESPs) - CLBs

- CLB – Canada Learning Bond
- Government contributions to the RESP. $525 in the first year, $100 in each subsequent year.
- Not based on contributions made by others
- Made to a beneficiary's RESP when the family qualifies for the National Child Benefit supplement.
- Stops when the child turns 15, family income must be below $25,356.

Registered Education Savings Plans (RESPs) - Restrictions

- Tax free growth of earnings is limited to 35 years (40 years if beneficiary has a disability)
- Total contributions are limited to $50,000 for any one beneficiary
- Penalty of 1% per month on the excess over $50,000.
- Lifetime maximum CESG of $7,200.

Registered Education Savings Plans (RESPs) - Withdrawals

- Contributions can be withdrawn at any time by beneficiary or contributor unless restricted by the plan itself (the bank’s terms)

- Education Assistance Payments
  - Paid from accumulated earnings, CESG amounts and CLB amounts.
  - Included in the income of the recipient if recipient qualifies due to enrollment in post-secondary education.

Registered Education Savings Plans (RESPs) - Withdrawals

- Accumulated Income to Subscribers
  - Paid after beneficiaries turn 21 & not eligible for EAP
  - CESG and CLB Repaid to the government
  - Extra 20% tax on remaining income to compensate for tax deferred growth

- Limits
  - Full time students can withdraw $5,000 in the first term, unlimited thereafter.
  - Part time students have lower limits.

Registered Education Savings Plans (RESPs) - Plans

- Single beneficiary plans – limits as we described
- Family plans – beneficiaries can be any child of the contributor.
  - Attractive if several children and not all pursue education.
  - Same contribution limits per beneficiary.
  - No restriction on which beneficiary can withdraw funds.

Practice Example A – 1 (Exam realistic)

Jeremy and his wife, Diane, have a 2 year old daughter. They make a $3,000 contribution to her RESP each year.

Calculate the amount of basic savings grants the government will contribute to the RESP.

Annual max is 20% x $2,500 = **CESG of $500 = amount contributed**

Practice Example A - Expanded

Jeremy and his wife, Diane, have a 2 year old daughter. They have made annual contributions of $3,000 to her RESP since she was born. Their family income is $120,000.

Calculate the amount the government will contribute to the RESP if the family contributes $3,000 in the current year.

No unused CESG carried forward since more than $2,500 has been contributed each year.

No Extra CESG as the family earns too much income.
No Canada Learning Bond as the family earns too much income.

Annual max is 20% x $2,500 = **CESG of $500 = amount contributed**

Practice Example B - Expanded

Jeremy and his wife, Diane, have a 2 year old daughter. Last year was the first year they opened her RESP and they contributed $1,000 to it. Their family income is $50,000.

Calculate the amount the government will contribute to the RESP if the family contributes $4,000 in the current year.

max $1,000 CESG over past lifetime (2 yrs x $500 per year), only $200 used to date = $800 max carry forward.

10% Extra CESG on first $500 as family earns between 43,953 and 87,907
No Canada Learning Bond as the family earns too much income.

$4,000 contributions x 20% = $800 ($500 cy + $300 py) + (500 x 10% extra) 50 = **850 CESG** (less than $500 + carryforward so ok)
Maxed at $1,000 per year = not relevant as did not reach

Practice Example C - Expanded

Jeremy and his wife, Diane, have a 1 year old daughter. This year was the first year they opened her RESP. Her grandparents opened an RESP for her last year and contributed $1,500 Their family income is $90,000.

Calculate the amount the government will contribute to the RESP if the family contributes $4,500 in the current year.

max $500 CESG over past lifetime (1 yrs x $500 per year), only $300 used to date by grandparents = $200 max carry forward.

No Extra CESG as family earns too much income
No Canada Learning Bond as the family earns too much income.

$4,500 contributions x 20% = $900 CESG (**Max #1 - maxed at $700. Carry forward of $200 + $500**)
Max #2 - Maxed at $1,000 per year = not relevant, did not reach

Practice Example D - Expanded

Jeremy and his wife, Diane, have a 21 year old daughter. She has an RESP worth $36,000 and is attending a Canadian university Full-time this Fall. She plans to withdraw $5,000 each term from her RESP.

Who will pay tax on the withdrawals? Which amounts will be taxable to them? Is the daughter permitted to take withdrawals as she has specified.

As a post-secondary student, daughter will pay tax on the withdrawals. They are considered Education Assistance Payments.

Daughter will be taxable on any earned income, CESGs, or CLBs included in her withdrawal. It will not be taxable to the extent that it is contributions made to the RESP.

Yes, as a full time student, is limited to $5,000 in her first term, and has no withdrawal limit after that point.

RDSPs

Registered Disability Savings Plan

Image obtained November 1, 2013 from: https://www.comsavings.com/Personal/ProductsAndServices/Investing/RDSP/

Registered Disability Savings Plans(RDSPs) - Overview

- Intended to assist in providing care to disabled individuals, particularly beyond the lifespan of the care providers.
- Contributions are made by the adult relative.
- Beneficiary is the disabled individual.
- No deduction on contributions, income grows tax free.
- Income portion is taxable to the beneficiary on withdrawal. Withdrawn contributions are tax free.

Registered Disability Savings Plans (RDSPs) - Restrictions

- Total contributions are limited to $200,000 over the beneficiary's lifetime.

- Similar to RESPs
  - Canada Disability Savings Grant
  - Canada Disability Savings Bond

- Additional information for those interested can be found online in CRA's guide: RC4460

TFSAs

Tax Free Savings Accounts

Image obtained November 1, 2013 from: http://www.financefox.ca/do-you-have-a-tfsa-account/

Tax Free Savings Plans (TFSAs) - Overview

- Resident individual's over 17 years old can establish a TFSA (since 2009)
- Total individual limit based on years since 2009 or over 17. No annual limit to contributions.
- No deduction on contribution, no tax on earnings, no tax on withdrawals.
- TFSA belongs to the contributor. Not established for the use of someone else.

Tax Free Savings Plans (TFSAs) – Contribution Room

- Annual Limits:
  - 2009 - $5,000
  - 2010 - $5,000
  - 2011 - $5,000
  - 2012 - $5,000
  - 2013 - $5,500
  - 2014 - $5,500
  - 2015 - $10,000
  - 2016-2018- $5,500
  - 2019 - $6,000
  - 2020 - $6,000

- As of 2020 the max an individual can contribute is $69,500 total

  ** this assumes they've been eligible since 2009.*

  ** the count begins once a taxpayer turns 18*

Tax Free Savings Plans (TFSAs) – Contribution Room

- Annual Limits:
  - 2009 - $5,000
  - 2010 - $5,000
  - 2011 - $5,000
  - 2012 - $5,000

  2013 - $5,500
  2014 - $5,500
  2015 - $10,000
  2016 & 2017 - $5,500

  2019 - $6,000
  2020 - $6,000

- An individual turns 18 in 2012. How much can they contribute in 2015 when they open a TFSA?

- $26,000 total ($5,000 for 2012 + $5,500 for 2013/2014 + $10,000 for 2015)

Tax Free Savings Plans (TFSAs) – Contribution Room

- No account needed to accumulate contribution room.
- Withdrawals are added back to contribution room the year AFTER withdrawal. (Do not treat it like a chequing account).
- Over-contributions taxed at 1% per month

Practice Example A

Francis has an starting contribution room of $13,000 in 2013. He contributed $4,000 in February, withdrew $6,000 in May, and contributed another $11,000 in September.

Calculate Francis' contribution room after the September contribution.

$13,000 Starting Balance
(4,000.00) Contribution – reduces balance
(11,000.00) Contribution – reduces balance

(2,000.00) Overcontribution (1% penalty per month).

Practice Example A

Francis has over-contributed by $2,000 at the end of 2013 and withdrew $6,000 in May 2013.

Calculate his contribution room in 2014.

(2,000.00) Over-contribution (ending balance)
5,500.00 New annual limit added to room
6,000.00 Prior year withdrawals added to balance.

$9,500.00 Contribution room in 2014.

Tax Free Savings Plans (TFSAs) – Miscellaneous

- TFSA's are investment accounts

  Some investments are restricted:
  - Investments in private companies which the TFSA owner or a related individual owns.

- On Death
  - A spouse named as a beneficiary can maintain the deceased spouses TFSA account or roll it into their own account without affecting their contribution room.

