

History of the Canadian Federal Income Tax Act (Page 11 of text) (refer to overhead)

1917 - Income War Tax Act

- imposed for the purpose of producing the revenues required by Canada's involvement in World War I
- the original Act was approximately 10 pages in length and persisted, with a large number of amendments, until 1949

1948 - Income Tax Act

- replaced the Act of 1917: was largely a rewording codification, with relatively few changes in policy
- revised in 1952: the revision made few real changes other than to renumber the sections

1971 - first major tax reform resulting from the 1969 White Paper on Tax Reform

- radical changes were made including the taxation of capital gains, use of personal exemptions
- since January 1, 1972, every budget has presented a considerable number of amendments to fine tune existing legislation or to introduce new policies

1987 - second major tax reform

- Phase One - changes to the personal and corporate income tax systems (give example)
- interim changes to the existing federal sales tax system
- Phase Two - replacing the existing federal sales tax system with GST

Structure of the Federal Income Tax Act (page 11)

Parts of the Act - refer to page 11 of the text and overhead

Divisions of Part I of the Act - refer to pages 12 - 14 of the text and overhead

Other income tax legislation (pages 14-15)

Income Tax Application Rules, 1971

- were provided to facilitate the transition from the old Act to the revised Act of 1971 and to ensure that the effects of the new legislation were not retroactive, e.g. Valuation Day rules
- significance of these rules declines with each passing year

Income Tax Regulations

- pertain to the administration and enforcement of the Act
- cannot extend the limits of the law, however they can serve to fill in details and to some extent modify the statutes
- use example of CCA
- the Regulations can be issued without formal legislative approval

Other income tax legislation (cont.)

International Tax Agreements

- Canada currently has tax agreements with over 89 countries
- purpose of the agreements is to prevent double taxation of taxpayers who may have reason to pay tax in more than one jurisdiction and to prevent international tax evasion
- in situations where there is a conflict between the Act and an international agreement, the terms of the agreement prevail

Other sources of income tax information: (pages 16-17)

Interpretation Bulletins

- give the CRA's interpretation of particular sections of the law that it administers and to announce significant changes in departmental interpretation

Information Circulars

- provide information regarding procedural matters which relate to both the Income Tax Act and to the provisions of the Canada Pension Plan and to announce changes in organization, personnel, operating programs and other administrative developments, i.e. guidelines for the preparation of tax returns by individuals

Advance Tax Rulings and Technical Interpretations

- provide an interpretation of a transaction that was being contemplated by a taxpayer (for a fee!)
- in general, the ruling would be binding on the CRA
- it is the policy of the CRA to publish selected Advance Tax Rulings that it considers of particular interest to taxpayers
-

Guides and Pamphlets

- published by the CRA and available on the web site or at district taxation offices

Web Site: <http://www.cra-arc.gc.ca>. - GREAT WEB SITE - USE IT!

Interpretation of tax legislation

General Principles of Tax Laws

- It is fundamental that tax laws be written in clear and unmistakable language
- Except in circumstances where alternative definitions are provided by statute, the words used are to be given their everyday meaning, i.e. dictionary meaning
- Each law should state specifically:
 - Who is liable to pay the tax
 - On what basis the tax is being levied i.e. taxable income
 - What are the rates of tax
 - When and how the tax is to be paid

Court Decisions

- of the hundreds of tax cases that are reported each year, the great majority do not involve tax evasion or other criminal offenses, but rather an honest difference of opinion between the taxpayer and the CRA
- these court decisions do serve to establish precedents in the application of Income Tax legislation, however in each individual case, it is necessary to review all of relevant facts

The Canadian Income tax system can be described as predominantly progressive.

Read pages 7 - 10

- advantages and disadvantages of a progressive system and a flat tax system
- problems with the Canadian income tax system

Charging provisions: (page 18)

- the portion of any tax legislation which specifies who is liable to pay tax is called a charging provision
- two subsections of the Act make this specification
- **subsection 2(1)** states: an income tax shall be paid as hereinafter required upon the taxable income for each taxation year of every person **resident** in Canada at any time in the year
- **subsection 2(3)** states: where a person, who is not taxable under subsection (1) for a taxation year,
 - (a) was employed in Canada
 - (b) carried on a business in Canada,
 - (c) disposed of a taxable Canadian propertyat any time in the year or a previous year, an income tax shall be paid as hereinafter required upon his taxable income earned in Canada for the year determined in accordance with Division D (this relates to non-residents)
- **Also discuss PART XIII TAX**

DETERMINATION OF RESIDENCY (Page 994 +)

General Concept

- a person is ordinarily a resident of the country where they normally and customarily live in the settled routine of their regular life
- a **resident** of Canada will be taxed on their "**world income**" for the entire year

Temporary Absences

- the period of time the individual is absent from Canada is **not** a determining factor with respect to residency
- if an individual severs all primary and secondary residential ties, it appears that he will cease to be a resident of Canada without regard to his period of absence
- primary residential ties (**most significant**) include: dwelling, spouse and dependants
- secondary ties include: personal property, social ties, economic ties, vehicle, driver's license, passport, etc. (page 995)
- if some residential ties are retained during a temporary absence, other factors will be considered: **intent, frequency of visits, establishment of residential ties outside Canada**
- if, at the time of departure, there is evidence to suggest that the individual intended to return to Canada, this will also indicate that residential ties were not severed
- therefore if residential ties exist, the individual would be taxed on **world income** for the period of absence

Part-year Resident

- in a year in which a person clearly terminates or establishes residence in Canada, they will be considered a part-year resident for the part of the year that they were residing in Canada.
- a part-year resident will be taxed on their world income only for that period of time that they were considered a resident of Canada
- the date on which an individual becomes a non-resident is the latest of:
 - (a) the date they leave Canada
 - (b) the date their spouse and dependants leave Canada
 - (c) the date they become residents of the country to which they emigrated

Deemed Residents

- the meaning of residency is extended by the Act to include Deemed Residents
- Deemed Residents are taxed in the same way as Residents
- includes individuals who temporarily sojourned in Canada for 183 days or more, during a taxation year;
- **it is important to note that the Sojourners' rule does not include part-time residents**
- other examples of deemed residents can be found on page 984 of the text **(READ!)**

Dual Residency – read page 999 for “tie-breaker rules”

Read pages 1004 - 1006 for more in-depth look at the Canada/US tax treaty provisions

Taxation Of Non-Residents

- **Employment income earned in Canada**
- **Income earned by carrying on a business in Canada**
- **Disposition Of Taxable Canadian Property**
 - Canadian real estate
 - Capital property used by a Canadian business
 - Shares of Canadian private companies
 - Some partnership interests
- Non-residents earning Canadian source employment income, business income, or capital gains on taxable Canadian property are taxed under Part I
- Property income (interest, rents, royalties, and dividends) are generally subject to tax under Part XIII
- General rate is 25 percent – However, usually modified by tax treaties.

- **Interest Income - General**
 - **Part XIII is applicable only to**
 - Interest on participating debt
 - Interest paid to non-arm's length non-residents (unless exempt)
 - **Most arm's length interest is exempt**

- **Interest Income – to U.S. residents**
 - Part XIII not applicable

- **Dividends**
 - **In general, dividends are subject to Part XIII at 25 percent**
 - **U.S./Canada tax treaty**
 - Rate to 5 percent if U.S. recipient is a corporation and owns 10 percent or more of payor
 - Rate to 15 percent for other dividends to U.S. recipients

HOMEWORK:

Exercise 20-1, page 996
Exercise 20-2 and 20-3, page 997
Exercise 20-4, page 998
Exercise 20-5, page 999
Exercise 20-6, page 1000
Self-study problem 20-1, 20-2 and 20-3, page 1034 and 1035
Self-study problem 20-5, page 1036, parts A and B
Assignment problem 20-1, page 1040
Assignment problem 20-2, page 1040
Assignment problem 20-3, page 1041

Handout - chapter 1/20 quiz

Filing date requirements:

- general rule for individuals is that returns must be filed by April 30th of the calendar year following the relevant taxation year. The income taxation year is defined as the calendar year.
- **exception** - for individuals reporting income from an unincorporated business, as well as their spouses, their returns must be filed by June 15th. However, the payment of taxes is still due on April 30th.
- **for deceased individuals** - if death occurs before October 31st, April 30th of the year following, is still the due date. If the date of death occurs during the six month period prior to April 30th, the due date is six months after the date of death.

Requirements for filing of a tax return:

- if there are taxes owing
- if there is a taxable capital gain for the year
- if a capital property has been disposed of during the year
- if a demand to file has been received by the CRA

ALSO - in order to obtain a refund of tax, the child tax benefit, or a HST credit

Requirements for an individual to make instalments:

- in situations where the individual is not subject to withholding of tax or has large amounts of income that are not subject to withholding of tax, quarterly instalments must be made
- an individual will be required to make instalments if the combined federal and provincial tax payable exceeds amounts withheld at source, in the current year **and** either of the two preceding tax years
- the instalments are due on March 15, June 15, September 15 and December 15.

Interest and Penalties:

- interest will be charged if an individual fails to make any instalment when it is due or if the amount of the instalment is less than the amount required
- a penalty will be charged on "large" amounts of late or deficient instalments and is calculated based on a percentage of the interest owing
- a penalty will be charged for late filing of a tax return equal to 5% of the taxes owing at the filing due date plus 1% per month of the unpaid tax for a maximum period of 12 months (first offense)
- other penalties:
 - failure to file a return
 - failure to file a partnership return
 - false statements or omissions
 - failure to withhold at source or to remit amounts withheld
 - evasion
- **Note that there are rules assessing penalties against tax preparers involved in encouraging or assisting clients with evasive practices**

Maintenance of books and records:

- every person carrying on a business as well as every person who is required to pay or collect taxes, is required to keep adequate books and records at the place of business or residence in Canada, for a period of six years from the end of the last taxation year to which they relate

Income Tax Evasion

- the commission or omission of an act with the intent to deceive.
- this includes knowingly failing to report revenue, or claiming the deduction of a false expense or both
- it also includes knowingly omitting material facts from tax records

Tax Avoidance

- the taxpayer has apparently circumvented the law, without giving rise to a criminal offence, by the use of a scheme, arrangement or device, often of a complex nature, whose main or sole purpose is to defer, reduce or completely avoid tax payable under the law

Tax Planning

- the legitimate arranging of one's financial activities in a manner that reduces or defers the related tax costs
- cases in which a taxpayer, in seeking a beneficial result, has merely selected a certain course of action that is either clearly provided for or not specifically prohibited in law and has implemented that decision in a real way.

