TAX LETTER

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THE 2015 FEDERAL BUDGET: NICE CHANGES AND NEW PERSPECTIVES

You may have read other newsletters and reports about the federal Budget of April 21, 2015. If so, this newsletter will give you some new perspectives and ideas about the Budget proposals. And if not, there's lots of new information for you here!

This is a "political" Budget, with an eye to the upcoming election in October. Some of the changes are included in Bill C-59, which was tabled in Parliament on May 7 and will be enacted by the end of June. Others have been left to the fall, and might not be enacted if the Conservatives do not form the next government after the election.

Here are some of the nicer changes in the budget, and some new perspective and information about them that you may not have read.

Capital Gains Exemption for Farm/Fishing Property

The capital gains exemption for farm/fishing property and qualified small business corporations was $500,000 for many years, then was increased to $750,000 in 2007, $800,000 in 2014, and was indexed to inflation as of 2015, so that it is $813,600 for 2015. As well, in 2014 a technical change was passed to merge the exemptions for "farm property" and "fishing property", so that a business that is partly farming and partly fishing can qualify. The taxpayer has to meet certain conditions about active use of the property in farming or fishing. Shares of a "family farm/fishing corporation" or an

interest in a "family farm/fishing partnership" can qualify.
The exemption is not technically an exemption but the "capital gains deduction". The capital gain must still be reported; half the capital gain is still included in income as a "taxable capital gain". A deduction can then be claimed against the taxable capital gain (e.g., for 2015, up to $406,800, as that is half of $813,600).

What's the nice change? The Budget increases the exemption for qualified farm/fishing property to $1 million. This amount will no longer be indexed to inflation, until the small-business-share exemption (currently $813,600) catches up to $1 million. That will take many years; no doubt this rule will be changed long before then.

Donating Proceeds of Private Company Shares, or Real Estate, to Charity

The Income Tax Act has had a rule since 2006 permitting donations of publicly-traded securities to a charity without recognizing and paying tax on the capital gain that would normally apply when making a gift (i.e., the accrued capital gain up to current market value). The only exception is flow-through shares, which are already eligible for huge tax benefits when the shares are acquired.

What's the nice change? The Budget proposes to allow donation of the proceeds of private company shares, and real estate, to a charity without recognizing the capital gain from selling the property. A charity cannot normally own private company shares and would rarely own real estate, so the property itself would not be donated to the charity. Instead, you'll be able to *sell* the property and donate (all or part of) the cash proceeds to a charity within 30 days after the sale. You will then not have to recognize the capital gain (or a proportional part if you don't donate all the proceeds.) This will significantly increase the value of the donation from the existing 45-50% donation credit.

This rule will not take effect until 2017.
Notably, the Budget proposal does not make it clear whether the *actual* proceeds of sale have to be kept segregated, tracked and donated within 30 days, or whether it will be enough to donate any money within the 30 days. The Department of Finance has indicated that it will make the answer clear once it releases draft legislation.

Foreign Property Reporting Simplified for Many

Taxpayers with "foreign property" costing over C$100,000 have been required for many years to report this fact to the CRA on their T1 return and to file a Form T1135 foreign property reporting form. The purpose is to allow the CRA to ensure that the taxpayer is properly reporting, and paying tax on, income from foreign investments.

Until 2013, the T1135 was a simple "check the box" form that merely asked for the categories of foreign investment (e.g. foreign shares, loans or real estate). Starting with the 2013 year, the CRA made the form far more complex, requiring extensive work to complete. More changes were made for the 2014 year, making the form even more complex and requiring identification of the type and value of properties, the income from them and the country of source. Reporting is required even for foreign securities that are held in Canadian investment dealer accounts, though all amounts for one country in a single account can be grouped together.

What's the nice change? Starting with reporting for the 2015 year, the T1135 will be simplified for taxpayers whose total cost of foreign property is from $100,000 to $250,000. Only over $250,000 will the current detailed reporting be required.

Home Accessibility Tax Credit

In 2009, the government introduced a "home renovation tax credit", allowing all taxpayers a 15% credit for home renovations exceeding $1,000 and up to $10,000 (i.e., a maximum credit of $1,500). This measure was available only for 2009, as a stimulus to the economy in the middle of the 2008-09 recession. It proved to be very popular, and no doubt helped the economic recovery.

What's the nice change? The Budget proposes a similar "home accessibility tax credit", but limited to renovations that are needed to make a home more accessible for a person over 65 or a person with a severe disability (eligible for the disability credit) who lives in the home. The credit will be 15% of the renovation cost up to $10,000 — i.e., a maximum credit of $1,500 per year. It will not expire; it will be available for expenditures starting in 2016.