Deductible Contribution Types

Types

No Sponsor Required

Registered Retirement Savings Plans (RRSPs)

Registered Retirement Income Funds (RRIFs)

Employer Sponsored

Registered Pension Plans (RPPs)

Pooled Registered Pension Plans (PRPPs)

Deferred Profit Sharing Plans (DPSPs)

Motivations

Company pension plans disappearing

Defined Benefit

Defined Contribution

Aging Population

Government Funded Pensions

CPP $12,000 max

OAS $6,500 max

Total $18,500.

Canadian low income cutoff line $21,359

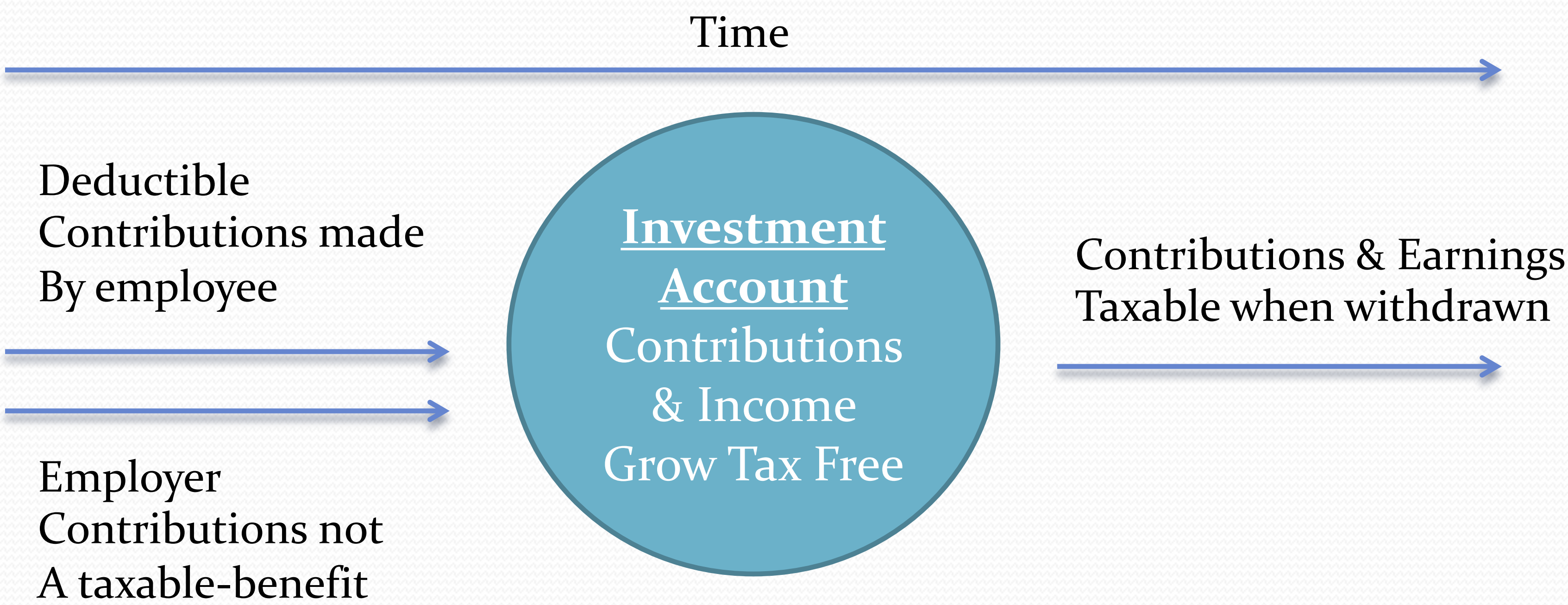
Benefits

Growth of Investment Earnings Tax Free

Tax Deferral – tax-deductible contributions eliminate current tax, and postpone it until retirements funds are needed.

Tax Reduction – Deductions are taken in high income years, retirement funds may be taxable in low income years. Better use of marginal tax rates.

Structure


Time
Deductible
Contributions made
By employee
Investment
Account
Contributions
& Income
Grow Tax Free
Contributions & Earnings
Taxable when withdrawn
Employer
Contributions not
A taxable-benefit

RRSPs

Registered Retirement Savings Plans

Image obtained November 3, 2013 from: http://www.helpingyoubuyyourfirsthome.ca/blog/bid/78032/Can-I-use-my-RRSP-to-buy-a-home

Registered Retirement Savings Plan (RRSPs) - Characteristics

- Administered by a financial institution
  - Banks, Insurance Companies, Mutual Funds, etc.
- Professionally managed or self-directed investing
- Defined Contribution (set pay in)
- Contributions can be made in the year or 60 days after. Payments in January, 2020 can be deducted in 2019.

Registered Retirement Savings Plans – (RRSPs) Tax Treatment

- Individual – Deductible Payments
- Income Grows Tax Free
- Individual - Taxable Proceeds as ordinary income
  - Important to note that capital gains and dividend lose their nature in an RRSP.

Registered Retirement Savings Plans – (RRSP) Special Rules

- Contributing Investments to an RRSP
  - Deemed disposition of investments
  - Capital gains included in income
  - Losses not able to be realized

- Spousal RRSP
  - Can contribute to a spouse's plan
  - Deducted from contributor's income & room
  - 3 year time delay on withdrawals.

Spousal Example A - Solution

Harriet contributes $5,000 to a spousal RRSP for her husband, Jake, in each of 2010 and 2011.

In 2013, Jake withdraws $12,000 from his RRSP.

What is the impact on Jake and Harriet's income from this withdrawal?

$5,000 attributed to Harriet and taxable in her hands. (any spousal contributes in current year (2013) or two preceding years (2012 or 2011)).

$7,000 taxable to Jake (12,000 total withdrawn – 5,000 attributed).

RRSP Deduction Room

- Prior year's ending balance
  - Plus: Lesser of:
    - 18% of prior year earned income, or
    - 26,230 (2018), 26,500 (2019), 27,230 (2020)
  - Less: Prior year's RPP (pension) Adjustment
  - Less: Current year contributions for self
  - Less: Current year contributions for spouse
- Equals: Ending Balance

- Withdrawals do NOT increase the deduction room.

Components of Earned Income

Additions:

Net employment income

Income from a business

Net rental income from real property

Income earned as a partner

Royalties where received by the author, composer, etc.

Taxable support payments (spousal support)

Research Grants, net of expenses

Canada Pension Plan Benefits

Employment Insurance Benefits

Components of Earned Income

<u>Deductions:</u>

Deductible Support Payments (Spousal Support)

Losses from a business

Losses from being a partner

Loss from the rental of real property

Example A

Mr. Kelly had $12,000 in RRSP deduction room at the end of 2012. His employer says his pension adjustment for 2012 was $4,000 on his $50,000 salary.

Mrs. Kelly has no income so cannot save for her own retirement. **Mr.** Kelly contributes $500 per month toward her retirement from January 2013 – December 2013. Because of his pension, he doesn't make payments for himself

Mr. Kelly has never deducted RRSP contributions before.

What is the impact on his taxable income and what is his RRSP Deduction room?

Example A - Solution

$12,000 Ending RRSP Deduction Room end of 2012

$9,000 $50,000 earned income from 2012 x 18% = $9,000 (less than RRSP 2013 annual limit of $23,820.)

(4,000) Pension Adjustment from T4.

17,000 2013 RRSP Deduction Room

(6,000) Spousal Contributions made by Mr. Kelly

$11,000 Ending RRSP Deduction Room end of 2013

Deduction from Mr. Kelly's income = (6,000) for Spousal Contributions

Example B

Mr. Kelly had $8,000 in RRSP deduction room at the end of 2012. He does not participate in any other pension savings. He earns $3,000 from interest and $80,000 from his rental properties in 2012.

Mr. Kelly contributes $1,300 per month to his RRSPs in 2013

What is the impact on his taxable income and what is his RRSP deduction room?

Example B - Solution

$8,000 Ending RRSP Deduction Room end of 2012

$14,400 $80,000 earned income from 2012 x 18% = $14,400
(less than RRSP 2013 annual limit of $23,820.)

22,400 2013 RRSP Deduction Room

(15,600) Ordinary Contributions made by Mr. Kelly

$6,800 Ending RRSP Deduction Room end of 2013

Deduction from Mr. Kelly's income = (15,600) for RRSP Contributions Made

Registered Retirement Savings Plans (RRSPs) – Special Rules

- Un-deducted Contributions
  - So long as there is RRSP deduction room, an employee can contribute to their RRSP.
  - There is no requirement that the contributions actually be deducted in the year made.

- Excess Contributions
  - Amounts contributed in excess of the RRSP deduction room are penalized 1%/month
  - $2,000 "cushion" before penalties are applied

Registered Retirement Savings Plans – (RRSP) Withdrawals

- Lump sum payments
  - Subject to lump sum tax withholdings
  - Not eligible for pension splitting or pension credit

- Convert to an Annuity
  - Payments still taxable as received

- Convert to a RRIF
  - Like an annuity, with minimum withdrawal rates.