Notice of Assessment

- document prepared by the CRA and sent to the taxpayer, assessing the individual's tax, interest and penalties payable.
Such a Notice must be sent to each individual who has filed a return

Notice of Reassessment

- document prepared by the CRA, indicating that a return has been more carefully scrutinized and errors or omissions have been discovered, resulting in additional taxes payable
- a Notice of Reassessment may be issued by the CRA:
 - in general, within three years from the date of mailing the original Notice of Assessment
 - at any time, the taxpayer has made any misrepresentation that is attributable to neglect, carelessness or wilful default or has committed any fraud in filing the return or supplying information
 - at any time if the taxpayer has filed a waiver of the three year time limit
 - within six years if a reassessment is required under circumstances provided in section 152(6) - i.e. taxpayer has requested a loss carry-back.

Amended Returns

- solved by filing a Reassessment of a Return of Income
- permitted if the following conditions are met:
 - (1) The CRA is satisfied that the previous assessment was incorrect
 - (2) the reassessment can be made within the normal reassessment period
 - (3) the requested decrease in taxable income does not solely depend on an increase in a permissive deduction such as CCA
 - (4) the change is not based solely on a successful appeal to the courts by another taxpayer

Procedure of Appeals

- if a taxpayer disagrees with a Notice of Assessment or Reassessment, he or she can:
 - contact the CRA immediately (informal contact)
 - if this does not solve the issue in question, the taxpayer can then file a Notice of Objection
 - the Notice of Objection must be filed before the later of:
 - 90 days from the date on the Notice; or
 - one year from the April 30th due date for the return under assessment
 - if the matter still remains unsolved, the taxpayer must either accept the Minister's assessment or continue to pursue the issue at a higher level of appeal

The role of the Canadian Courts

- the next level of the appeal procedure is the Tax Court of Canada
- either the Minister or the taxpayer can appeal a decision made by the Tax Court of Canada to the Federal Court of Appeal
- there is the possibility of pursuing a matter to the Supreme Court of Canada
- if the Federal Court refers the issue or the Supreme Court authorizes the appeal, however such appeals are not common

Income from employment

Income can be classified into 5 categories:

- (1) Income from office or employment
- (2) Income from a business (self-employment)
- (3) Income from property (investment, rental)
- (4) Capital gains
- (5) "Other"

Income from office or employment

Employment is defined in the Act as the position of an individual in the service of some other person.

Office is defined as the position of an individual entitling him or her to a fixed or ascertainable stipend.

The important issue is to determine whether the individual is an employee or self-employed.

The differences between an employee and a self-employed individual, from a tax perspective, are as follows:

- revenue is received by a self-employed individual without any withholding of Canada Pension Plan, Employment Insurance, Income Tax or any employee benefits; whereas for an employee, the employer is responsible for deducting and remitting C.P.P., E.I. and income tax
- self-employed individuals have no liability for Employment Insurance Premiums and therefore cannot collect E.I. benefits
- self-employed individuals must contribute to Canada Pension Plan
- this is done on the personal income tax return and contribution amount is "doubled"
- self-employed individuals do not receive the various fringe benefits that employers generally provide
- self-employed individuals are eligible to deduct more expenses from employment income than are employees

For purposes of determining if an individual is to be considered an employee or self-employed, the general approach is the question of whether a master-servant relationship exists. An employment contract is expressed as a contract **of** service; an arrangement with a self-employed individual would be referred to as a contract **for** service.

Handout – Guy S. James

Income from employment

For "borderline" situations, the following tests are used to make the distinction:

- (1) **CONTROL TEST** – generally, in an employer/employee relationship, the employer controls, directly or indirectly, the way the work is done and the work methods used. The employer assigns specific tests that define the real framework within which the work is to be done.
- (2) **OWNERSHIP OF TOOLS** – in an employer-employee relationship, the employer generally supplies the equipment and tools required by the employee. In addition the employer covers the following costs related to their use: repairs, insurance, transport, rental, and operations. However, in some trades it is customary for the employees to supply their own tools – i.e. garage mechanics.
- (3) **ABILITY TO SUBCONTRACT OR HIRE ASSISTANTS** – if the individual must personally perform the services, he is likely to be considered an employee
- (4) **RESPONSIBILITY FOR INVESTMENT AND MANAGEMENT** – if the individual has made an investment and is active in managing the business, he should be considered self-employed
- (5) **CHANCE OF PROFIT/RISK OF LOSS** – generally, in an employer/employee relationship, the employer alone assumes the risk of loss and the employee is entitled to receive his/her full salary regardless of the financial health of the business.

One of the "grey" areas is that of a commission salesperson. As a commission salesperson, you would probably be considered an **employee** of the company if the company:

- (1) **TRAINS** you, pays you a **BASIC SALARY**, and has the **RIGHT** to **DISCHARGE** you
- (2) requires you to **SELL** from **THEIR PREMISES** and follow established hours
- (3) restricts you to **THEIR PRODUCTS** and expects you to maintain a **QUOTA**
- (4) dictates the **TERRITORY** to be covered, **CLIENTS** and **METHODS**
- (5) **SUPPLIES** the **AUTOMOBILE**; **PAYS** your **EXPENSES** or gives you an **EXPENSE ALLOWANCE**
- (6) expects you to make **REGULAR COLLECTIONS**

Note: not all of these conditions must be met!!!!

For an independent relationship to exist (self-employment):

- (1) the salesperson is NOT restricted to a particular company's products
- (2) the salesperson is not expected to perform the services in person
- (3) the salesperson is given no instruction as to what territory to cover, clients, how or when

Income from employment

ITEMS TO BE INCLUDED IN INCOME FROM EMPLOYMENT

Employment income includes salaries, wages and other remuneration. (T4)

However, the Act states that all benefits received or enjoyed by an individual by virtue of an office or employment must be included in income

Refer to paragraphs 3-46 to 3-60 (inclusive) on pages 80 to 84 of the text for a list of taxable and non-taxable benefits and to the handout!!!

Please note that some of the taxable benefits, which require detailed explanation, will be discussed in class. It is the student's responsibility to ensure that he or she has a complete understanding of the tax treatment of all of the items listed.

HST on taxable benefits (page 86)

The Act requires that employee benefits be calculated on a basis that includes any PST, GST or HST that were paid by the employer on goods or services that were used to provide the benefit.

In situations where the employer is exempt from these taxes, a notional amount is added to the benefit, on the basis of amounts that would have been paid if the employer had not been exempt.

Employers, who are registered for GST, must actually remit the GST/HST calculated in the benefits allocated to their employees.

Board and Lodging taxable benefit – Page 87

This benefit is calculated at the fair market value of the benefit provided, less any amounts recovered from the employee.

Subsidized meals do not have to be included, provided that the employee is required to pay a reasonable charge.

In general, if an amount has to be included in income for board and/or lodging, the value of the benefit should be computed on a HST included basis. However, the supply of a house, apartment or similar accommodation to an employee is NOT subject to HST if the employee occupies it for at least one month.

(Refer to exceptions listed on the next page)

Rent-free and low rent housing

Where your employer provides you with living accommodations, the difference between what is charged (to the employee) and what would be considered to be the Fair Market Value for equivalent accommodation is a taxable benefit.

(Refer to exceptions listed on the next page)

Exceptions to the inclusion of a taxable benefit re: board and lodging and rent-free and low-rent housing:

- (a) you were required to work temporarily at a special work site which is too far away from your ordinary residence to communicate daily **and**
- (b) you were required to be away from your ordinary residence or to be at the location for a period of at least 36 hours, **OR**
- (c) you were required to work at a location at which, by virtue of its remoteness from any established community, you could not be expected to establish and maintain a self-contained domestic establishment **and**
- (d) you were required to be away from your ordinary residence or to be at the location for a period of at least 36 hours.

To fulfil the requirements of (a) above, you must in fact have a “self-contained domestic establishment” available for your use and not rented out to anyone else, that is beyond commuting distance from the special work site.

Generally the work will be considered temporary in nature if it can reasonably be expected that it will not provide continuous employment for more than two years.

ALLOWANCES PAID TO EMPLOYEES

An allowance generally involves a payment to an employee as “general compensation” (as opposed to direct reimbursement) to him or her for travel costs, use of their own automobile or other costs that have been incurred by an employee on behalf of the employer.

The general rule is that allowances received by an employee must be included in their income. However, many of the items for which the employee has received an allowance for, may be deductible against their employment income, provided that they meet the criteria involved with such deductions. i.e. salesperson's expenses, travel expenses, motor vehicle expenses.

