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CIMA 2014 TAX UPDATE 2013 FEDERAL BUDGET

Bateman MacKay LLP
Chartered Professional Accountants and Business Advisors

February 22, 2014

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Federal Budget 2013 – Overview

- ❑ Objective to curtail “aggressive tax planning”
- ❑ Several legislative arrows aimed at various sophisticated tax driven structures
- ❑ Minimal tax breaks

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Federal Budget 2013 – SR&ED Program

- ❑ Targeting “risky” SR&ED tax claimants
- ❑ Reporting more detailed information from 3rd party preparers:
 - Business Number
 - Billing arrangement
- ❑ \$1,000 Penalty for incomplete/inaccurate preparer information
- ❑ Claimant and preparer jointly and severally liable for the penalty
- ❑ Effective for SR&ED Claims after January 1, 2014

Federal Budget 2013 – Synthetic Dispositions

- ❑ Synthetic disposition: taxpayers entering into transactions to receive FMV consideration for property, without actual sale
- ❑ Future capital gain determined based on consideration previously received.
- ❑ Eliminate gain/losses
- ❑ Budget proposed to treat disposition as actual disposition eliminating tax deferral

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Federal Budget 2013 – Character Conversion Transactions

- ❑ Financial arrangements, using derivative contracts, whereby ordinary investment income is converted into capital gains
- ❑ Complex forward agreements
- ❑ Structured products sold by financial services industry
- ❑ Budget proposes to treat the returns unrelated to performance of underlying property to be on account of income

Federal Budget 2013 - Loss trading in Trusts

- ❑ Cannot purchase a “loss corporation” unless carry on same or similar business
- ❑ Budget introduced similar loss restriction regime for trusts
- ❑ Change in a “majority-interest beneficiary” may result in loss restriction rules
- ❑ Should not adversely affect normal changes in family situations including the death of a beneficiary

Extended Reassessment Period: Tax Shelters and Reportable Transactions

- ❑ Normal reassessment period is 3 years after date of Notice of Assessment
- ❑ Reassessment period extended to 3 years from date of filing of information return

Taxes in Dispute and Charitable Donation Tax Shelters

- ❑ Typically, if tax dispute, amounts owed held in abeyance
- ❑ Exception is large corporation where CRA allowed to collect 50% of disputed amount of tax
- ❑ Budget proposed to allow collection of 50% of disputed tax/interest/penalties for charitable donation tax shelter

Dividend Tax Credit (DTC)

- ❑ Reduction of net federal dividend tax credit re: non-eligible dividends
- ❑ Effective for such dividends paid after 2013, gross-up reduced from 25% to 18%; Dividend Tax Credit reduced from 13.33% to 11%
- ❑ Max federal tax rates increased from 19.6% to 21.2%
- ❑ Ontario/Federal top combined tax rate increased from 31.3% to 32.5% (assuming income <\$500k)

Lifetime Capital Gains Exemption

- ❑ Obtained on sale of individual's shares in a qualifying small business corporation
- ❑ Budget proposed to increase the capital gains exemption from \$750k to \$800k
- ❑ Effective for the 2014 and subsequent taxation years
- ❑ Exemption indexed for inflation for taxation years after 2014

Restricted Farm Losses

- ❑ Department of Finance's response to 2012 Supreme Court case of *Craig*
- ❑ *MNR v. Craig* allowed a taxpayer to deduct farm losses completely because his chief source of income was considered to be a combination of farming and law
- ❑ Budget proposed that farm losses only deductible if farming income chief source of income
- ❑ Otherwise, restricted farm loss
- ❑ annual restricted farm loss deduction increased from maximum of \$15,000 to a maximum of \$17,500 (\$2,500 plus 1/2 of the next \$30,000)

Mineral Exploration Tax Credit

- ❑ Budget extends Mineral Exploration Tax Credit to flow-through agreements entered into before April 1, 2014
- ❑ Credit for funds provided funds are spent on eligible exploration by the end the following calendar year