Registered Retirement Savings Plans – (RRSPs) Life Changes

- At Age 71 you must:
  - Transfer RRSP to an RRIF
  - Transfer the RRSP to an annuity
  - Withdraw the RRSP entirely
  - Can continue to make RRSP contributions to a spousal RRSP if the spouse is not yet 71.

- If you die the RRSP:
  - Can roll tax deferred to a spouse or dependant child
  - OR: Be fully taxed in the final return of the deceased

Registered Retirement Savings Plans (RRSPs) – Special Rules

- Home Buyers Plan
  - $35,000 limit per person for a home purchase
  - Non-taxable withdrawal from an RRSP
  - Non-deductible repayment over 15 years (straight line).
  - Repayment begins in the second year following the withdrawal.
  - Amounts not repaid are included in income each year.

Registered Retirement Savings Plans (RRSPs) – Special Rules

- Home Buyers Plan - Qualifying
  - Cannot have a HBP withdrawal outstanding when making a withdrawal.
  - Neither the individual taking the withdrawal or their spouse can have owned a home in the four years preceding the withdrawal.
  - Amounts deposited into RRSP within 90 days before purchase cannot be used.
  - Must have bought or built a qualifying home:
    - Housing unit located in Canada.

Registered Retirement Savings Plans (RRSPs) – Special Rules

- Lifelong Learners Plan
  - Maximum $10,000 per year, to a $20,000 max over four years.
  - Withdrawal to fund full-time post-secondary education for withdrawer or their spouse
  - Non-taxable withdrawal from an RRSP
  - Non-deductible repayment over 10 years (straight line).
  - Repayment begins in the fifth year following the withdrawal.
  - Amounts not repaid are included in income each year.

Registered Retirement Savings Plans (RRSPs) – Special Rules

- Lifelong Learners Plan - Qualifying
  - Cannot have a LLP withdrawal outstanding when making a withdrawal.
  - Amounts deposited into RRSP within 90 days before purchase cannot be used.

RPPs

Registered Pension Plans

Image obtained November 3, 2013 from: http://www.smallbizadvisor.ca/group-retirement/saskatchewan-pension-plan-to-apply-for-prpp-2093

Registered Pension Plans – (RPPs)

- <u>Characteristics</u>
  - Run by Employer
  - Defined Contribution (set pay in)
  - Defined Benefit (set pay out)

- <u>Tax Treatment</u>
  - Employer Contributions – No Taxable Benefit
  - Employee Contributions – Deductible Payments,
Taxable Withdrawals
  - Income Grows Tax Free

Contribution Limit

- Same limit as for RRSP contributions (a single limit for all plans).
- Delay in impact means that RPP's can use the current years expected income to absorb the deduction.
- Recall: prior year pension adjustment reduces the deduction room.

Obtained November 3 from:
http://www.telegraph.co.uk/finance/personalfinance/pensions/9028142/How-to-manage-your-own-pension.html

Contribution Limit

- Key to remember:
  - If you have an employer run RPP, you must adjust your self-administered RRSP contributions accordingly.
  - Failure to do so is the most common source of over-contributing & penalties.

Registered Pension Plans – (RPP) Withdrawals

- Lump sum payments
  - Subject to lump sum tax withholdings
  - Not eligible for pension splitting or pension credit

- Paid Out Over Time
  - Employer generally administers a scheduled payout

- Convert to an RRIF or Annuity
  - If permitted by the plan terms

PRPPs

Pooled Registered
Pension Plans

Image obtained November 3, 2013 from:
http://www2.macleans.ca/2012/02/09/how-the-government-wants-to-trick-us-into-saving-more/

Pooled Registered Pension Plans (PRPPs)

- MacLean Magazine:

  “How the government wants to trick us into saving more”.

- In 2011, only 24% of Canadians used RRSPs.

- The average contribution was $2,830.

Article obtained November 3, 2013 from: http://www2.macleans.ca/2012/02/09/how-the-government-wants-to-trick-us-into-saving-more/

Pooled Registered Pension Plans (PRPPs)

- Employer PRPP participation is optional.
- However, once chosen, employees of companies that opt in are automatically enrolled.
- Employees will have to opt-out to get out of the program.
- Similar to an RPP except many companies pool together to save administration costs.

Pooled Registered Pension Plans (PRPPs)

- Self-employed individuals and employees of company's that don't participate can still opt-in to a PRPP plan.

- Same contribution room as RRSPs/RPPs.

- Effective from January 1, 2013 onward federally.

- Participating requires the province of residence to have enacted legislation.

RRIFs

Registered
Retirement
Income Funds

Image obtained November 3, 2013 from:
http://www.advisor.ca/news/industry-news/are-you-getting-rrif%E2%80%99d-off-18788

Registered Retirement Income Funds – (RRIFs)

- Deductible contributions cannot be made to a RRIF
- A RRIF is another retirement plan that has been converted into an income stream.
- Ie. Stop depositing money in, start taking money out.
- Rollover of an RRSP or RPP into a RRIF is tax free, and begins the process of using the funds in retirement.

Registered Retirement Income Funds – (RRIFs)

- Withdrawals are taxed as ordinary income.
- Withdrawals from RRIFs are eligible for pension splitting and the pension credit.
- Minimum annual withdrawals are set by legislation and are based on the age of the recipient and the funds in the RRIF.
- No maximum withdrawal amount.

Registered Retirement Income Funds – (RRIFs) Life Changes

- If you die the RRIF:
  - Can roll tax deferred to a spouse or dependant child
  - OR: Be fully taxed in the final return of the deceased

DPSPs

Deferred Profit Sharing Plans

Image obtained November 3, 2013 from:
http://www.benplans.com/services/profit-sharing-plans.html

DPSP

- Characteristics
  - Payment made to plan by employer based on business profits
  - Not allowed for those related to those owning 10% or more of company
  - No specific payout schedule

- Tax Treatment
  - Employer Contributions – Payments not a taxable benefit, deductible
  - Employee Contributions – Not allowed to pay in
  - Income Grows Tax Free

Review

- Registered Education Savings Plans (RESP)
- Registered Disability Savings Plans (RDSP)
- Tax Free Savings Accounts (TFSA)
- Registered Retirement Savings Plans (RRSP)
- Registered Pension Plans (RPP)
- Pooled Registered Pension Plans (PRPP)
- Registered Retirement Income Funds (RRIF)
- Deferred Profit Sharing Plans (DPSP)

Capital Gains and Losses

Capital Gains

Occur on the disposition, or deemed disposition, of capital property

Remember to distinguish capital property from income earning property:

- Length of ownership
- Intention to resell
- Frequency of purchases/sales

Only since 1971 (V-Day) when capital gains became taxable

Calculating Gain or Loss

Proceeds	$10,000	
Adjusted Cost Basis (ACB)	(3,000)	
Disposition Costs	(1,500)	(ex. lawyer fees)

Capital Gain	$5,500	
Taxable Capital Gain 50%	2,750	

When A Disposition Occurs

Whenever Proceeds are Received and Assets Given Up:

- Sale of property
- Redemption of shares by a company
- Expropriations (property is taken from you)
- Exchanging one type of property for another

Transfers of Property – Change in 'beneficial' ownership

Deemed Dispositions

- Death, Change in Use, Ceasing to be a Resident
- Proceeds deemed to be FMV

Proceeds of Disposition

<u>An Actual Disposition</u>

- Sale Price
- Insurance or other compensation for property given up (destroyed, appropriated).

<u>Deemed Dispositions & Related Party Sales</u>

- Proceeds deemed to be FMV, or
- Greater of FMV or actual proceeds.