However, there is, of course, an exception to this general rule for the inclusion of allowances in income. Specifically, the following allowances do not have to be included in employment income:

- (1) Reasonable allowances paid to a salesperson for travel expenses, including the use of a motor vehicle for employment purposes.
- (2) Reasonable allowances paid to non-sales employee for travel expenses, not including the use of a motor vehicle for employment purposes.
- (3) Reasonable allowances paid for business use of an employee-owned vehicle, for employees other than sales persons

For the **travel expense allowances**, the rules essentially operate the same for both a salesperson and a non-sales employee:

- if the allowance is reasonable, it is not taxable
- if the allowance is unreasonably low, it **may** be added to income and the actual expenses deducted, provided that the employee meets the criteria for deducting such expenses (***explain the CRA interpretation***)
- if the allowance is unreasonably high, the allowance must be added to income. The employee can then deduct the actual expenses incurred, provided that the employee meets the criteria for deducting such expenses

"REASONABLE"

- in determining the reasonableness of the allowance, the actual costs incurred would provide a measurement for comparison

For **motor-vehicle allowances**, the rules are somewhat different. Such an allowance will automatically be considered **unreasonable** (and therefore taxable) unless the following 2 conditions are met:

- (1) the allowance must be based solely on km driven for business use **and**,
- (2) there can be no reimbursement in addition to the allowance, (except for supplementary business insurance, toll or parking charges)

Note: that if these 2 tests **are** in fact met, that doesn't necessarily mean that the allowance is not taxable. It simply means that the allowance will not **automatically** be deemed unreasonable. The next step will be to consider if the allowance appears to be **OTHERWISE** unreasonably high or low, taking into account the same rules for travel allowances. Reasonability will then be determined according to what the ITA will permit the **employer** to deduct for such automobile costs. For **2013** these rates are \$.54 per kilometer for the first 5,000 kilometers driven for business use and \$.48 per kilometer thereafter. The employer is also required to maintain employee-by-employee mileage records to support this deduction. If the allowance exceeds these amounts, the employer will be permitted to deduct the excess, only if the allowance is included on the employee's T4.

Example #1 - Mr. Salesperson drove his car 30,000 kilometers for business use during 2013. His employer paid him an allowance equal to \$.45 per km for a total of \$13,500. No other amounts were paid to him with respect to vehicle costs incurred.

TAX TREATMENT: the allowance does in fact meet the 2 tests and does in fact appear "otherwise" reasonable according to the rates established by Revenue Canada. (\$14,700) Therefore, the allowance would be considered non-taxable. However, if the actual deductible costs incurred by Mr. Salesperson substantially exceeded the allowance, he could then choose to add the allowance to income and deduct the actual expenses incurred. ***Note that according to the textbook the CRA may disallow this treatment! (Refer to paragraph 3-137, page 98)***

Example #2 - Using the same data as for Example #1, except that the allowance received by Mr. Salesperson was \$1.00 per kilometer.

TAX TREATMENT: The allowance exceeds the “reasonable limits” and must be added to Mr. Salesperson’s income.

Examples #3 - Using the same data as for Example #1, assume that Mr. Salesperson also received a flat rate of \$200 per month. The allowance would then not meet the 2 conditions and will therefore be automatically deemed unreasonable. Mr. Salesperson must then add the allowance to income and can deduct the business use portion of the actual costs incurred.

Just one final point - when a non-taxable allowance is received, the employee cannot make any deductions for the expenses to which the allowance relates.

Other benefits:

Gifts from employer - read paragraphs 3-50 → 3-53, page 81 - 82

Loyalty programs - read paragraphs 3-54 → 3-56, page 82 - 83

Tuition fees - read paragraphs 3-57 and 3-58, page 83

Housing loss reimbursement - read paragraphs 3-185 → 3-188 on page 111

Discount on employer’s merchandise - read paragraphs 3-189 → 3-191 on page 111

Club dues and recreational fees - read paragraphs 3-192 and 3-193 on page 111

DEDUCTIONS FROM EMPLOYMENT INCOME

Overview – page 112, paragraph 3-194 and 3-195

Registered Pension Plan contributions

- more in-depth discussion of RPP's further on in the text
- RPP contributions are indicated on the employee's T4
- contributions are deductible from employment income
- income accumulating under an RPP is tax free until such time that amounts are received from the RPP
- amounts ultimately received from an RPP are fully taxable

Note: contributions to CPP and EI are NOT deductible; these amounts are non-refundable tax credits!

Salesperson's Deductions

- available to a salesperson who meets all of the following criteria (paragraph 3-197, page 113):
 - (1) receives at least a part of his or her remuneration in the form of commissions or by reference to the volume of sales
 - (2) is required to pay his or her own expenses - form T2200 is required
 - (3) does not receive a non-taxable allowance from the employer (note that if the allowance has been added to income, the expenses can be deducted)
 - (4) is ordinarily required to carry on duties away from the employer's place of business
- items that can be deducted are listed on page 113, paragraph 3-198 (**refer to your handout!**)
- the total expenses that can be deducted under section 8(1)(f) **cannot** exceed the commissions earned
- salespersons are also entitled to claim deductions for CCA on a vehicle used for business use and interest on a loan to purchase that vehicle – section 8(1)(j); these deductions are not limited to the commissions earned

Note: there are limitations on the amount of CCA and interest which can be deducted:

CCA

- \$30,000 cost plus HST and PST for vehicles purchased after December 31, 2000

Interest

- \$10.00 per day (**before prorating for business use**) for Class 10.1 vehicles purchased after December 31, 2000 (or \$300 per month)
- remember to prorate other expenses for business use, where applicable

Restrictions on leased vehicles - maximum \$800 plus HST per month for 2013

- it would be advisable for the students to make two lists in their notes of the "restricted" and "non-restricted" expenses
- if the deduction of interest and CCA creates a loss, it can be deducted against income from other sources or carried forward to subsequent years as a non-capital loss

Travelling Expenses and Motor-Vehicle costs of Employees

- available to employees who meet the following criteria (paragraph 3-202, page 114):
 - (1) must ordinarily be required to perform duties away from the employer's place of business
 - (2) must be required to pay their own travel and motor- vehicle expenses - form T2200 is required
 - (3) must not be in receipt of a non-taxable allowance from the employer (remember that if the allowance has been added to income, the expenses can be deducted)
- review the list of deductible expenses on **page 114** and note any restrictions
- also, note that the amount of expenses deductible is NOT limited to the employment income earned: in other the deduction could in fact create a loss.
- same restrictions apply to automobile interest and CCA and lease payments for a vehicle

Other expenses of performing duties – Section 8(1) (i)

- paragraph 3–211 on page 115

Home Office costs

- review the criteria and deductible items on **page 116, paragraph 3-215**
- note that for non-sales employees, there is no deduction for property taxes or house insurance
- note the restrictions in paragraph 3-220 page 117

Special issues

Due to the fact that the deduction for Salesperson's expenses is limited to the amount of commissions earned, a salesperson could make the following choices:

- (a) taking the deductions available to a salesperson or,
- (b) taking the deductions available to a non-sales employee

The second option may be advisable if travel and auto expenses exceeded the commissions earned.

Another way to word these choices is to think in terms of sections of the Income Tax Act:

- (a) deductions under sections 8(1)(f) and 8(1)(j) or,
- (b) deductions under sections 8(1)(h), 8(1)(h.1), 8(1)(i) and 8(1)(j)

Note that the deductions **cannot** be taken simultaneously under Section 8(1)(f) and Sections 8(1)(h) and 8(1)(h.1)

Special issues (continued):**Example:**

Joe Salesperson's employment income for the year was \$25,000, which included commissions in the amount of \$4,000. Assume that Joe meets all of the 4 criteria for claiming deductions as a salesperson. The following expenses were incurred and paid by him:

Advertising & promotion	\$ 1,100
Travel and auto (business use portion)	3,500
C.C.A. (business use portion)	2,600
Professional dues	300
Cost of supplies	500
Office-in-home:	
Fuel, electricity, repairs (business use portion)	1,200
Property taxes (business use portion)	400
Insurance (business use portion)	100

Solution:**Alternative (a) – claim deductions as a salesperson:**

Earnings from employment		\$25,000
Less salesperson's deductions - section 8(1)(f):		
Travel and Auto	\$3,500	
Advertising and promotion	1,100	
Professional dues	300	
Cost of supplies	500	
Office-in-home:		
Fuel, electricity, repairs (business use portion)	1,200	
Property taxes (business use portion)	400	
Insurance (business use portion)	<u>100</u>	
	7,100	
	maximum	(4,000)
Less: CCA - section 8(1)(j)		<u>(2,600)</u>
Net Income from Employment		<u>\$18,400</u>

Alternative (b) – claim deductions as a non-salesperson:

Earnings from employment			\$25,000
Less: deductions available to non-sales employees:			
Travel and auto - Section 8(1) (h) and (h.1)	\$ 3,500		
Professional dues - Section 8(1) (i)	300		
Cost of supplies - Section 8(1) (i)	<u>500</u>	(4,300)	
Less: Office-in-home - Section 8(1) (i):			
Fuel, electricity, repairs (business use portion)		(1,200)	
Less CCA - section 8(1) (j)		<u>(2,600)</u>	
Net income from employment			<u>\$16,900</u>

Note that the trick is to watch the travel and auto expenses!!

HOMEWORK:

Exercise 3-2, page 82 (inclusions of taxable benefits)
Exercise 3-3, page 84
Exercises 3-8 and 3-9, page 98
Exercise 3-10, page 99
Exercise 3-16, page 115
Self-study problem 3-11, page 124
Self-study problem 3-12, page 124
Assignment problem 3–11, page 133 (ignore #9)

Sample problem on handout – Jake Yacumflastor

INVESTMENT INCOME

INVESTMENT INCOME

- income you receive as a result of your ownership of corporate shares, bank deposits, bonds, debentures, mortgages, notes, annuity contracts, beneficial interests in an estate or trust, in general, any other property other than real estate - includes interest and dividends
- reported on a Schedule 4

INTEREST INCOME (T5 information slip)

- the basic provision on interest income as stated in the Act, can be found on pages 320 and 321 paragraphs 7-39, 7-40, 7-43, 7-44, 7-45 and 7-46
- interest must be reported on the annual accrual basis, by corporations and partnerships
- however, for individuals, the Act allows a modified version of accrual accounting
- interest is reported based on the anniversary date of the investment
- for example, if you purchased a five-year investment on July 1, 2012, the first year's interest is calculated to the end of June 30, 2013 and must be reported in 2013.
- the interest accrued for the period July 1, 2012 to December 31, 2012 does not have to be reported in 2012!