A taxpayer will be able to split work over a calendar year-end and effectively double the $10,000 limit by spending half in one year and half in another year.

Manufacturing & Processing —
Capital Cost Allowance

A business that purchases capital equipment can claim capital cost allowance, or CCA (tax depreciation), to write off the cost of the equipment over time. The Income Tax Regulations provide incentives to acquire certain kinds of property, by offering a high rate of CCA relative to the property's likely actual depreciation.

Machinery and equipment acquired since 2007 and through 2015, primarily for use in Canada for the manufacturing or processing of goods for sale or lease, qualifies for a temporary accelerated CCA rate of 50% calculated on a straight-line basis (Class 29). In other words, the cost of the machinery or equipment can be fully written off over two years. For such property acquired after 2015, this measure is scheduled to expire, and the CCA rate goes back to 30% on a declining-balance basis (Class 43).

What's the nice change? The Budget proposes to create a new Class 53, allowing a 50% declining-balance CCA rate for such machinery and equipment acquired from 2016 through 2025.

While this is an improvement over the 30% rate, this is actually a negative change from the current rule allowing a two-year writeoff. The new Class 53 will be, as noted, on a "declining balance" basis, and the "half-year rule" allowing only half of the CCA in the year of acquisition, will apply to Class 53. So for such property acquired in 2016 for $1,000, instead of $500 in each of 2016 and 2017, the deduction will be:

Year	CCA claim	UCC for next year
2016	$250 (50% of $1,000, subject to half-year rule)	$750
2017	$375 (50% of undepreciated capital cost of $750)	$375
2018	$183 (50% of undepreciated capital cost of $375)	$182
2019	$92	$91

and so on

Penalties Relief — Repeated Unreported Income

As we explained in our March 2015 Tax Letter, Income Tax Act subsection 163(1) provides a penalty that can be devastating to someone who fails to report some amount of income in two years out of any four. The penalty (including a parallel provincial penalty) is currently 20% of the unreported income, *even if* tax was withheld at source so that there is no unpaid tax.

In our March letter, we gave this example of how harsh the penalty can be:

> When Joe gave his accountant his papers for his 2011 tax return, he misplaced one of the twelve T5 and similar slips he'd received for various kinds of investment income. The slip in question showed he'd earned interest of $75. So that $75 of income was omitted from his return.
>
> In 2014, Joe retired and received a payout of $100,000, from which tax was withheld by his employer. Because of the tax withheld, he did not have to pay any additional tax on the $100,000. Again he misplaced the T-slip and neglected to tell his accountant about this amount, and his 2014 return was filed without showing the $100,000 of additional income or the tax that had been withheld on it.
>
> The CRA will assess penalty of $20,000, even though the 2011 unreported income was trivial and the 2014 amount led to no unpaid tax.

What's the nice change? The Budget proposes to change this penalty so that it will apply only if *both* unreported amounts were at least $500; and the penalty cannot exceed 50% of the unpaid tax on the unreported income. In Joe's example above, the penalty would not apply because the first year's unreported income was only $75; and even if that were not the case, since there was no additional tax to pay due to the source withholding, there would be no penalty at all.

This new rule will apply to 2015 and later years.

RRIF Minimum Withdrawals Reduced

A taxpayer with an RRSP must wind up the RRSP by the year they turn 71 (or in some cases, the year their younger spouse turns 71). They can withdraw all the funds and pay full tax immediately; or buy an annuity; or convert the RRSP to a registered retirement income fund (RRIF). A RRIF is like an RRSP, but allows no new contributions, and a "minimum amount" must be withdrawn every year (somewhat like a pension). The taxpayer can always choose to withdraw more than the minimum.

The minimum amount is based on a table that was set in 1992, when 6-10% interest rates on government bonds were common. It requires an increasing amount to be withdrawn each year, e.g. 7.85% at age 75 and 8.75% at age 80. With interest rates at all-time lows in recent years, few taxpayers have been able to withdraw the minimum without impairing their RRIF capital and thus their future income.

What's the nice change? The Budget proposes to change the "minimum amount" table in subsection 7308(4) of the Income Tax Regulations, to allow lower withdrawals and thus to allow taxpayers to keep funds growing tax-free in their RRIF for longer. Using the above examples, the required withdrawal at age 75 will now be 5.82%, and at age 80 will be 6.82%. Of course, this

will only be helpful to a taxpayer who has enough to live on without taking too much out of their RRIF.
This change takes effect as of 2015. Recognizing that some taxpayers may have already taken out their "minimum amount" for 2015 before the Budget, and thus will have taken out more than they needed to, a special rule in Income Tax Act section 60.022 will allow the excess to be recontributed back to the RRIF without penalty, by February 29, 2016.