Capital Cost - Refresher

- Recall from Session 5 – CCA, how to calculate the cost of a capital asset acquired:

- Purchase price

  + Cost to bring the asset to the location of use (shipping & duties)

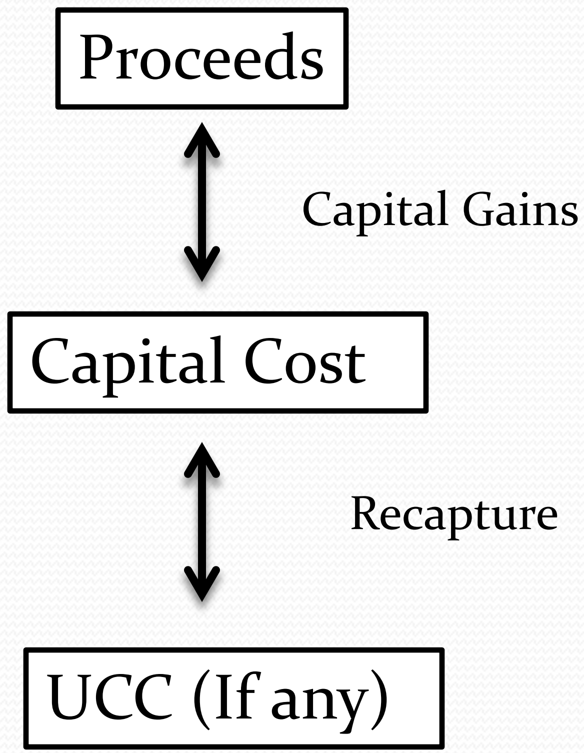
  + Cost to purchase the asset (legal/valuation fees)

  - Government assistance to purchase the asset

  + Superficial losses incurred on identical property (New)

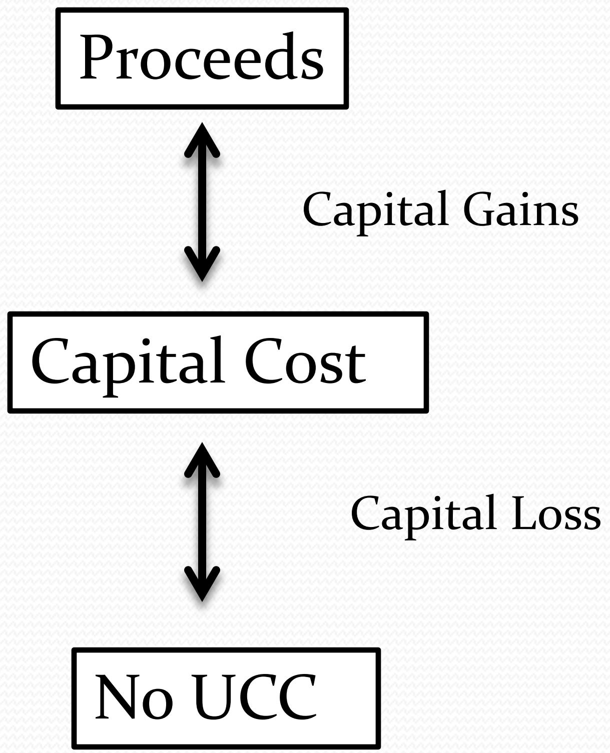
Adjusted Cost Base (ACB)

- <u>Depreciable Property</u>
  - Capital Cost (original cost).
  - NOT UCC



Adjusted Cost Base (ACB)

- <u>Other Property (Land)</u>
  - Capital Cost (original cost)



ACB Identical Properties

- Marketable Securities and other Liquid Assets
  - When you buy assets at different times you don’t use a First In First Out (FIFO) method for ACB.
  - Instead, the ACB of the properties is the combined average cost of all the units you hold.

This calculation must be redone after each <u>purchase</u>.

ACB Identical Properties

Ex. Dave purchases 100 shares for $25 in February, and 100 shares for $10 in March. In June he sells 100 shares. What is the ACB of the shares sold?

$2,500 Calculated as 100 shares x $25/share February purchase
$1,000 Calculated as 100 shares x $10/share March purchase

$3,500 Total ACB/ 200 shares = $17.50 per share

$1,750 Total ACB sold in June Calculated as 100 shares x 17.50 per share

ACB Identical Properties

After Dave sells his 100 shares in June, he purchases another 200 shares in September for $40 each. In December he sells 50 shares for $35. What is the gain on the shares he sells in December?

$3,500 Total ACB after purchases / 200 shares = $17,50 per share
(1,750) Total ACB of 100 shares sold in June

1,750 Remaining ACB for 100 shares Dave has left
8,000 Calculated as 200 shares x $40 each September purchase

9,750 Total ACB for 300 shares on hand = $32.50 per share

1,750 Proceeds of disposition of 50 shares sold
(1,625) ACB of 50 shares sold (50 shares x $32.50 ACB per share)
125 capital Gain x ½ = $62.50 taxable capital gain on sale.

Partial Dispositions

- Generally, partial dispositions involve prorating the cost based on a reasonable basis.
- Ex. 100 shares owned with ACB of $100,000. If selling 40 of these shares, ACB will be $40,000 (40%)
- Ex 2.
- 600 acres of land owned that has a cost of $500,000. If selling 300 acres of that land, cost of disposition is assumed to be $250,000 (50%).
- Exceptions: when reason to believe some part is not equal (ex. part of the land is waterfront property)

Reserves

- <u>If Proceeds Aren't All Received at Once</u>
  - Can defer gain over 5 years if normal sale.
  - Can defer gain over 10 years if QSBC shares sold to a child.

  (Qualified Small Business Corporation Shares)

- <u>Not Given to:</u>
  - Non-Residents
  - Exempt Entities (Charities)
  - When the sale is to a Corporation you own.
  - Deceased Individuals

Reserves - Calculated

- Deduction is Lesser of:

  1) $\dfrac{\text{Unpaid Proceeds}}{\text{Total Proceeds}} \times \text{Capital Gain}$

  and

  2) Year 1 – 4/5 of the gain
  Year 2 – 3/5 of the gain
  Year 3 – 2/5 of the gain
  Year 4 – 1/5 of the gain
  Year 5 – No reserve

& Prior year reserve is included in current year income

Example A

Mr. Anderson sold a piece of land for $150,000 during the year. He had purchased the land for $100,000 six years ago.

He is paid his proceeds in chunks of $25,000 in years 1-3 and then the remainder is paid off in year 4.

Calculate the impact on his income in each year.

Reserves – Calculated Year 1

- 150,000 Proceeds – 100,000 Cost = 50,000 Capital Gain

Year 1: Reserve is the lesser of:

Unpaid Proceeds	=	(150,000-25,000)	=	125,000
Total Proceeds		150,000		150,000

=83.33% x 50,000 Capital Gain = 41,666.67

OR

4/5 Capital Gain = 40,000

Income Inclusion: 50,000 Gain – 40,000 Reserve = 10,000 Gain x 50% Capital Gains Rate = $5,000 income inclusion

Reserves – Calculated Year 2

- 150,000 Proceeds – 100,000 Cost = 50,000 Capital Gain

Year 2: Reserve is the lesser of:

$$\frac{\text{Unpaid Proceeds}}{\text{Total Proceeds}} = \frac{(150{,}000-50{,}000)}{150{,}000} = \frac{100{,}000}{150{,}000}$$

=66.67% x 50,000 Capital Gain = 33,333.33

OR

3/5 Capital Gain = 30,000

Income Inclusion: 40,000 P/Y Reserve – 30,000 C/Y Reserve = 10,000 Gain x 50% Capital Gains Rate = $5,000 income inclusion

Reserves – Calculated Year 3

- 150,000 Proceeds – 100,000 Cost = 50,000 Capital Gain

Year 3: Reserve is the lesser of:

$$\frac{\text{Unpaid Proceeds}}{\text{Total Proceeds}} = \frac{(150{,}000-75{,}000)}{150{,}000} = \frac{75{,}000}{150{,}000}$$

=50% x 50,000 Capital Gain = 25,000

OR

2/5 Capital Gain = 20,000

Income Inclusion: 30,000 P/Y Reserve – 20,000 C/Y Reserve = 10,000 Gain x 50% Capital Gains Rate = $5,000 income inclusion

Reserves – Calculated Year 4

- 150,000 Proceeds – 100,000 Cost = 50,000 Capital Gain

  Year 4: Reserve is the lesser of:

  $$\frac{\text{Unpaid Proceeds}}{\text{Total Proceeds}} = \frac{(150{,}000\text{-}150{,}000)}{150{,}000} = \frac{0}{150{,}000}$$

  =0% x 50,000 Capital Gain = 0

  OR

  1/5 Capital Gain = 10,000

Income Inclusion: 20,000 P/Y Reserve – 0 C/Y Reserve = 20,000 Gain x 50% Capital Gains Rate = $10,000 income inclusion

Reserves – Calculated Year 5

- 150,000 Proceeds – 100,000 Cost = 50,000 Capital Gain

Year 5: Reserve is the lesser of:

Income Inclusion: 0 P/Y Reserve

Therefore, no reason to calculate reserve in year 5 since all proceeds collected and no p/y reserve to take into income.

Bad Debts on Loans Receivable

When an amount owed to a taxpayer becomes uncollectible, it is called a bad debt.

Taxpayers have the option to treat bad debts as though they were sold for $0 proceeds and reacquired for $0 (new ACB of $0).