Note: interest earned on Child Tax Benefits invested in **the name of the child** is taxable income of the child's

Treasury Bills, Commercial Paper - T5008

- proceeds of disposition minus the cost of the investment is reported as interest

Royalties

- are reported as other investment income

INTEREST AS A DEDUCTION

- the Act basically provides for the deduction of interest paid on funds borrowed for the purpose of producing business income or income from property
- interest cannot be deducted if it relates to other sources of income such as capital gains
- read pages 314 → 317 – excellent information!

INVESTMENT INCOME

Non-deductible interest:

- interest on funds borrowed to purchase idle land
- interest on funds borrowed to purchase an RRSP
- interest on funds borrowed to purchase personal property or listed personal property
- interest on funds borrowed to make interest-free loans to family members
- interest on funds borrowed to make tax instalments or to pay personal living expenses

DIVIDEND INCOME (T5)

Dividends from taxable Canadian corporations

- must report the dividends received at a "grossed-up" or taxable amount

(1) For ***non-eligible dividends*** – the calculation of the taxable amount and the federal dividend tax credit are as follows:

$$\text{TAXABLE AMOUNT} = \text{ACTUAL AMOUNT RECEIVED} \times 1.25$$

- the taxpayer will also be entitled to claim a federal dividend tax credit, which reduces federal tax payable

$$\text{FEDERAL DIVIDEND} = \text{ACTUAL AMOUNT} \times 16 \frac{2}{3} \%$$

$$\text{TAX CREDIT} = \text{RECEIVED}$$

$$\text{or } \text{TAXABLE AMOUNT} \times 13 \frac{1}{3} \%$$

(2) For ***eligible dividends*** received in 2013 – the calculation of the taxable amount and the federal dividend tax credit are as follows:

$$\text{TAXABLE AMOUNT} = \text{ACTUAL AMOUNT RECEIVED} \times 1.38$$

$$\text{FEDERAL DIVIDEND TAX CREDIT} = \text{ACTUAL AMOUNT RECEIVED} \times .38 \times \frac{6}{11}$$

Eligible dividends (page 330, paragraphs 7-80) are defined as dividends paid after 2005 by:

- (1) public corporations that are subject to the general corporate tax rate
- (2) Canadian controlled private corporations, out of active business income that has been taxed at the general corporate tax rate, and
- (3) Canadian controlled private corporations, out of eligible dividends that it has received

Stock dividends

- are reported exactly the same way as cash dividends - the value of the dividend is usually the Fair Market Value of the shares received and this amount must be "grossed-up" in the same way as cash dividends and the federal dividend tax credit is also calculated the same

Dividends not subject to tax:

- dividends received from the "Capital Dividend Account" of a C.C.P.C.
(I will explain this in class!)

Foreign Non-Business Income

- includes interest and dividends received from foreign sources
- must be reported in Canadian dollars using the average exchange rate for the calendar year
- these rates are available from the CRA
- usually dividends are received NET of a non-resident withholding tax
- all foreign source income must be reported at GROSS amount BEFORE taxes withheld and in Canadian currency (see below)
- the taxpayer will receive a tax credit for the foreign taxes withheld; this tax credit reduces federal tax payable and is limited to 15% of the foreign source non-business income
- if the amount withheld exceeds 15%, the excess can be claimed as a deduction under ITA 20(11)
- dividends received from foreign sources are **not** reported at a "grossed-up" amount as are dividends received from taxable Canadian corporations

If NRT was withheld from foreign non-business income:

$$\text{AMOUNT TO BE INCLUDED IN INCOME} = \frac{\text{ACTUAL AMOUNT RECEIVED}}{(100\% - \text{NRT RATE})} \times \text{AVERAGE EXCHANGE RATE}$$

INVESTMENT INCOME

Deductions in calculating Net Investment Income:

- Interest on funds borrowed to purchase investments
- Safety deposit box charges
- portfolio management fees
- fees paid to an investment counsellor
- accounting and bookkeeping fees
- interest benefit on interest-free/low interest loans when loan proceeds are used to purchase an income producing property

ATTRIBUTION RULES

- (1) If you have transferred the right to "income from property" to a person with whom you are dealing in a non-arm's relationship (blood, marriage or adoption) then the income received shall be deemed to be your income, unless you have transferred or assigned the property as well, at fair market value.

These rules apply to situations where property is transferred or loaned in non-arm's length transactions:

- (2) For property transferred or loaned to your spouse:
- (a) income earned on the property shall be deemed to be your income, this also applies to income earned from property substituted or transferred
 - (b) capital gains or losses on the property also attribute back to the transferor spouse

The only way to circumvent the attribution rules in this situation is to elect to transfer the property at FMV, thereby realizing a capital gain (or loss) on the transfer, or in the case of a loan, if interest on the loan is charged at the lesser of the commercial rates or prescribed rates. The transferor spouse must therefore pay tax on either the capital gain or the interest. In addition to the transferor electing to report the transfer at FMV, the transferee spouse must provide out of his or her own resources, consideration equal to the FMV of the property.

INVESTMENT INCOME

- (3) For property transferred to a child, with whom you deal in a non-arm's length relationship (includes your own child, grandchild, siblings and, for purposes of this section of the ITA, nieces and nephews)), the property is deemed to have been disposed of at FMV.

However, if the child is a minor, the income from that property is still deemed to be your income, until the child reaches the age of 18.

Note: that the attribution rules do not extend to capital gains (losses) on substituted property because of the initial transfer being recorded as a deemed disposition at FMV.

Note: that the transferor will pay tax on the capital gain on the transferred property.

Interest-free and low interest loans also constitute transfers of property. Where the proceeds of the loan were used to purchase property that will produce "income from property", that income will also attribute back to the transferor, regardless of the age of the person with whom you are dealing at non-arm's length. The only way to circumvent the attribution rules in this case, is for the transferor to charge and pay tax on interest on the loan at the lesser of the commercial rates or prescribed rates.

For more in-depth reading on this topic, refer to pages 458 to 465 of the text!

Homework: Hand in assignment (included with the handout) – Mr. Speculator
Exercise 7-3, page 322
Exercises 9-15, 9-16 and 9-17, pages 462 and 463

Lecture notes: OTHER INCOME AND DEDUCTIONS

Pension Benefits

(1) Old Age Security pension (T4OAS)

- paid to individuals in the year they reach age 65 (and subsequent years)
- the base amount is taxable and included on line 113 of the T1
- a Guaranteed Income Supplement is available to low income recipients
- ***the Guaranteed Income Supplement is not taxable, but must be added to total income on line 146 and then deducted in the calculation of taxable income on line 250***
- note that the Supplement is **NOT** deductible in arriving at **net** income
- if the recipient's Net Income is in excess of \$70,954.00 (for 2013), the taxpayer will be required to repay all or a portion of the OAS benefits. Repayments as calculated when preparing the tax return and are deductible on line 235 in the calculation of **net income** and are added to the total tax liability on line 422.
- Depending on the level of income, the taxpayer may be required to repay some of the benefits during the taxation year; such repayments would be indicated on the information slip and deducted on line 232 in the calculation of **net income**.

(2) Canada or Quebec Pension Plan Benefits - T4A(P) – include on line 114

- types of payments received:
 - (1) retirement pension - begins at age 65
 - (2) disability benefits
 - (3) death benefit paid to the spouse or the estate of the deceased
 - (4) spouse survivor benefit - paid to the surviving spouse
 - (5) child and orphan benefits - paid to the deceased's children

(3) Other Pension or Superannuations - T4A - line 115

- periodic payments from a company pension fund (i.e. RPP) upon retirement of the employee and lump sum payments on withdrawal from the fund or termination of the plan
- ***if the 60 (j) rollover option has been exercised, the amount received from the RPP and corresponding RRSP contribution do not have to entered on the tax return – just include the information slips***
- foreign pension payments , i.e. U.S. Social Security - one-half of the amounts received must be included in income

Universal Child Care Benefit (line 117) (***not on test #1***)

- Paragraphs 9-27 → 9-29, page 425
- Families receive \$100 per month for each child under the age of six
- The amounts received are taxable in the hands of the lower-income spouse
- To receive these payments, a one-time application is required
- For other relevant points, refer to paragraph 9-29

Lecture notes: OTHER INCOME AND DEDUCTIONS

Employment Insurance Benefits T4E - line 119

- benefits received are fully taxable
- any tax deducted at source should be entered on page 4 of the T1 on line 437
- repayments made to the government **during** the year are deductible in arriving at **net income** on line 232 (these repayments would be indicated on the information slip)
- the income threshold is \$59,250 for 2013
- repayments as calculated when preparing the tax return are also deductible in arriving at **net income** on line 235 and added to total taxes payable on line 422

Retiring Allowances (*not on test #1*)

- defined and discussed in paragraphs 9-13 and 9-15 on page 423
- RRSP rollover – discussed in paragraph 9-15

Death benefits

- Defined in paragraph 9-16 on page 423 of the text
- **the first \$10,000 is exempt from tax and this exemption may be shared**

Alimony and Maintenance payments received/paid (line 128/line 220)

- if ALL of the 5 criteria are met as specified in paragraph 9-82, page 437 of the text, then the spousal support payments shall be included in the income of the recipient and deducted from income by the payor; line 128 (income)/ line 220 (deduction)
- 1996 Budget changes re: child support payments – I will explain this in class

Payments received from Deferred Income Plans (*not on test #1*)

- listed in paragraph 9-21 on page 424 of the text; most common are payments from RRSPs, DPSPs, RRIFs

Annuity payments (*not on test #1*)

- defined in paragraph 9-88 on page 438 of the text
- income earned by an annuity purchased with after-tax dollars (as opposed to tax deferred annuity plans) must be reported annually

Lecture notes: OTHER INCOME AND DEDUCTIONS

Education assistance payments (page 424)