First-Time Donor's Super Credit

- ❑ Increased federal tax credit for a first-time donor on up to \$1,000 of donations
- ❑ Increased tax credit adds 25% to the current credit
 - Donations of up to \$200, credit of 40%, as opposed to the current 15%
 - Donations in excess of \$200, credit of 54%, as opposed to the current 29%
- ❑ Increased tax credit only applies to cash donations, NOT donations in kind
- ❑ First-time donor: an individual (other than a trust), including their spouse or common-law partner, who has not claimed the donation tax credit in any year after 2007
- ❑ First time donor couples may share the increased tax credit.
- ❑ Applicable to donations made after Budget and prior to 2018

Adoption Expense Tax Credit (AETC)

- ❑ Current AETC available for qualifying expenses during the period from the time the child is matched with his or her adoptive family and the time that the child begins to permanently reside with the family
- ❑ For adoptions finalized after 2012, Budget proposes to commence the eligible period with the time that an adoptive parent makes adoption application

Deduction for Safety Deposit Boxes

- ❑ Deduction for rental safety deposit box eliminated

Labour-Sponsored Venture Capital Corporations Tax Credit (LSVCC)

- ❑ Proposed phase out of federal LSVCC
- ❑ Commencing in 2015, LSVCC reduced from 15% to 10%
- ❑ Further reduction to 5% in 2016 and to zero after 2016
- ❑ LSVCC cannot be federally registered post-Budget

BUSINESS INCOME TAX MEASURES

Manufacturing and Processing (M&P) Machinery and Equipment: Accelerated Capital Cost Allowance (CCA)

- ❑ Extend current 50% CCA rate for M & P machinery and equipment included in Class 29 by an additional two years
- ❑ Apply for 2014 and 2015 instead of ending in 2013
- ❑ Half-year CCA rule will apply to M&P equipment acquired in 2014 and 2015 (previously did not)

Clean Energy Generation Equipment: Accelerated CCA

- ❑ Currently 50% rate on a declining basis for investment in specified clean energy generation and conservation equipment
- ❑ Biogas production equipment that uses more types of organic waste now eligible
- ❑ In addition, range of cleaning and upgrading equipment used to treat eligible gases from waste broadened

Mining Expenses

- ❑ Pre-production mine development expenses represent Canadian exploration expenses (CEE): 100% deductible
- ❑ Budget treats these expenses as Canadian development expenses (CDE), subject to a 30% declining balance deduction
- ❑ Phased in over 3 calendar years, applying to expenses incurred after Budget

INTERNATIONAL

Form T1135

- ❑ Except for personal-use property, Canadian residents and certain partnerships must disclose foreign property holdings
- ❑ Form T1135 is reporting mechanism, where total cost of foreign property exceeds \$100,000
- ❑ Budget proposes to extend the normal reassessment period by three years if:
 - The taxpayer has failed to report the income from such property, and
 - Form T1135 was not filed on time or the property was not identified or was incorrectly identified
- ❑ Form T1135 will be modified to require the disclosure of more specific information
- ❑ Efiling of T1135?

International Electronic Funds Transfers (EFTS)

- ❑ Beginning in 2015, most financial institutions will be required to report EFTs of \$10,000 or more to the CRA
- ❑ CRA will be able to obtain information from 3rd parties on more timely basis

Whistle Blower Program

- ❑ Rewards program to report major international non-compliance
- ❑ 15% of federal tax collected in excess of \$100,000

FEDERAL BUDGET 2014

PERSONAL INCOME TAX

Adoption Expense Tax Credit

- ❑ Increase maximum amount of eligible expenses to \$15,000 per child for 2014
- ❑ Maximum amount will be indexed to inflation for taxation years after 2014

Medical Expense Tax Credit (METC)

- ❑ Amounts paid for the design of an individualized therapy eligible for METC
- ❑ Condition: the cost of the therapy itself would be eligible for the METC
- ❑ Expenses for service animals specially trained to assist an individual in managing their severe diabetes eligible for METC
- ❑ Applies to expenses incurred after 2013

Search and Rescue Volunteers Tax Credit (SRVTC)