This creates a capital loss for the taxpayer

Bad Debts - Example

Marley was owed \$120,000 from a sale of land two years ago. The purchaser went bankrupt and Marley does not think she will ever be repaid.

What can she do and what are the tax implications to her?

Marley can elect under subsection 50(1) to dispose of her debt for \$0 proceeds.

\$0 proceeds - \$120,000 ACB of debt = (120,000) loss x ½ = (60,000) taxable capital loss. Can be applied against capital gains in current, past, or future years, if any.

Sale of Land and Building

Land and Building are ordinarily sold together as a package, under a single purchase price.

Sale of land gives rise to capital gains, sale of building gives rise to recapture or terminal loss.

There is incentive to shift proceeds to land vs. building to take advantage of lower taxable income and higher terminal losses.

CRA reallocates proceeds under ITA 13(21.1)

Sale of Land & Building - $30,000 net income

Cannot have a terminal loss on a building and a capital gain on land where they are sold as part of one transaction. – proceeds gets reallocated until the terminal loss is eliminated or the loss has been, whichever comes first.

	Building	Land
Proceeds	30,000	220,000
Cost	60,000	120,000
UCC	50,000	

This would create a terminal loss of ($20,000) (50,000 – 30,000 = 20,000)

And taxable capital gain of $50,000 (220,000 – 120,000 = 100,000 x 50% = 50,000)

Sale of Land & Building - $40,000 net income

	Building		Land
Proceeds	30,000 (50,000)	220,000	(200,000)
Cost	60,000		120,000
UCC	50,000		

This would create a terminal loss of $0 (50,000 – 50,000 = 0)

And taxable capital gain of $40,000 (200,000 – 120,000 = 80,000 x 50% = 40,000)

Principle Residence Exemption

- Tax free residence with no gain on sale
- Available on 1 family home (per couple) per year.
- Can be claimed on any house that is "ordinarily inhabited" by the family (Cottage, regular home, etc.)

Principle Residence Exemption

$$\frac{\text{1+ Number of years after 1971 that the property was the principle residence of the taxpayer}}{\text{The number of years after 1971 that the taxpayer owned the property.}} \times \text{Capital Gain}$$

Principle Residence Example

Kimberley and her husband, Mark, have owned their family home since 2005 when they purchased it for $150,000. This home is worth $200,000

In 2003, they purchased a cottage for $100,000. It is currently worth $170,000.

They wish to sell both of these properties in 2015 for their FMV. Which property should the exemption be used on? What is the amount of income they will report?

Principle Residence Solution

Which property should the exemption be used on?

The decision should be based on the highest gain per year.

Cottage has a gain of $70,000 and was owned for 13 years = $5385 / year

Home has a gain of $50,000 and was owned for 11 years = $4,545 / year

Therefore, the family should use the exemption first against the gain on the cottage to minimize taxes.

Principle Residence Solution

What is the amount of income they will report?

Cottage: (12 years exempted + 1 from formula)/13 years of ownership = 100% exempt

$70,000 gain - $70,000 exempt = $0 gain to report

Home: (1 years exempted + 1 from formula)/11 years of ownership = 18% exempt

$50,000 gain – (50,000 x 18%) = $41,000 gain to report

$41,000 total gains x 50% taxable = $20,500 taxable income.

Principle Residence Example

Kimberley and her husband, Mark, have owned their family home since 2005 when they purchased it for $150,000. This home was sold in 2010 for $200,000 and the principle residence exemption was used on it for the 2006 to 2010 years.

In 2003, they purchased a cottage for $100,000. It is currently worth $170,000.

In 2013 the couple wish to give the cottage to their children for their use. The couple plans to move to Florida to retire.

Has a disposition occurred? Which property should have the principle residence exemption used on it? What is the taxable gain to the couple?

Principle Residence Solution

Has a disposition occurred?

Yes, a change in beneficial use has occurred. Kimberley and Mark have gifted the cottage to their children. Gifts to family members are deemed to occur at FMV.

What property should the principle residence exemption be used on?

In this case, the principle residence exemption from 2006-2010 was used on the home, therefore the exemption can only be used on the cottage for the other years that it was owned (2003, 2004, 2005, 2011, 2012, 2013).

Principle Residence Solution

What is the taxable gain to the couple?

1+ 6 (2003, 2004, 2005, 2011, 2012, 2013) Years since 1971 that the property was the principle residence of the taxpayers

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11 (number of years the taxpayer owned the property (2003-2013)

70,000 Ordinary gain on sale of cottage (170,000 FMV-100,000 Cost)

(44,545) Exempt gain on sale of cottage (170,000 FMV – 100,000 Cost = 70,000 Gain on cottage x (7/11 ratio from above)

25,455 Total Non-Exempt Gain on Sale

X 50% Taxable

12,728 taxable gain on sale to be included in income

Principle Residence - Rental

- When a portion of the principle residence is used to earn rental income, a partial disposition occurs and that portion is no longer a “principle residence”

- However, CRA will ignore this impact on the principle residence exemption where:
  - The income earning use is ancillary to the main purposes (not the major use).
  - There are no structural changes
  - No CCA is taken

Personal Use Property (PUP)

- Held for the personal use or enjoyment of the owner or related person
- No losses are allowed on this property
- When reporting gains, a deemed ACB and Proceeds of Disposition occurs of $1,000. Only proceeds higher than this will trigger a gain.

PUP - Example

- Michaela has several pieces of furniture that she no longer wants. She decides to sell them on eBay/Kijiji.
- Calculate the gain on sale she must report.

	Cost	FMV	Gain	Tax. Gain
Chair	500	300		
Loveseat	800	900		
Couch	2500	1500		
TV	800	1200		

PUP - Example

- Michaela has several pieces of furniture that she no longer wants. She decides to sell them on eBay.
- Calculate the gain on sale she must report.

	Cost	FMV	Gain	Tax. Gain
Chair	500	300	0	0
Loveseat	800	900	0	0
Couch	2500	1500	0	0
TV	800	1200	200	100

Listed Personal Property (LPP)

- Prints, drawings, sculptures, jewelry, rare books, stamps, coins
- Losses only deductible against LPP Gains.
- 3 year carry back, 7 year carry forward
- $1,000 floor on cost and FMV

LPP - Example

- Michaela has several collectibles that she no longer wants. She decides to sell them on eBay.
- Calculate the gain on sale she must report.

	Cost	FMV	Gain	Tax. Gain
Stamp	300	500		
Painting	15000	8000		
Sculpture	20000	23000		
Coin	900	1400		

LPP - Example

- Michaela has several collectibles that she no longer wants. She decides to sell them on eBay/kijiji.
- Calculate the gain on sale she must report.

	Cost	FMV	Gain	Tax. Gain
Stamp	300	500	0	0
Painting	15000	8000	(7,000)	(3,500)
Sculpture	20000	23000	3,000	1,500
Coin	900	1400	400	200

*Only 1,700 of taxable losses are able to be used (applied against current year gains). The remainder must be used in other years.

Superficial Losses

If a property is disposed of and 30 days before or after that disposal, an affiliated person held the same or an identical property any loss on the disposal is denied and added to the ACB of the purchaser.

Examples:

I sell shares of RBC, but then reacquire them in 5 days.

I sell shares of RBC but then my spouse buys some in 20 days.

I sell a piece of land to my spouse.

Superficial Losses - Example

I own shares of RBC which I bought for $1,000. I sell them for $500 on August 1. My spouse buys shares of RBC on August 20 for $2,000.

Superficial Losses - Example

I own shares of RBC which I bought for $1,000. I sell them for $500 on August 1. My spouse buys shares of RBC on August 20 for $2,000.

Someone affiliated with me (my spouse) owns identical property purchased within 30 days before or after my sale.

Therefore, my loss of $500 (1,000 cost – 500 sale price) is denied.

Spouses ACB gets increased for my denied loss $2,500 (2,000 amount paid + 500 denied loss).

Emigration/Immigration

When entering or leaving Canada permanently, an individual is deemed to dispose of all their assets at FMV except:

- Real Property (land or buildings)
- Deferred Income Plans (TFSA, RRSP, RESPs)
- Property used in active business carried on in Canada

Example

Stan is leaving Canada to work in France. He isn't certain he'll ever come back. He owns the following property when he leaves, what is his income inclusion on emigration?

	ACB	FMV	Gain	Tax Gain
Home	5,000	10,000		
Common Shares	2,000	10,000		
RRSP	3,000	7,000		
Land	10,000	25,000		

Example

Stan is leaving Canada to work in France. He isn't certain he'll ever come back. He owns the following property when he leaves, what is his income inclusion on emigration?