- scholarships, bursaries, grants and prizes must be included in income, to the extent that these amounts exceed the student's scholarship exemption under ITA 56(3)
- This exemption includes 100% of all scholarships and prizes that are received in connection with:
 - An education program that qualifies for the education tax credit; and
 - An elementary or secondary school education program
- Research grants in excess of unreimbursed expenses must be included in income; note that the exemption does not apply to research grants

Social Assistance and WSIB payments

- ***such payments are not taxable but must be added to total income on lines 144 and 145 of the T1 and are deducted on line 250 (in calculating taxable income)***
- discuss what is meant by "Social Assistance" payments (page 424)

Registered Education Savings Plans and Registered Disability Plans
(not on test #1)

- there is a ton of information on this and related topics - pages 441 → 446

CPP contributions on Self-employed Earnings *(not on test #1)*

- refer to paragraphs 9-30 → 9-33 on page 425

Moving Expenses (pages 426 → 428)

Moving expenses are deductible by the following taxpayers:

- (1) taxpayers who move to a new work location either as an employee or as an independent contractors
- (2) taxpayers who move in order to commence full time attendance at a post-secondary institution
- (3) taxpayers who move to a new work location after ceasing to be a full-time student at a post-secondary institution
- (4) an unemployed taxpayer who moves to a new location in Canada to take up employment at that new location

The new home must be at least 40 kilometers closer to the new work location or post-secondary institution than the previous home. ***Expenses can only be deducted against income, including scholarships, received in the new work location or institution. Any excess deductions can be carried over to the next taxation year and deducted against the following year's income at the new location.***

Interesting to note that there is no time limit as per paragraph 9-36!

Lecture notes: OTHER INCOME AND DEDUCTIONS

Deductible expenses include:

- *travelling costs (including a reasonable amount for board and lodging) in the course of moving the taxpayer and members of the household from the old residence to the new one*
- *the cost of transporting or storing household effects*
- *the cost of meals and lodging near either the old or new residence for a period not exceeding 15 days*
- *the cost of cancelling a lease on the old residence*
- *the selling costs on the old residence*
- *the legal and other costs associated with the acquisition of the new residence, provided an old residence was sold in conjunction with the move*
- *Up to \$5,000 of interest, property taxes, insurance and heating and utilities costs on the old residence, subsequent to the time when the individual has moved out and during which reasonable efforts are being made to sell the property*
- *costs of revising legal documents to reflect a new address, replacing drivers' licences and non commercial vehicle permits and connecting and disconnecting utilities*

Simplified method to calculate vehicle and meal expenses (not on test #1)

- refer to paragraph 9-41, page 427

Employer Reimbursements of Moving Expenses

- review the text book material in paragraphs 9-42 → 9-46, pages 427 and 428

Child Care expenses (Pages 428 → 432)

- ***a taxpayer is permitted to make this deduction, provided that the costs were incurred in order to produce earned income***
- ***for two parent families, the general rule is that childcare costs must be deducted by the spouse with the lower net income***

Exceptions: - ***see paragraphs 9-57, 9-58 and 9-59 on pages 430 and 431 of the text***

Eligible children: - a child of the taxpayer or his spouse
- a child that is dependent on the taxpayer or his spouse and whose income does not exceed the basic personal exemption
- Also, the child must be under 16 years of age or dependant on the taxpayer or the taxpayer's spouse for reasons of mental or physical infirmity

Lecture notes: OTHER INCOME AND DEDUCTIONS

Deductible costs: include the costs of sending a child to boarding school or camp, however such costs are limited to \$100 per week per child, 7 years of age or older or a dependent child over 16 who has a mental or physical infirmity but does not qualify for the disability tax credit; \$175 per week per child, under the age of 7; \$250 per week per child of any age who is physically or mentally disabled and qualifies for the disability tax credit

If the lower income spouse is claiming the full amount of the deduction, limitations A, B and C apply (see the form!)

If the higher income spouse is claiming a portion or all of the deduction, limitations A, B, C and D apply (see the form!)

Disability Supports Deduction *(not on test #1)*

- review the material on pages 432 and 433

Tax Free Savings Accounts (TFSA's) *(not on test #1)*

- review the material on pages 446 and 447

For practice: Exercise 9-1, page 428
Exercise 9-2, page 432
Exercise 9-5, page 438
Self-study problem 9-1, page 467
Self-study problem 9-2 and 9-3, page 468
Assignment problems 9-1, 9-2 and 9-3, pages 477 → 478

CHILD CARE EXPENSES – sample problem:

In 2013, Mr. and Mrs. Strugglers were both employed on a full-time basis. He earned \$20,000 and she earned \$15,000. The Strugglers have three children who are 3, 5 and 8 years old. During the year, Mrs. Strugglers was imprisoned for 8 weeks after having pleaded guilty to a charge of shoplifting. Total child care expenses for the 3 year old and the 5 year old were \$7,500 and \$2,500 for the 8 year old.

Required:

Complete the child care expense schedules to be filed by both Mr. and Mrs. Strugglers with their 2013 personal income tax returns. (These schedules will be handed out in class)

Hint: Prepare the schedule for the person with the highest earned income **first!**

CAPITAL COST ALLOWANCE

Defined - the Income Tax Act does not allow a deduction from income with respect to depreciation, amortization or depletion on capital assets; however it does permit an equivalent deduction called Capital Cost Allowance

Who is eligible to claim CCA:

- (1) Taxpayers earning income from a business
- (2) Taxpayers earning rental income
- (3) certain employees who are required, by their employer, to use their vehicle for business use

C.C.A. will only be deductible with respect to:

- (1) expenditures on property of a capital nature, i.e. providing long-term benefit and included in one of the CCA classes
- (2) acquired for the purpose of producing income and NOT for resale

Comparison of accounting terms with tax terms:

<u>TAX TERM</u>		<u>ACCOUNTING TERM</u>
Capital Cost	=====	Acquisition Cost
Capital Cost Allowance	=====	Depreciation Expense
Undepreciated Capital Cost	=====	Net Book Value

CCA is permitted at, more or less, arbitrary rates on classes of assets that are not necessarily of like kind, size or useful life.

A somewhat limited list of these classes and rates can be found in the text on pages 212 to 223 – **review this list!** This list will be sufficient for our purposes. (Also refer to pages 232 and 233 for alphabetical listing.

For personal income tax, the students will be responsible for knowing the "contents" of classes 1, 3, 6, 8, 10, 10.1, 12, 13, and 50.

Generally, capital cost allowance classes fall into two groups:

- (1) those for which CCA is calculated on the declining balance basis at the applicable percentage
- (2) those for which CCA is calculated on the straight line basis (few in number!). Explain how the CCA is calculated for Class 13.

DISTRIBUTE CCA SCHEDULES !!!!!

Review the format as per the schedule.

Determination of capital cost

- generally the capital cost of an asset includes the full cost to the taxpayer of acquiring the property and preparing it for use :
 - invoice price
 - freight
 - installation costs
 - applicable taxes
 - duties
- legal, accounting or any other fees incurred to purchase the property
- any repairs to prepare the asset for use
- capital cost will be reduced by any amounts received or receivable from any level of government for the purposes of acquiring the asset - i.e. grants, subsidies, forgivable loans, tax deductions
- a taxpayer may elect to capitalize any interest associated with the purchase of a depreciable asset , but generally this is no a desirable choice
- **if an HST input tax credit is received with respect to the HST paid upon acquisition, the HST must NOT be included in the capital cost**
- where the asset is acquired in a non-arm's length transaction, the capital cost is deemed to be the FMV of the asset

Do sample calculations: (1) class 8 - declining balance
(2) class13 - leasehold improvements

- (1) class 8
 - U.C.C. at beginning of year = \$ 10,000
 - cost of additions = \$ 5,000
 - during the year equipment, which originally cost \$4,000, was sold for proceeds of \$2,000

- (2) class 13 - on January 2, 2013, Ms. Taxpayer entered into a 10-year lease on a building to be used for operating her business. During 2013, the cost of leasehold improvements was \$ 20,000. During 2014, the cost of leasehold improvements was \$27,000. Calculate the CCA for 2013, 2014, and 2015

Assets which cannot be pooled

- (1) assets of the same class which are used in separate businesses

- (2) passenger vehicles, the cost of which exceeds the following:

- (a) \$30,000 - if acquired after December 31, 2000 (plus HST)

Each vehicle in this situation must be classified as a class 10.1 asset - NO POOLING!

Only the threshold amount is shown as the capital cost of the addition to the class

In the year of disposition, ½ of the normal amount of CCA can be deducted and the UCC at end of year will automatically become NIL.

- (3) Eligible class 8 assets, as defined in paragraph 5-78, page 223 (optional)
- (4) Class 1 buildings that are eligible for the 6% or 10% CCA rate – Page 212 and page 224
- (5) Rental properties acquired after 1971 at a cost of \$50,000 or more

Assets acquired for Business and Personal use

For assets **other than automobiles**, the capital cost of the addition to the applicable class is calculated as follows:

$$= \text{Actual Cost} \times \text{Business use \%}$$

The percentage is calculated with reference to time used.

Example: computer purchased at a cost of \$5,000, which is used 80% for business use

$$= \text{addition to class 50} = \$5,000 \times 80\% = \underline{\underline{\$4,000}}$$

For **automobiles**, apportion the CCA - this option is recommended if the business use percentage is expected to vary each year

- **NOTE**: on the CCA schedule, claim the FULL amount of CCA and apportion the CCA on the statement of income

NOTE: the business use percentage is calculated with reference to kilometers driven

Short Taxation Years

For taxation years that are less than 12 months in length, i.e. the first period of operations, the CCA must be prorated according to the number of days or months divided by the number of days or months in a full taxation year. Note that the ½ year rule still applies as well. Do an example !!!