- ❑ SRVTC to allow eligible ground, air and marine search and rescue volunteers to claim a 15-per-cent non-refundable tax credit based on an amount of \$3,000
- ❑ Eligible individual must perform at least 200 hours of volunteer search and rescue services in a taxation year, for one or more ground, air or marine search and rescue organizations
- ❑ Choose between Volunteer Firefighters Tax Credit or SRVTC

Extension of the Mineral Exploration Tax Credit for Flow-Through Share Investors

- Extend eligibility of Mineral Exploration Tax Credit for one year, to flow-through share agreements entered into on or before March 31, 2015

Farming and Fishing Businesses

- ❑ Simplifies tax rules relating to the intergenerational rollover and the Lifetime Capital Gains Exemption
- ❑ Extends eligibility for tax free transfer for farm/fishing property and lifetime capital gains exemption of this property
- ❑ Property must be used principally in farming and/or fishing

GST/HST Credit Administration

- ❑ Budget proposes rules to eliminate application for GST/HST Credit
- ❑ Allows CRA to automatically determine eligibility for GST/HST Credit
- ❑ In case of eligible couples, the GST/HST Credit will be paid to the spouse or common-law partner whose tax return is assessed first

Tax on Split Income (Kiddie Tax)

- ❑ Kiddie tax: deems highest marginal tax rate where minor children receive certain types of income
- ❑ Pre-budget: 1) Dividends from Private Corporations 2) Cap gains generated by non-arm's length transactions
- ❑ Kiddie tax did not apply on partnership business income or rental activities conducted with third parties

Kiddie Tax (cont'd)

- Budget proposes that Kiddie Tax be applicable to income paid to a minor from trust/partnership if:
 - income is derived from a source that is a business or a rental property; and
 - a person related to the minor
 - is actively engaged on a regular basis in the activities of the trust or partnership to earn income from any business or rental property, or
 - has, in the case of a partnership, an interest in the partnership (whether held directly or through another partnership)

Graduated Rate Taxation of Trusts and Estates

- ❑ New flat top tax rate applicable to testamentary trusts that end more than 36 months after death of relevant individual and to all grandfathered inter vivos trusts and trusts created by will
- ❑ Graduated rates still allowed for testamentary trusts with beneficiaries who are eligible for Disability Tax Credit
- ❑ Testamentary trusts that do not already have a calendar taxation year will have a deemed taxation year-end on December 31, 2015 (or in the case of an estate for which that 36-month period ends after 2015, the day on which that period ends)

Non-Resident Trusts – “Immigration Trusts”

- ❑ Common planning tool for immigrants, provided for “tax holiday” for 60 months
- ❑ Budget eliminated the 60-month exemption from the deemed residence rules
- ❑ Limited grandfathering where no contributions are made to the Trust between Budget Day and December 31, 2014

Estate Donations

- ❑ For deaths arising after 2015, donations made by will no longer deemed made by person prior to death
- ❑ Donations deemed to be made by estate
- ❑ Trustee then has flexibility to allocate the available donation among any of:
 - the taxation year of the estate in which the donation is made
 - an earlier taxation year of the estate
 - the deceased's personal tax return for the year of death or the year preceding death
 - donations must be made from the Estate to the charity within 36 months after the date of death



BUSINESS INCOME TAX

Remittance Thresholds for Employer Source Deductions

Budget 2014 proposes to:

- ❑ Increase the threshold level of average monthly withholdings at which employers are required to remit up to two times per month to \$25,000 from \$15,000
- ❑ Increase the threshold level of average monthly withholdings at which employers are required to remit up to four times per month to \$100,000 from \$50,000

Consultation on Eligible Capital Property (ECP)

- ❑ Public consultation on proposal to repeal existing ECP rules
- ❑ Replace with new CCA class
- ❑ Transfer taxpayers' existing Cumulative Eligible Cost (CEC) pools to the new CCA class
- ❑ Timing of implementation of TBD
- ❑ Proposed to add CEC (75% inclusion rate) in new CCA class (100% inclusion rate)
- ❑ 5% annual CCA rate; ½ year rule

INTERNATIONAL TAX

FATCA: Automatic Exchange of Information with the U.S.