	ACB	FMV	Gain	Tax Gain
Home	5,000	10,000	0	0
Common Shares	2,000	10,000	8,000	4,000
RRSP	3,000	7,000	0	0
Land	10,000	25,000	0	0

Replacement Property – Real Property

Capital Gain on the disposition of property can be deferred if a similar property is purchased to replace the one disposed of.

Deferral is limited to the amount expended on the new property compared to the proceeds of the old (ie. If you spend less on the new building, you don't get to defer 100% of the old building's gain)

Replacement Property – Real Property

ACB of new property decreased by the deferral

Time limit to purchase:

Involuntary Dispositions – 24 months to buy replacement
Voluntary Dispositions – 12 months to buy replacement

Replacement Property - Shares

A similar deferral is available on the disposition of Eligible Small Business Corporation Shares (ESBC Shares) when the proceeds are invested in another ESBC.

A CCPC more than 90% of whose assets are used 50% of more of the time in active business carried on in Canada, and whose book value of assets is less than $50 million.

During the year of disposal or 120 days after year end to buy replacement shares

You must have held the shares for at least 185 days before the sale occurred.

Gifts, Attribution and Death

Non-Arm’s Length Transfers (Gifts)

Determining Proceeds

- Transfers to arm's length person (unrelated) are assumed to be at FMV
- Transfers to a non-arm's length person (related), must be at FMV to avoid negative tax consequences.
  - In this case, FMV would need to be determined.
- Unrelated people can be acting non-arm's length

Arm's Length Sales

- Proceeds of Sale assumed to be FMV

- Each party has incentive to act towards their own best interest.

Example: Jake sells a piece of land to a man who responded to his advertisement. The land cost $50,000 to Jake and he will sell it for $100,000. The two men don't know each other.

Jake's proceeds of disposition $100,000

Stranger's adjusted cost base after purchase $100,000

Non-Arm's Length Transfers

When transferring property to a related person, CRA requires that the transaction happen at fair market value (FMV). If this doesn't happen, they will punish individuals using double taxation. The chart below shows how

Price Transacted	Proceeds to Vendor	ACB to Purchase
FMV	FMV	FMV
Over FMV	Proceeds	FMV
Under FMV	FMV	Proceeds
Gift ($0)	FMV	FMV

Non-Arm's Length - FMV

- IF proceeds of sale are equal to actual FMV
- No adjustment required, parties are transacting at arm's length.

Example: Jake sells a piece of land to his brother. The land cost $50,000 to Jake and an appraiser says it is worth $100,000. His brother agrees to pay $100,000 for it.

Jake's proceeds of disposition $100,000

Brother's adjusted cost base after purchase $100,000

Non-Arm’s Length - FMV

Jake’s proceeds of disposition $100,000

Brother’s adjusted cost base after purchase $100,000

Jake: $100,000 - $50,000 = $50,000 gain

Brother: $100,000 ACB on future sales

If Brother sold immediately for FMV $100,000 - $100,000 = $0

Non-Arm's Length –More than FMV

- If proceeds of sale are greater than actual FMV
- Proceeds equal to price paid, cost equal to FMV.

Example: Jake sells a piece of land to his mother. The land cost $50,000 to Jake and an appraiser says it is worth $100,000. His mother agrees to pay $150,000 for it because she knows Jake needs the money.

Jake's proceeds of disposition $150,000

Mother's adjusted cost base after purchase $100,000

Non-Arm's Length – More than FMV

Jake's proceeds of disposition $150,000

Mother's adjusted cost base after purchase $100,000

Jake: $150,000 - $50,000 = $100,000 gain

Mother: $100,000 ACB on future sales

If Mother sold immediately for FMV $100,000 - $100,000 = $0

Non-Arm's Length – Less than FMV

- IF proceeds of sale are less than actual FMV

- Proceeds equal to FMV, cost equal to price paid.

Example: Jake sells a piece of land to his son. The land cost $50,000 to Jake and an appraiser says it is worth $100,000. Jake agrees to accept $80,000 from his son since he knows he's short on cash.

Jake's proceeds of disposition $100,000
Son's adjusted cost base after purchase $80,000

Non-Arm's Length –Less than FMV

Jake's proceeds of disposition $100,000

Son's adjusted cost base after purchase $80,000

Jake: $100,000 - $50,000 = $50,000 gain

Son: $80,000 ACB on future sales

If Son sold immediately for FMV $100,000 - $80,000 = $20,000

Non-Arm's Length – Gift

- IF proceeds of sale are zero
- Proceeds equal to FMV, cost equal to FMV.

Example: Jake gives a piece of land to his sister. The land cost $50,000 to Jake and an appraiser says it is worth $100,000.

Jake's proceeds of disposition $100,000

Sister's adjusted cost base after purchase $100,000

Non-Arm's Length – Gift

Jake's proceeds of disposition $100,000

Sister's adjusted cost base after purchase $100,000

Jake: $100,000 - $50,000 = $50,000 gain

Sister: $100,000 ACB on future sales

If Sister sold immediately for FMV $100,000 - $100,000 = 0

Comprehensive Example

Sigmund owns shares which he purchased for $30,000. Their current fair market value is $70,000.

He's always wanted to give something to his father as a gift to show how successful he's become, but his father insists on paying him something.

Sigmund sells the shares to his father for $50,000.

One year later, his father sells the shares for $90,000.

Calculate the impact on each individual's income from the sales.

Calculate the impact if they'd transacted at FMV.

Comprehensive Example – Proceeds **$50,000**

Sigmund and his father are non-arm's length (related).
Disposition occurred at less than FMV.

70,000 Proceeds to Sigmund (FMV)
(30,000) Sigmund's Cost

40,000 total gain x 50% = 20,000 Taxable Income to Sigmund.

90,000 Sale price of father
(50,000) Price paid to Sigmund by father = ACB

40,000 total gain x 50% = 20,000 Taxable Income to Father

Comprehensive Example – Proceeds **$70,000**

Sigmund and his father are non-arm's length (related).
Assuming disposition occurred at FMV.

70,000 Proceeds to Sigmund (FMV)
(30,000) Sigmund's Cost)

40,000 total gain x 50% = 20,000 Taxable Income to Sigmund.

90,000 Sale price of father
(70,000) Price paid to Sigmund by father = ACB

20,000 total gain x 50% = 10,000 Taxable Income to Father

Inter-Vivos Spousal Transfers

No deemed disposition when property transferred to spouse

Can be gifted without proceeds & no tax consequences

However, income the spouse earns continues to belong to the "giftor" – attributed back

Must pay tax on transfer in order for future income to be taxed in recipients hands. (elect out of rollover)

Inter-Vivos Spousal Transfers

Non-Depreciable Capital Property

Proceeds of disposition = Capital Cost of Vendor

Cost basis to purchaser = Capital Cost of Vendor

Depreciable Capital Property

Proceeds of disposition = UCC pool balance of vendor

UCC addition of purchaser = UCC balance of vendor*

Capital cost of purchaser = Capital Cost of vendor*

Means that if sold, same recapture & capital gain as if the transferor still owned it.

Inter-Vivos Spousal Transfers

Reasons to elect out of rollover (& Trigger Tax)

Capital losses that the vendor wishes to use.

Wish for future income to be taxed in the hands of the purchasing spouse.

Wish to realize income to take advantage of tax brackets.

Spousal Transfers - Example

Ex. Joe gifts land to his spouse Mary and doesn't file any elections. Joe's cost is $10,000 and the FMV is $50,000

What is the impact to each of them on the transfer?

73(1) applies, spousal rollover applies

Joe $10,000 proceeds - $10,000 cost = $0 gain

Mary $10,000 ACB going forward

Spousal Transfers - Example

Ex. Joe gifts land to his spouse Mary and files an election to avoid 73(1). Joe's cost is $10,000 and the FMV is $50,000

What is the impact to each of them on the transfer?

73(1) does not apply – no spousal rollover

Joe $50,000 proceeds - $10,000 cost = $40,000 gain x 50% = $20,000 taxable capital gain

Mary $50,000 ACB going forward

Spousal Transfers - Example

Ex. Joe gifts his rental property to Mary and doesn't report a gain since she is his wife. Mary earned $50,000 in rental income the following year.

Who will pay tax on the rental income?

Because the property rolled tax free to Mary, and Mary did not pay FMV consideration, the income still belongs to Joe.

Joe will pay tax on the $50,000 rental income.

Spousal Transfers - Example

Ex. Joe sells his rental property to Mary for its FMV of $400,000 and reports a taxable gain on the sale. Mary earned $50,000 in rental income the following year.

Who will pay tax on the rental income?