NOTE: the Cantax program prorates CCA for a short taxation year based on the number of **days**

Exceptions to half-year rule

Certain class 12 assets are NOT subject to the ½ year rule. See paragraph 5-39 on page 215.

Recapture - when the deduction of the lesser of cost or proceeds from the opening UCC of a given class results in a **negative** number, this negative number is referred to as RECAPTURE.

Recaptured CCA is added to income and the UCC of the class at the end of the year is NIL.

Terminal Loss - when the last asset in the class is disposed of and the deduction of the lesser of cost or proceeds from the opening UCC results in a POSITIVE number, this positive number is referred to as a TERMINAL LOSS. A terminal loss is deducted from income and the UCC of the class at end of year is NIL.

Do one example of each!

CHANGE IN USE

When a property was acquired for some other purpose (i.e. personal use) and becomes an income producing property or when a property used to produce income is converted to some other purpose, a deemed disposal or acquisition has taken place.

For property converted to business use:

(1) if FMV is less than cost - the cost of the asset will be recorded at FMV

(1) if FMV is greater than cost - the cost of the asset will be recorded for CCA purposes **only** at:

$$\text{COST} + \frac{1}{2} (\text{FMV} - \text{COST})$$

Note that the ACB will be equal to FMV

Example:

Assume a taxpayer transfers a computer that was used strictly for personal use, to his or her business, to then be used 100% for business use. Cost of the computer was \$5,000 and the FMV at date of transfer was \$6,000.

$$\begin{aligned} \text{Capital cost of additions to class 10} &= \frac{1}{2} \times (\$6,000 - \$5,000) \\ &= \$5,000 + \$500 \\ &= \underline{\underline{\$5,500}} \end{aligned}$$

NOTE:

$$\text{ACB} = \underline{\underline{\$6,000}}$$

The taxpayer would have to recognize a taxable capital gain
= $1/2 \times (\$6,000 - \$5,000)$
= **\$500**

This issue can definitely lead to more complex calculations, depending on the situation, as illustrated in the example in the text on pages 382 to 384. However, it is sufficient at this point to have at least an understanding to the degree illustrated in the above example.

CCA and tax planning

It should be noted that CCA is an “optional deduction” – a taxpayer can choose to claim less CCA than is permitted by calculation. For example if the taxpayer’s net income from self-employment is \$2,000 and the maximum CCA deduction is \$5,000, the taxpayer could choose to claim only \$2,000 of CCA, i.e. just enough to bring the net income to zero. The “rule of thumb” is to claim CCA in the classes with the lowest rates first and restrict the CCA deduction in the classes with the highest rates. This will leave a larger potential CCA deduction for future years. One exception to this “rule of thumb”, is if you knew that in the following year an asset would be sold, which would trigger recapture in a class that you would normally have chosen to claim CCA. It would be best to restrict the CCA claim in that class, on order to reduce the recapture in the subsequent year. (Illustrate this with an example!)

Homework: Exercise 5-2, 5-3, and 5-4, page 215 and 216
Exercise 5-6, page 217
Exercise 5-7, page 218
Exercise 5-9, 5-10 and 5-11, page 220 and 221
Exercise 5-12, page 224
Self-study problem 5-1, page 234
Self-study problem 5-2, page 234, ignore class 29
Self-study problem 5-3, page 235
Self-study problem 5-4, page 236, ignore class 29
Self-study problem 5-6, page 237 – ignore item #6
Self-study problem 5-7, page 237 – ignore item #3 – “other information”
Assignment problem 5-2, page 240, ignore class 29
Assignment problem 5-3, page 240
Assignment problem 5-5, page 242

Plus the Handout questions

INCOME OR LOSS FROM A BUSINESS - Defined in paragraphs 6-20 on page 249 of the text.

It is the student's responsibility to transfer this information to their notes!!!!!!

Note that the ensuing discussion on Active Business Income is not relevant to personal tax.

A hobby may constitute a business, if it produces income.

If a business does not generate an income within say 5 years of starting up, the CRA may choose to declassify it as a business and any previous non-capital losses claimed, may be disallowed.

If a taxpayer operates more than one type of business, it will be necessary to calculate the profits of each business separately.

Due to the difference in the taxation of a business gain vs. a capital gain, it has become necessary for the courts to establish criteria to distinguish between the two. These criteria are listed in **paragraphs 6-38 to 6-41 on page 251 and 252.** Review these criteria and emphasize the importance of taking all of them into account.

There are two methods of reporting income or loss from a business:

- (1) cash method - available ONLY to farmers and fishermen
 - also available to self-employed commissioned salespersons...
 - “as long as it accurately reports your net income for the year.”
- (2) accrual method - must be used by all other taxpayers

When preparing the tax return for taxpayers who are reporting income from a business, there are two possibilities for reporting the net income.

- (1) prepare the statement of net income for tax purposes according to the statement provided by Revenue Canada in the Business and Professional Income Guide (refer to this)
- (2) prepare a statement of income for accounting purposes in accordance with GAAP and a Reconciliation Schedule to adjust the accounting net income to the net income for tax purposes. This will depend on the needs of the taxpayer.

This reconciliation schedule will appear as follows (Page 275):

Net income per financial statements \$xxxxxx

Add items which have been deducted
for accounting purposes which are
not deductible for tax purposes;

- i.e. Depreciation
- Charitable donations and Political contributions
- Losses on disposal of fixed assets, Club dues
- Non-deductible auto expenses, 50% of meals and entertainment
- Cost of recreational facilities

Less items that are deductible for tax purposes which
have not been deducted for accounting purposes

- i.e. CCA
- Gains on disposals of fixed assets
- Investment income

Net income for tax purposes **\$xxxxxxx**

INCLUSIONS IN INCOME (REVENUES)

Accounts Receivable and Reserve for Bad Debts

All amounts received or receivable for goods or services that have been or will be delivered must be included in income for tax purposes.

With respect to the allowance for doubtful accounts as used for accounting purposes, there is concurrence with the tax treatment. The reserve for bad debts is essentially permitted as long as it has been established on a reasonable basis. (It would probably be a good idea to review the accounting treatment !!!) The method of calculating the deduction is somewhat different for tax purposes, but the effect on Net Income from Self-employment for Tax Purposes is exactly the same. Refer to the example illustrated in paragraphs 6-60 to 6-61 on pages 255 and 256.

Do exercise 6-3 on page 256 for practice!

Reserve for Unpaid Amounts - paragraph 6-63 to 6-64, page 257.

When an amount has been included in computing a taxpayer's income from a business in respect of inventory sold in the course of the business and part of that amount is receivable after the end of the taxation year, a reasonable reserve is allowed as deduction from income.

Where the property sold is land, a reserve is allowed if all or a portion of the proceeds of sale are receivable **after the end of the taxation year**.

In any other case, **the terms of payment must be spread out over a period that exceeds two years from the date of sale**.

However, the deduction of the reserve is prohibited where the sale occurred more than 36 months before the end of the year. In other words, a maximum three-year reserve is allowed for proceeds not yet received.

Computation of the maximum reserve:

$$\frac{\text{Amount receivable (@ year end)}}{\text{Sale Price}} \quad \times \quad \text{Gross profit}$$

In the year of sale, the full amount of gross profit is added to income and the maximum reserve for that year will be deducted. In subsequent years, the reserve of the prior year will be added to income and the reserve for the current year will be deducted.

Reserve for Unpaid Amounts Example:

Ms. Foley operates a construction business. In 2013, the business sold a parcel of land, which had been held in inventory, for proceeds of \$2,000,000. The terms of sale called for a down payment of \$1,000,000 with the balance to be received in 5 equal annual instalments, the first payment being due on July 31, 2014. The cost of the land was \$200,000.

Required:

Calculate the amount to be included in Ms. Foley's income from self-employment for 2013, 2014, 2015 and 2016.

Do exercise 6-5 on page 257 for practice!

Solution:

<u>2013</u>	Gross profit from sale	\$ 1,800,000
	Less Reserve for current year: \$1,800,000 x \$1,000,000/\$2,000,000	<u>(900,000)</u>
	Amount to be included in income	\$ <u>900,000</u>
<u>2014</u>	Add Reserve from previous year	\$ 900,000
	Less Reserve for current year: \$1,800,000 x \$800,000/\$2,000,000	<u>(720,000)</u>
	Amount to be included in income	\$ <u>180,000</u>
<u>2015</u>	Add Reserve from previous year	\$ 720,000
	Less Reserve for current year: \$1,800,000 x \$600,000/\$2,000,000	<u>(540,000)</u>
	Amount to be included in income	\$ <u>180,000</u>
<u>2016</u>	Add Reserve from previous year	\$ 540,000
	Less Reserve for current year: None allowed!	<u>-0-</u>
	Amount to be included in income	\$ <u>540,000</u>

Other inclusions in income

Refer to paragraph 6-65 on pages 257 and 258 of the text.

Criteria for deductibility of an expense

In order for an expense to be deductible it must meet the following 6 criteria:

- (1) it is incurred for the purpose of producing income
- (2) the expense must be operating in nature (as opposed to a capital expenditure)
- (3) the income to which the expense relates must be such that it is not exempt from tax (mention life insurance premiums)
- (4) the expense must not be a personal or living expense
- (5) the expense must be **reasonable** in amount in the circumstances (use salary to spouse as an example)
- (6) the expenditure must not be a transfer to a non-allowable reserve (i.e. reserve for warranties)

Specific restrictions and deductions (pages 259 to 274)

Recreational fees and club dues

- see paragraphs 6-79 and 6-80 on page 260 of the text

Restrictions on deductibility of auto expenses

(paragraphs 6-83 and 6-84 on page 260 and 261 and paragraphs 6-115 to 6-121 on pages 267 and 268)

- CCA on Class 10.1 vehicles – as previously discussed in Chapter 2
- interest on loan to purchase a class 10.1 vehicle (\$10.00 per day)
- mileage payments 2013 rates: \$.54 for the first 5,000 km; \$.48 thereafter

Do exercise 6-8 on page 268 for practice

Home-Office Costs

- see paragraphs 6-95 to 6-100 on pages 262 → 264 of the text

Note:

- criteria for deductibility
- expenses that can be deducted
- in most cases it is not advisable to deduct CCA
- this deduction cannot create a loss, any excess can be carried forward to the next year, therefore leave this deduction until the very end

Do exercise 6-7 on page 264 for practice!