- ❑ Foreign Account Tax Compliance Act (FATCA) enacted by US in 2010
- ❑ Require non-US financial institutions to identify accounts held by US persons
- ❑ Canada-US agreement signed Feb.5, 2014
- ❑ Canadian financial institutions will report to the CRA information re: US persons
- ❑ CRA can transmit info to IRS under Canada-US tax treaty
- ❑ Registered accounts (RRSPs, RRIFs, RESPs, RDSPs, TFSAs) and smaller financial institutions (assets < \$175m) exempt from reporting
- ❑ CRA will receive info from US re: Canadian resident taxpayers that hold accounts at US financial institutions
- ❑ Canada-US tax treaty can allow mutual tax collection, CRA will not collect US tax liability of Canadian citizen where individual was a Canadian citizen at time US tax liability arose (irrespective of US citizenship)
- ❑ New reporting regime in effect July 2014
- ❑ Canada/US receiving enhanced tax info in 2015

SALES AND EXCISE TAX

Improving the Application of the GST/HST to the Health Care Sector

- Proposed exemption for training individuals with disorder/disability
 - Includes services re: training design
- Acupuncturists and Naturopathic Doctors exempt from HST/GST
- Add specialty eyewear designed to treat/correct vision defect by electronic means to list of zero-rated medical and assistive devices

GST/HST Election for Closely Related Persons

- ❑ Group relief election must be filed for inter-corporate HST/GST transactions
- ❑ Effective Jan.1/15, new election to be filed with CRA

Joint Ventures

- ❑ JV election simplifies GST/HST filings by allowing one person file on behalf of co-venturers
- ❑ New JV election measures as long as activities of JV are exclusively commercial and participants engaged exclusively in commercial activities

Standardizing Sanctions Related to False Statements in Excise Tax Returns

- ❑ New administrative monetary penalty, and to amend the existing criminal offence, for the making of false statements or omissions in an excise tax return and related offences under the non-GST/HST portion of the Excise Tax Act
- ❑ Greater of \$250 and 25 per cent of the tax avoided
- ❑ Revised criminal offence: the fine will range from 50 to 200 per cent of the tax evaded, along with a potential maximum two year term of imprisonment

CRA SERVICE

Submitting Documents Electronically

- ❑ Efiling AMENDED T2s in April 2014
- ❑ In October 2014 businesses will be able to update their banking and direct deposit information online

Electronic Pre-Authorized Debit Service for Business

- ❑ In October 2014, business owners registered with My Business Account will have the option for paying taxes online
- ❑ CRA to provide businesses with a detailed payment history for all of their accounts

Business Number

- ❑ CRA will reduce restrictions re: online BN registration
- ❑ Enhance authentication
- ❑ Improve registration process

Registration of Tax Preparers Program

- ❑ January 17, 2014, CRA launched proposal to register tax preparers
- ❑ No mandatory PD requirement proposed
YET

CASE LAW UPDATE

Case Law Update – Gwartz v. HMQ, 2013 TCC 86

- Gwartz implemented complex series of transactions to avoid “kiddie tax”
- Instead of dividends, family trust realized capital gain on non-arm’s length sale of shares of a private corporation
- CRA reassessed under GAAR
- TCC ruled GAAR not applicable:
 - Planning not abusive
 - GAAR not the correct mechanism to close a legislative gap
 - No broad policy in Income Tax Act against dividend stripping
- Has not been appealed by CRA
- CRA may still audit “abusive” dividend stripping transaction
- Kiddie tax planning using capital gains shut down in 2011 Federal Budget

Case Law Update – Acanac Inc. V. MNR, 2013 TCC 163

- High-tech workers: employees or independent contractors (“IC”)?
- TCC found they were employees:
 - **Intention:** Notwithstanding Independent Contractor Agreement, workers considered it as “just a job”
 - **Control:** ICs were given a troubleshooting system and they were monitored
 - **Tools:** IC was provided with software and passwords; IC provided computer and hardware.
 - **Knowledge** – no specific expertise required by IC. Training provided by Payor.
 - **Risk:** no risk of loss; ICs paid by the hour