Because the property was sold by Joe to Mary at its FMV, and the sale was reported at FMV to achieve a gain, future income is considered to belong to Mary.

Mary will pay tax on the $50,000 rental income.

Spousal Transfers - Example

Ex. Joe gifts his rental property to Mary. Joe had purchased the rental property for \$300,000 and had \$200,000 left in UCC in the Class 1 CCA pool.

What will be Mary's addition to the UCC pool after receiving the property?

Mary's UCC pool for Class 1 will be increased by \$200,000. The same UCC as Joe had prior to the transfer.

Inter-vivos Farm or Fishing Transfers

- Tax free inter-vivos transfer to children, grandchildren, great grandchildren, and their spouses.
- Child must be resident of Canada.
- Property must be in use as a farm or fishing business operated by the taxpayer, their spouse, or children.

Image obtained November 11, 2013 from: http://www.williamkentinc.com/wny-farm-appraisal

Attribution

Attribution - Overview

Goal of Tax Planning: To split income with family members and use lower marginal tax rates.

Goal of Attribution: to prevent income splitting where no economic basis for it.

What this means: Income "split" with a family member is taxed in the hands of the original owner of it.

How we say it: Income is "attributed" back to the original owner

Attribution - Rules

Requirement 1: An individual has transferred property (cash or income earning assets)

Requirement 2: To a specified person (spouse or minor child, grandchild, niece or nephew)

Requirement 3: Income earned by the specified person on that property is attributed back to the individual.

Attribution - Exceptions

Active Business Income (If related person not involved)

Effort required to earn it. Not a real result of the transfer but of the efforts of the current owner.

Second Generation Income

Compound income (or income, on the first generation of income earned).

Attribution - Exceptions

<u>Income Subject to Kiddie Tax</u>

Already penalized (discussed next) so not punished again.

<u>When FMV is paid for the property</u>

Triggering a taxable gain on sale

Collecting CRA prescribed interest rates on a loan

<u>Capital Gains</u>

Only when

1) specified person was minor child.

2) sold to spouse at FMV

Attribution - Example

- Dave loans $1,000,000 to his wife, Audra, and charges no interest. The prescribed rate is 1%. Audra earns $25,000 in investment income on the loan proceeds.

- What is the impact caused by attribution?

As interest is not being charged at least at the prescribed rate (1%), FMV consideration has not been paid and attribution applies.

Audra's earnings of $25,000 will be included in Dave's taxable income and NOT in Audra's.

Attribution - Example

- Dave loans $1,000,000 to his wife, Audra, and charges 1% interest. The prescribed rate is 1%. Audra earns $25,000 in investment income on the loan proceeds.

- What is the impact caused by attribution?

As interest is being charged at least at the prescribed rate (1%), Audra's earnings of $25,000 will be included in her taxable income and she can deduct interest paid to Dave. ($25,000-$10,000 = $15,000 taxable income)

Dave must include interest received in his income $10,000.

Attribution - Example

- Dave gives a rental building to his son, Tris (age 14). The rental building earned $15,000 in net income during the year and was sold by Tris to another investor for a gain of $40,000.

- What is the impact caused by attribution?

  Dave has transferred property to a specified person (minor child). Income earned is taxed in his hands. Dave's taxable income = $15,000.

  Exception for capital gains to minors. Tris pays tax on taxable capital gains of $20,000 ($40,000 x 50%).

Attribution - Example

- Dave gives a rental building to his wife, Audra. He makes no elections. The rental building earned $15,000 in net income during the year and was sold by Audra to another investor for a gain of $40,000.
- What is the impact caused by attribution?

Dave has transferred property to a specified person (spouse). Income earned is taxed in his hands. Dave's taxable income = $15,000.

Exception for capital gains where tax paid on rollover. However, no election filed in this case, tax deferred rollover to spouse. Income attributes back to Dave.

$15,000 Rental Income + $20,000 taxable gain = $35,000 Dave's income

Attribution - Example

- Dave gifts shares in RBC to his son, Greg (age 21). The shares earned $20,000 in dividends during the year.

- What is the impact caused by attribution?

Dave's transfer was not to a specified person – Greg is an adult child.

No attribution will occur.

Attribution - Example

- Dave gifts a GIC worth $1 million to his son, James (age 12). The GIC earns interest at 2%. In year 1 James earned $20,000 and reinvested his earnings. In year 2 James earned $20,400.

- What is the impact caused by attribution in year 2?

  Dave's transfer was to a minor child – income is attributed to him.

  Compound interest does not attribute. $400 taxable to James & $20,000 taxable to Dave.

Death

That's Right… Death

- <u>Full Stop!</u>
  - Immediate Year End Triggered.
  - Only income from January 1 – Death of Death reported on personal tax returns.
  - If income occurs after DOD, can be reported on an Estate Return (essentially a trust)

Definitions

Executor

- The person you've chosen to look after your estate.
- They coordinate the payout of your assets, the filing of your tax returns, and go to probate court if necessary.
- They are also responsible for any financial issues that go wrong with the estate.

Will

- Sets out who is your executor
- Sets out what assets you'd like to go to whom

Definitions

Administrator

- The overseer of your estate if you die without a will (intestate)
- Without a will, your estate is distributed based on common law principles.

Probate Court

- Means to 'validate' a will in court. Must go before a judge.
- Makes public your list of assets, charges a fee on their value.

Clearance Certificate

- A certificate that says CRA is fine with all Estate filings
- Executor/Administrator cannot be held liable after getting one.

Tax Returns

- Final Return
  - Income from January 1 – Date of Death reported on a personal tax return
  - Deemed disposition of all assets occurs at FMV
- Return for Rights or Things
  - If filed, must include all rights or things due to the taxpayer at death but not yet paid (such as unpaid employment income)
  - Includes OAS, unpaid dividends, certain farming or artist inventory, WIP for professionals
  - Gets an extra set of marginal tax rates & personal tax credit

Tax Returns

- Return for a Partner or Proprietor
  - If deceased passed away after the year end of a partnership or proprietorship to which they were a part.
  - This return can report that stub period income.

Example:

Jim belongs to a law partnership that has a March 31, 2020 year end. He passes away on May 20, 2020. Income from April 1 to May 20, 2020 can be reported on the Return for a Partner.

Tax Returns

- <u>Return for Income from a Testamentary Trust</u>
  - If the deceased was earning income from a testamentary trust, that had a year end before the date of death.
  - This return can report the stub period income until the date of death.

Example:

Jim earns income from his mother's estate which has a March 31 year end. He passes away on May 20. Income from April 1 to May 20 can be reported on the Return for Income from a Testamentary Trust.

Year of Death – Deemed Disposition

Deemed Disposition on All Assets:

- Property deemed sold at it's FMV, less Cost or UCC.

$100,000	FMV of portfolio investments
(50,000)	Cost of portfolio investments

50,000 x 50% =

$25,000 taxable capital gain on death

Year of Death – Deemed Disposition

Deemed Disposition on All Assets:

- RRSPs, RRIFs, included in income 100%

$100,000 FMV of assets in RRSP
(50,000) Cost of assets in RRSP

$100,000 taxable income on death – why?

Withdrawals would be 100% taxable

Year of Death – Deemed Disposition

Exception from deemed disposition:

- By giving assets to a spouse OR spousal trust.
- RRSP's & RRIF's can be left to a dependent child until they reach the age of 18.
- Farm and Fishing Property can be transferred to a child, grandchild, or great grandchild living in Canada

Year of Death – Example

Sheena is doing some estate planning and wants to know how much tax will be triggered if she were to pass away. The assets listed below are outlined in her will.

Description	Cost	FMV	Beneficiary
Home	150,000	200,000	Son (Adult)
Car	500	800	Son (Adult)
Non-registered investments (A)	160,000	250,000	Husband
Non-registered investments (B)	90,000	140,000	Daughter (Adult)
RRSP	170,000	300,000	Daughter (Adult)

Consider

- What the asset is
  - Capital or full income inclusion
- Who the asset was left to
  - Spousal rollover or not
- Whether other exemptions exist.
  - Principle Residence
  - Qualified Farm Property

Retrieved November 13, 2014 from: http://rodgers-associates.com/newsletters/planning-on-leaving-your-legacy-to-your-children-make-sure-they-can-handle-it-first/

Year of Death – Example

What are the tax consequences?