Meals and entertainment

- the same 50% restriction applies
- see paragraphs 6-111 to 6-114 on page 266 of the text for exceptions

Conventions

The deductibility for conventions is limited to two conventions per accounting year (page 274). Therefore remember to include the cost of the two most expensive conventions. If the actual cost of the meals (at the convention) is not specified, then the deemed cost is \$50 per day of which 50% is deductible (paragraph 6-113, page 267).

Inventory valuation

- refer to page 271
- ***also mention the tax treatment of charitable donations, political contributions, owner' withdrawals, life insurance premiums, CCA***

HOMEWORK: Self-study problem 6-1 and 6-2, page 286
Self-study problem 6-3 and 6-4 page 287
Self-study problem 6-7, page 289
Self-study problem 6-12, page 293
Assignment problem 6-1, page 299
Assignment problem 6-4, page 301
Assignment problem 6-5, page 301
Assignment problem 6-7, page 302
Assignment problem 6-8, page 303
Assignment problem 6-10, page 306

Recommended reading: for a detailed description and list of deductible expenses refer to the Business and Professional Income guide.

Income for Professionals

Professionals are currently required to compute their income using either the accrual basis or the billed basis.

Accrual basis - the taxpayer must take into account all changes in receivables, payables and unbilled work-in-progress

Billed basis - work-in-progress is not accounted for until such time as the clients are billed

See paragraph 6-173 on page 281 of the text for a list of which taxpayers who are permitted to elect to not include unbilled work-in-progress in their income.

Taxation year (Refer to pages 277 – 278)

The Act defines a taxation year as follows:

For the purpose of this Act, a "taxation year" is

- (a) in the case of a corporation, a fiscal period, and
- (b) in the case of an individual, a calendar year,

and when a taxation year is referred to by reference to a calendar year, the reference is to the taxation year or years coinciding with, or ending in, that year.

For corporations, ITA 249.1(1) defines a fiscal period as a period that does not exceed 53 weeks. The 53 week designation provides for situations where a corporation wishes to have a fiscal period that ends in a specified week within a month. For example, if the corporate year end is the last Friday in January, the fiscal year will, in some years, include 53 weeks.

Unincorporated Businesses - Non-Calendar Fiscal Year

Unincorporated businesses such as proprietorships and partnerships are not, for income tax purposes, separate taxable entities. The income of such businesses is included in the tax return of the individual proprietor or partner.

While unincorporated businesses are not required to file an income tax return, they are required to calculate an annual business income figure to be included in the tax returns of their owners. Given that the individuals who are the owners of proprietorships and partnerships must use a taxation year based on the calendar year, it would seem logical to require that these unincorporated businesses also base their taxation year on a calendar year.

This logic is overridden, however, by the fact that there can be important reasons, unrelated to income tax, for the use of a non-calendar fiscal year (e.g., having the year end at a low point in the activity of the business). As a consequence, under ITA 249.1(4), a proprietorship or partnership can elect to have a fiscal year that does not end on December 31.

This election is available to any new unincorporated business. However, it must be made on or before the filing date for the individual proprietor or partner. This would be June 15 of the year following the year in which the business commences. The election cannot be made in a subsequent year.

If the election is made, ITA 34.1(1) requires taxpayers to include an amount of income for the period between the end of their normal fiscal year and December 31 of that year. This income is referred to as "additional business income" and, in simple terms, it is a pro rata extrapolation of the income earned during the non-calendar fiscal period that ends in the year. It is used to create an estimate of the income that will be earned from the end of the non-calendar fiscal period to the end of the calendar year.

(Refer to the example on page 278)

Rental Income

Rental income will be classified as income from property where the renting of the property is not part of, or incidental to, an existing business and normal services are provided, such as heat, air-conditioning, parking and laundry facilities. i.e. rental of apartments, offices in a building.

Rental income will be classified as business income where the rental of property to others is incidental to the rest of the business i.e. renting of temporarily unused warehouse space OR the services provided go beyond that which is considered customary, such as cleaning, protective services, meals i.e. operation of a hotel, motel, boarding house

We will be discussing rental income under the classification of "income from property".

Deductible expenses

- property expenses
- insurance
- repairs and maintenance
- heat, hydro and water
- interest paid on money borrowed to purchase or improve the property
- salaries and wages paid to superintendent, maintenance staff
- accounting fees
- legal fees (**not in connection with the purchase or sale of the property**)
- commissions
- advertising
- landscaping of grounds ****
- certain auto expenses
- CCA within restrictions

Non-deductible expenses

- cost of land
- principal portion of debt repayments
- travel and auto expenses **HOWEVER** - if you own one building, you may deduct the cost of transporting tools and materials to the property
- if you own more than one property, you may deduct the cost of automobile expenses incurred for the purposes of collecting rents, supervising repairs and generally providing management services

CCA restrictions:

- (1) rental properties acquired after 1971, costing more than \$50,000 each cannot be pooled
- (2) generally you may not create or increase a rental loss by deducting CCA on the buildings: you may only claim enough CCA to bring the net rental income to zero.

If you own more than one building, you must calculate the aggregate net rental income (or loss) from all properties before calculating the CCA deduction - it is generally advisable to claim CCA in the classes of buildings with the **LOWEST** CCA rates first (I will illustrate this by example)

(3) Recapture - you MAY include recapture in income BEFORE deducting CCA. This allows the taxpayer to eliminate any recapture by the deduction of CCA

(4) Terminal Loss - A terminal loss **must** be deducted BEFORE the CCA is deducted.

Example #1:

A taxpayer owns one rental property, Building "A", which is a class 1 building (4%). The UCC of the building at the end of the previous year is \$80,000.

Rental revenue	\$17,000
Rental expenses	<u>(15,200)</u>
Rental income before CCA	1,800
Maximum CCA	<u>(1,800)</u>
NET RENTAL INCOME	<u>\$ NIL</u>

Show how the CCA schedule would appear.

Example #2:

A taxpayer owns two rental properties. Building "A" is a class 1 building (4%) and Building "B" is a class 3 building (5%). the UCC of Building A at the end of the previous year is \$80,000 and the UCC of Building "B" is \$60,000.

	<u>Building A</u>	<u>Building B</u>
Rental revenues	\$ 17,000	\$ 15,000
Rental expenses	<u>(15,200)</u>	<u>(16,000)</u>
Rental income before CCA	\$ <u>1,800</u>	\$ <u>(1,000)</u>

The two figures must be combined before deducting CCA. Therefore, the net rental income before CCA is \$800. CCA should be claimed on the class 1 building (Building "B") first. Show how the CCA schedule would appear and complete the statement of rental income.

Example #3:

Using the same data as in example #2, assume that Building "A" was sold for proceeds of \$82,000. The original cost of the building was \$120,000. This would result in a recapture of \$2,000 which would be added to rental income before CCA is calculated and deducted.

Net rental income combined	\$ 800
Add recapture - Building A	<u>2,000</u>
Net rental income before CCA	2,800
Maximum CCA - Building "B"	<u>(2,800)</u>
NET RENTAL INCOME	<u>\$ NIL</u>

Example #4:

Using the same data as in example #2, assume that Building "A" was sold for proceeds of \$75,000. This would result in a terminal loss of \$5,000 which would be deducted from net rental income BEFORE CCA is calculated and deducted.

Net rental income combined	\$ 800
Less terminal loss	<u>(5,000)</u>
Net rental loss before CCA	(4,200)
Less CCA	-0-
NET RENTAL LOSS	<u>\$ (4,200)</u>

Interesting point to note is that last month's rent deposits must be included in rental income in the year received. This is contrary to the accounting treatment!

HOMEWORK:

- Exercise 7-6, page 327
- Self-study problem 7-2, page 347
- Assignment problem 7-2, page 353
- Assignment problem 7-3, page 354

One other factor to consider is the secondary intention at the time of purchase; i.e. if a taxpayer has an alternate intention to resell an investment at a profit if the original intention is thwarted, the gain may be taxed as an income gain.

IT IS IMPORTANT TO NOTE THAT **ALL** FACTORS MUST BE TAKEN INTO ACCOUNT WHEN DETERMINING IF THE GAIN IS A CAPITAL GAIN OR AN INCOME GAIN.

A disposition is defined to include any transaction or event entitling a taxpayer to proceeds from the disposition of property. A disposition may occur as a result of a sale, theft, destruction, expropriation, redemption of a share, bond or debenture, transfer of property or death of a taxpayer

In most cases, the proceeds of disposition will be the value of the consideration received or receivable. In the case of property transferred in a non-arm's length situation to someone other than the taxpayer's spouse, the proceeds will usually be deemed to be the FMV of the property at the time of disposition.

For capital properties acquired after 1971, the **Adjusted Cost Base** of the property will be the actual cost at acquisition -remember from the discussion on capital cost allowance this will include all costs associated with the acquisition.

There are special rules for determining the A.C.B. of properties acquired before 1972. These rules will be discussed briefly in BTAX2!

Selling expenses include:

- real estate commissions
- brokerage fees
- legal costs of drawing up documents
- advertising costs
- a penalty paid for early discharge of a mortgage

DISPOSITION OF REAL ESTATE

As mentioned earlier, when the disposition of real estate involves land and building (non-depreciable and depreciable property) it will be necessary to allocate the proceeds, cost and selling expenses between land and building, using ratio proportions. ***(I will do a complete example in class!)*** The allocation should be done based on one of the following methods:

- (a) based on appraised values
- (b) based on tax assessed values
- (c) based on original capital costs

NOTE THAT CAPITAL LOSSES ON THE SALE OF DEPRECIABLE PROPERTY ARE NEVER ALLOWABLE.