Case Law Update – 3142774 Nova Scotia Limited v. MNR, 2013 TCC

- ❑ Six workers for cleaning business: employees or independent contractors (“IC”)
- ❑ **Intention:** subjective intent was independent contractor relationship
- ❑ **Control:** could refuse jobs and determine start times for jobs.
 - Limited training provided by Corporation.
 - ICs looked for other work online
- ❑ **Tools:** ICs provided their own vehicles; Corporation provided supplies and other equipment (vaccums, mops, etc.)
- ❑ **Risk:** paid by the job, irrespective of time to complete work.
- ❑ TCC disregarded lack of invoicing

Case Law Update – Swirsky v HMQ, 2013 TCC 73

- Mr. S owed his corporation money
- Mrs. S borrows funds from bank and purchases Mr. S's shares (automatic spousal rollover)
- Mr. S repaid his corporation to avoid income inclusion for shareholder loan
- Mr. S took interest deductions of \$1.6m from 1996 to 2003 (attribution rules)
- CRA denies interest deduction – no reasonable expectation of dividends.
- TCC rules against Taxpayer
- Implications to public company share purchases?

Case Law Update – Kossow v. HMQ, 2013 FCA 283

- Leveraged donation scheme: 20% cash + 80% 25-year non-interest bearing loan
- FCA:
 - Tax savings principal reason for donation
 - Benefit flowed through to donor
 - Donation + Financing linked together; financing constituted a benefit
- Entire donation amount reassessed (including Cash portion)
- CRA initially reassessed disallowing just the 80% donation via loan

Case Law Update – *HMQ v. Bagtech*, 2013 FCA 164

- ❑ Taxpayer claimed enhanced ITCs for SR&ED filing as a Canadian Controlled Private Corporation (CCPC).
- ❑ CCPC? Non-residents held > 60% of voting shares in the company
- ❑ Unanimous shareholders' agreement (USA) allowed Canadian shareholders to elect 4 of 7 directors
- ❑ Non-resident shareholders still bound by USA and would not control Bagtech.
- ❑ Taxpayer entitled to CCPC status for SR&ED purposes.

Tales from the Trenches

- Application of Gross Negligence penalties
 - The “thank you gift” on sale of shares
- CRA review of land transfers and property sales
 - Principal residence exemption?
 - Capital gain?
 - Ordinary income?
 - The “Dream Home” never realized
- Deduction of \$18,000 of storage costs: Department of Justice – the last frontier?
- Department of Justice information request – can go beyond 3 year statute of limitations
- Offshore inheritances, possible foreign reporting requirements and Voluntary disclosures

T1 135 UPDATE

- ❑ Requirement to report all Specified Foreign Property with a total cost of more than \$100k Cdn
- ❑ Prescribed form: T1135 Foreign Income Verification Statement
- ❑ 2013 Federal Budget: revised T1135 to improve quality of information and ensure reporting of foreign income

- Categories of Specified Foreign Property:
 - Funds held outside Canada
 - Shares of a non-resident corporation (other than a foreign affiliate)
 - Indebtedness owed by a non-resident
 - Interests in non-resident trusts
 - Real property outside Canada (other than personal use and real estate used in an active business)
 - Other property outside Canada

T1135 Update (cont'd)

- Can exclude from Specified Foreign property where taxpayer received a T3 or T5 from a **Canadian** issuer
 - Practical issues of identification and tracing
 - Cost still included to determine filing requirement
 - Still need to file T1135 – check the box re: property exclusion
 - May not be issued T3/T5 in time for tax filing for non-calendar year-ends
- Required reporting for Specified Property:
 - Name of institution holding funds
 - Country where property relates
 - Foreign income of the property

T1135 Update (cont'd)

- New form released June 25, 2013
- Required information per revised T1135:
 - Country code for each property
 - Maximum cost amount during the year
 - Cost amount at year-end
- New form effective for taxation years ending after June 30, 2013
- Penalties for non-compliance
- Reassessment period extended for 3 years if:
 - No T1135 filed
 - Information not reported or inaccurately reported
 - **Any** income re: specified foreign property not reported.

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Any Questions?



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