Description	Cost	FMV	Beneficiary	Income
Home	150,000	200,000	Son (Adult)	$0 Principle Residence
Car	500 (deemed $1,000)	800 (deemed $1,000)	Son (Adult)	$0 Personal Use Property
Non-registered investments (A)	160,000	250,000	Husband	$0 Left to Spouse, rollover
Non-registered investments (B)	90,000	140,000	Daughter (Adult)	$25,000 taxable capital gain
RRSP	170,000	300,000	Daughter (Adult)	$300,000 full inclusion

Year of Death – Special Rules

No restriction on how much of your charitable donations you can use in the year of death (usually 75% of income)

Medical expenses can be claimed for any 24 month period ending in the year of death (instead of the ordinary 12)

Capital Losses can be applied against any income in the year of death (instead of only capital gains).

What This Means for Will Planning

Consider estate intentions.

- Is intent to grant equal assets to each children?
- If so, must use after tax value of each asset to calculate their estate interest.

Example:

Family Home worth $1,000,000

&

RRSP worth $1,000,000

Is it fair to leave one asset to each child?

What This Means for Will Planning

<u>Consider estate intentions</u>.

Retrieved November 13, 2014 from: http://www.amazon.com/SentrySafe-SFW123GDC-Cubic-Electronic-Fire-Safe/dp/B005P12C5A

- Is intent to leave assets to the children while caring for the remaining spouse while they live?
- If so, a spousal trust is likely a good option

Spousal Trust

A legal agreement:

1) The Spouse is entitled to receive all income from the assets in the trust

2) No person except the spouse is entitled to receive any income or capital from the trust while the spouse is alive

3) Property rolled to a spousal trust for the benefit of the deceased's spouse is not subject to a deemed disposition.

Other Testamentary Trusts

Generally, permits other beneficiaries such as children to have access to the income of the trust and sometimes the capital of the trust.

Deemed disposition still occurs before the trust acquires assets from the estate.

Taxable Income and Tax Payable Revisited

Net Income for Tax Purposes

- Net Employment Income
- Net Business Income
- Net Property Income
- Capital Gains and Losses
- Other Income
- Other Deductions
- <u>Current Year Losses – Capital or Non-Capital</u>

- = Net Income For Tax Purposes

From Where We Were:

Net Income for Tax Purposes		=
Less:	Allowable capital losses	-
	Employee Stock Options	-
	Deductions – sections 60 to 66.8	-
	Capital gains deduction	-
	Losses from an office or employment	-
	Losses from a business	-
	Losses from property	-
Taxable Income		=

Capital and Non-Capital Loss Carryovers

Types of Losses

- Non- Capital Losses
  - Can be applied against any income or gains
  - Can be carried back 3 years
  - Can be carried forward 20 years

- Capital Losses
  - Can be applied only against capital gains
  - Can be carried back 3 years
  - Can be carried forward indefinitely

Types of Losses

- Loss on Listed Personal Property
  - Can be applied against gains on listed personal property
  - Can be carried back 3 years
  - Can be carried forward 7 years

Application of Losses

- <u>Losses Incurred in Current Year</u>
  - Step 1: Applied where able against current year income. (mandatory)
  - Step 2: Taxpayer <u>can</u> apply to carry back losses if income in past three years (optional)
    Will recover taxes if they were paid in those years.
  - Step 3: Losses carried forward until income arises that they <u>can</u> reduce or the losses expire (optional)

Example

- Bob has non-capital losses carried forward from 1990 of $20,000 and 1997 of $15,000.
- In 2014 his income from taxable capital gains is $30,000 and his income from business income is $10,000.
- Calculate the lowest amount of taxable income he can report in 2014.

$40,000 Combined net income
(15,000) Loss carried forward from 1997 – non-capital losses can reduce capital gains.

25,000 Minimum income. 1990 losses have expired (over 20 years old)

Example

- Bob has non-capital losses carried forward from 2009 of $5,000 and capital losses carried forward from 1980 of $30,000.
- In 2014 his income from a rental operations is $50,000.
- Calculate the lowest amount of taxable income he can report in 2014.

$50,000 rental income
(5,000) Loss carried forward from 2009 – less than 20 years old.
capital losses can only be applied against capital gains.

45,000 Minimum income

Capital vs. Non-Capital Losses

- What IF…
- Current year non-capital losses &

  Capital gains in the current year &

  Capital losses carried forward

- Based on the mandatory reduction of income rules, you might think that you'd need to apply current year losses first & be unable to use capital losses carried forward.
- Not so, act allows capital loss use because of restrictions.

Example

- Bob has capital losses carried forward from 2008 of \$20,000.
- In 2014 he has a net business loss of \$50,000 and taxable capital gains of \$15,000.
- Calculate the lowest amount of taxable income he can report & his loss carryforward balances.

(50,000) Current non-capital losses
15,000 taxable capital gains
(15,000) Carried forward losses (can only use up to current year gains)

(50,000) Current year non-capital loss. Can be carried forward or back
(5,000) End of year capital loss balance. (20,000 less 15,000 used)

Planning Considerations

- Personal credits are non-refundable.
- Therefore, it is better to use them fully against some form of income.
- Losses carried forward should be saved for years with income not reduced by credits.

- Example: Brent earns $11,000 of income in 2014 and has losses carried forward of $20,000. Should he reduce his income using his losses carried forward?

  No, Brent's income is already offset by his $11,000 personal tax credit. He should save his losses until a year when he pays tax that can be refunded.

Example

- Bob had taxable income in 2009, 2010, 2011, and 2012 of $90,000, $50,000, $20,000, and $3,000, respectively.
- In 2013 he has a business loss of $150,000
- Calculate his non-capital loss carryforward if he were to fully reduce income in past years where he is able.
- Should he do this?

150,000 Current year loss
(3,000) carried back to first prior year
(20,000) carried back to second prior year
(50,000) carried back to third prior year
77,000 Losses available for carry forward. Cannot go back more than 3 yrs

No! He should use his non-refundable credits against income each year.

Allowable Business Investment Losses (ABILs)

- Loss on disposition of debt or shares of:
- Active, Canadian, private investment.
- Because of insolvency, bankruptcy, or uncollectible.

- Impact:

  50% of loss which would otherwise have been a restricted capital loss is instead deductible against ordinary income.

  Carry back 3 years

  If unused after 20 years, turns back into a capital loss

Capital Gains Deduction

Capital Gains Deduction

- $880,000 deduction against capital gains on Qualified Small Business Corporation (QSBC) Shares (indexed to inflation)

- So $880,000 tax free capital gains, or $440,000 tax free taxable capital gains (this is an exemption on the gross vs. deduction on the net)

Capital Gains Deduction

Available to residents of Canada.

QSBC Shares:

- Canadian Controlled Private Corporation (CCPC)
- In the last 24 months cannot have been owned by anyone other than the vendor or someone related to them
- Throughout the 24 months preceding sale at least 50% of the FMV of total assets must be used in active business carried on in Canada
- At the time of sale 90% of the FMV of total assets must be used in active business carried on in Canada

Capital Gains Deduction

<u>Balance Sheet</u>

Cash	100,000
Inventory	25,000
PP&E	500,000
Boat	<u>10,000</u>
Total	635,000
Liabilities	<u>(135,000)</u>
Net assets/equity	$500,000

The net assets of the company are $500,000

The value of the company is $700,000

Net Assets = Total Assets – Total Liabilities. The Book Value of the company.

700,000 FMV – 500,000 Book Value = 200,000 Goodwill.

Calculate the value of non-active investments

Capital Gains Deduction

Balance Sheet - Accounting

Cash	100,000
Inventory	25,000
PP&E	500,000
Boat	10,000
Total	635,000
Liabilities	(135,000)
Equity	(500,000)
Total	(635,000)

Balance Sheet – Valuation

Cash	100,000
Inventory	25,000
PP&E	500,000
Boat	10,000 (1.2%)
Goodwill	**200,000 (active)**
Total	835,000
Liabilities	(135,000)
Market Value	**(700,000)**
Total	(835,000)

Alternative Minimum Tax

"AMT"

- Using the CGD to reduce your taxes can give rise to AMT.
- A notional tax that is refundable, over 7 years, if taxable income is earned in the future.

Retrieved December 2, 2013 from: http://www.bbt.com/bbtdotcom/financial-education/income_tax_and_estate_planning/alternative_minimum_tax.page

Kiddie Tax

Kiddie Tax

- <u>Applies to children under 18</u>
  - Dividends and other benefits received from a private corporation
  - Shareholder benefits or loans
  - Partnership or trust income where the income is derived from a business carried on by a relative of the child.

Income is taxed at the highest marginal rate.

Kiddie Tax

There are methods of compensating underage children to avoid the kiddie tax rules. They include:

- Fair pay for work performed (ie hourly wage reasonable for the job they do).
- Dividends from a public company
- Income from property inherited from a parent (never any attribution after death, since no one to attribute income to)