A **terminal loss** is permitted as a deduction from income, but **not** a capital loss!

Non-depreciable capital properties

Election re: disposition of Canadian securities

Where the **frequency** of trading would indicate income gains (losses), a taxpayer can elect to have gains or losses from the disposition of **Canadian securities** treated as capital gains (losses). This election is not available to taxpayers who are traders or dealers in securities, or to non-residents. **Once the election is made it cannot be revoked.**

Capital losses on the disposition of non-depreciable properties can only be deducted against capital gains. Any unused capital losses can be carried back 3 years and forward indefinitely and be used to offset capital gains in those years. Explain application, using examples.

SUPERFICIAL LOSSES

A superficial loss occurs when a taxpayer or the taxpayer's spouse disposes of a capital property at a loss and within 30 days before or after the disposition, one of the cited taxpayer's acquires the same or identical property. The loss on disposal of the original property is called a "superficial loss" and is not allowable. The full amount of the loss is added to the Adjusted Cost Base of the substituted property. The purpose of this rule is to prevent a taxpayer from intentionally creating a loss when the intent was never to rid himself of the property.

Example:

Assume that Mrs. X owns 500 common shares of ABC Limited that were originally purchased at a cost of \$2,000. On December 1, 2013, she sold the shares for \$1,500. On December 15, 2013, her spouse purchased 500 common shares of ABC Limited at a cost of \$1,200. Her loss on sale would be deemed a "Superficial Loss" and added to the ACB of **his** shares. ($\$1,200 + \$500 = \$1,700$) This would also be the case if he had purchased his shares on November 15, 2013. If he were to sell the shares on January 31, 2014 for \$2,500, he would include a taxable capital gain of \$400 in his 2014 income.

Do exercise 8-2, page 366 for practice!

Disposition of non-depreciable identical properties

One of the most common examples of identical properties is shares of the **same class** of the **same corporation**.

The important point to note in this situation is that the A.C.B. of the shares (acquired after 1971) must be calculated on a **moving average** basis. Every time new shares are added to the "pool" of identical shares the average cost per share changes

Example:

2011 purchased 2500 shares @ \$11 each	=	\$ 27,500
2012 purchased 3000 shares @ \$10 each	=	30,000

Average cost per share = $\$57,500/5500$ shares = $\$10.45$ per share

In 2013, 2000 shares are sold @ $\$12$ per share. The ACB of the 2,000 shares would be $\$10.45 \times 200$ shares = **$\$20,900$** .

This would leave 3,500 shares on hand with a total cost of $\$36,600$ and an average cost per share of $\$10.45$ per share.

If 1000 shares are purchased in 2014 @ $\$12$ per share, the average cost per share would be recalculated as follows:

On hand from 2013	3,500 shares @ $\$10.45$ each	=	$\$36,600$
Purchased in 2014	<u>1,000</u> shares @ $\$12$ each	=	<u>$12,000$</u>
	<u>4,500</u>		<u>$\\$48,600$</u>

The new average cost per share = $\$48,600/4500$ shares
= **$\$10.80$ per share**

If shares were subsequently sold the A.C.B. of those shares would be calculated by multiplying $\$10.80$ by the number of shares sold.

Do exercise 8-3, page 368 for practice!

Special categories of properties

Personal use property

- any property owned by the taxpayer and used primarily for his or her enjoyment and not for the purpose of earning business or property income i.e. personal use autos, boats, furniture etc.

Listed personal property

- certain specified items of personal use property
- see **paragraph 8-90** on page 374 of the text

RULES:

- (1) the ACB and proceeds of disposition are both deemed to be the greater of the actual amount or **$\$1,000$**
- (2) capital losses on the disposition of personal use property that is NOT listed personal use property are not deductible in any circumstances
- (3) capital losses arising on the disposition of **listed** personal use property, can only be deducted against capital gains from listed personal property. Any unused capital losses of this type can be carried back 3 years and forward 7 years

Do exercise 8-10, page 378 for practice!

Treatment of Allowable Capital Losses

If net capital losses (allowable capital losses) are being carried forward from a previous year and applied to reduce taxable capital gains of the current year, they are a deduction from taxable income and are claimed on line 253.

I will discuss the Lifetime Capital Gains Deduction in class.

HOMEWORK: Self-study problem 8-1 page 399 - stock dividend is added to ACB
of the shares

Self-study problem 8-8, page 401

Assignment problem 8-1, page 410

Assignment problem 8-8, page 413

Registered Retirement Savings Plans

RRSPs allow a taxpayer to invest amounts into some sort of trustee arrangement for purposes of having income at retirement. Inside the trustee arrangement, the funds are invested and the income earned on the investments accumulates tax free, until such time as the funds are drawn out. Contributions to these plans are deductible in the calculation of net income and funds withdrawn are added to total income. The RRSP must provide for maturity no later than 71 years of age.

Contributions made in the first 60 days of the subsequent taxation year may be deducted in either the previous taxation year or in the year actually made. Contributions are limited to a maximum amount per year and only those excess contributions made in the first 60 days of the subsequent taxation year can be carried forward and deducted in the following year, without penalty.

RRSP Deduction Limit for 2013

Unused RRSP contribution room at the end of the previous year	\$\$\$\$
<u>Add</u> the lesser of: (1) 18% of earned income from previous year	+
OR (2) \$23,820 (RRSP Dollar limit for 2013)	<u>\$\$\$\$</u> <u>\$\$\$\$</u>
<u>Less</u> the Pension Adjustment from the previous year's T4	(\$\$\$\$)
<u>Less</u> the Past Service Pension Adjustment for the current year (per PSPA information slip)	(\$\$\$\$)
<u>Add</u> the total pension adjustment reversal for the year	<u>\$\$\$\$</u>
Maximum Allowable contribution limit for the year	<u>\$\$\$\$</u>

RRSP Deduction = **Lesser** of (1) the maximum allowable contribution limit
 OR (2) the actual RRSP contribution

Earned income, for purposes of this calculation, is defined in paragraph 10-51, page 471 of the text. Note that this calculation of earned income differs from the calculation of earned income for the child care expense deduction.

The pension adjustment and past service pension adjustment relate to the taxpayer's contributions to an RPP and these amounts will be available on the T4 or T4A from the employer.

Example:

Assume the following data for 2013:

Unused contribution room at the end of 2012	\$ 900
Earned income from 2012	40,000
Pension adjustment for 2012	1,500
Actual RRSP contribution for 2013	5,500

The RRSP deduction for 2013:

Unused RRSP contribution room at end of 2012	\$ 900
Add the lesser of: (1) 18% of \$40,000 = \$ 7,200	7,200
(2) \$23,820	
Less pension adjustment from 2012 T4	<u>(1,500)</u>
Maximum allowable contribution for 2013	\$ <u>6,600</u>
Actual contribution for 2013	\$ <u>5,500</u>
RRSP deduction for 2013	\$ <u>5,500</u>
Unused contribution room at the end of 2013 (\$6,600 – \$5,500)	\$ <u>1,100</u>

Redo the above example assuming the actual RRSP contribution for 2013 was \$7,000 and (a) the contribution was made in December, 2013 and (b) March 1, 2014

Spousal RRSPs

- explain spousal RRSPs
- explain the advantage re: income splitting
- explain the contribution limits, using the previous example
- Note that such contributions do not effect the other spouse's contribution limits for the year
- anti-avoidance rule: if a withdrawal is made from a spousal RRSP and the registrant's spouse has made a contribution to the plan either in the current year or in the two preceding calendar years, the withdrawal will taxed in the hands of the contributor, up to the amount of the contributions made to the spousal RRSP. That is to say that if there is a withdrawal from your spouse's plan in 2013 and you made a contribution to that plan in 2011, 2012 or 2013, the withdrawal would have to be included in your income, up to the amount of the contributions you made in those years.

Special Rollovers

Certain amounts can be rolled over into an RRSP, without affecting the taxpayer's current year allowable contribution limit:

- lump-sum payments received from an RPP
- eligible retiring allowances
- amounts received from an RRSP or an RRIF of a spouse who has died (in some cases applies to a parent or grandparent who has died)
- lump sum distribution from a DPSP

Home Buyer's Plan

- refer to the material on pages 483 to 485 of the text

Lifelong Learning Plan - pages 485 and 486 of the text

Excess contributions to an RRSP

Due to the fact that RRSP earnings accumulate tax-free, rules have been developed to limit excess contributions. The basic limiting provision found in the Act, imposes a penalty of 1% per month on the "cumulative excess amount for a year in respect of registered retirement savings plans". The "cumulative excess" = undeducted contributions in excess of the sum of the RRSP Deduction Limit plus a \$2,000 cushion. This, in effect, means that the penalty applies to undeducted contributions that are \$2,000 greater than the individual's deduction limit.

RRSP Administration fees

- are no longer deductible, effective March 6, 1996

RRSP withdrawals

A lump sum withdrawal from an RRSP is possible at any point in time, but the amount withdrawn must be added to income.

However, it is possible to choose one of the following conversion options to avoid paying income tax on the full amount withdrawn in the year of withdrawal:

- Life annuity - taxation occurs only as the payments are received
- Fixed term annuity - same tax implications as above
- RRIF - similar to an annuity - however more flexible
- minimum withdrawal formula

Registered Pension Plans

Types of plans: Defined Benefit Plan (benefit based)
Money purchase plan (contribution based)

Combined employer/employee contributions are essentially subject to the same limitations of an RRSP, in order to qualify for registration.

Lump-sum benefits can be rolled into an RRSP or an RRIF, tax-free.

Otherwise, at retirement, the employee is limited to receiving the specified pension benefits, which are taxable upon receipt.

Tax-free Savings Accounts – pages 424 and 425