Small Business Corporate Income Tax Rate Reduced

The "small business deduction" provides for a much lower rate of corporate income tax on small corporations' first $500,000 of active business income than applies to large corporations or to income at higher levels. The $500,000 must be shared by "associated" corporations (within the same control group).

The regular federal tax rate on corporations (not counting provincial corporate tax) is 28%. The small business deduction is 17 points of tax, so the small business rate is 11%.

What's the nice change? The Budget proposes to increase the small business deduction, and thus reduce the small business corporate income tax rate, by half a percentage point per calendar year for four years (with prorating across January 1 each year). The federal corporate income tax rate will thus be 10.5% for 2016, 10% for 2017, 9.5% for 2018 and 9% starting 2019.

(Provincial corporate tax rates on small business income range from 0% (in Manitoba) to 4.5% (in Ontario and PEI), except that the rate is 8% in Quebec.)

TFSA Contribution Limit Increased to $10,000

The tax-free savings account (TFSA) permits cumulative contributions of up to $5,000 per year for 2009-2012 and $5,500 per year for 2013-2015 — total $36,500 for someone born before 1992 (since a TFSA can be set up only if the taxpayer is at least 18 by year-end). Funds grow tax-free in the TFSA and can be withdrawn at any time. Withdrawing funds re-creates the same amount in new contribution room, but not immediately — only as of the next calendar year January 1.

What's the nice change? The Budget proposes to increase the TFSA contribution limit to $10,000 per year, starting 2015. As a result, if you have already contributed the maximum, you can contribute another $4,500 immediately. The CRA announced on April 25, 2015 that they will immediately administer the Act as though this rule were enacted, so the extra $4,500 can be contributed right away.

Veterans who are Injured

Veterans Affairs Canada has created a new "Critical Injury Benefit", a $70,000 award to support the most severely injured and ill Canadian Armed Forces (CAF) members and veterans.

Veterans Affairs Canada has also created a "Family Caregiver Relief Benefit", which will provide veterans with an annual tax-free grant of $7,238. This funding can be used for relief options such as covering the cost of having a professional caregiver come into the home or covering the cost for another family member or friend to travel to the veteran's home. The new benefit is expected to provide relief to approximately 350 spouses

or caregivers of the most seriously ill and injured veterans by 2020.

Both of these awards will be tax-free.

DANGERS OF FILING A CORPORATE RETURN VERY LATE

Some small business owners get busy running their business, and do not get around to filing their company's corporate income tax returns until long after they are due. Of course, in practice the owner usually hires an accountant for this process; what the owner fails to do is get the business's records in enough order to provide them to the accountant in time.

There are penalties for filing returns late: usually 17% of the unpaid tax once a return is 12 months late.

Some business owners prepay their companies' instalments in amounts they think are "about right", so that they are not in debt to the CRA even though they have not gotten around to filing.

There is a serious danger in doing this.

If a corporate return is filed **more than 3 years after the year-end** — i.e., more than 2.5 years after its due date — then the CRA **cannot refund any overpaid instalments**. Subsection 164(1) of the Income Tax Act prohibits it.

It may be possible to get the CRA to transfer the unrefundable balance to a later year for which tax is owing, using Income Tax Act section 221.2. The CRA used to permit this. However, in 2014 the CRA created a new procedure and form for this procedure. New Form RC431 requires the corporation to show why it was "unable" to file its return within the 3 years. This stringent test will be almost impossible to meet in most cases. (Representations are being made to the CRA to change this administrative requirement.)

Even if you do not pay instalments, the same problem arises if the **CRA issues an "arbitrary assessment"** of the corporation because it has not filed, and then seizes funds from the corporation to pay that assessment. If the corporation then files its return more than 3 years after year-end, it will not be able to get a refund of the "overpaid" amount. (It might be able to argue in Federal Court that funds seized have not been "paid" by the corporation and so are not subject to the 3-year rule, but this is uncertain.)

So it's important to get your corporation's income tax return filed on time, or at least not overly late.

AROUND THE COURTS

Double liability for the same corporate debt

In the recent *Syed* appeal, a company's director and his sister-in-law ended up liable for the same GST debt of the company.

Syed and his brother ran an Indian restaurant in Montreal. Syed was the only shareholder and director of the company for the years in question. It reported losses year after year, and came to the attention of Revenu Québec (RQ), which administers the GST in Quebec.

The RQ auditor found the business's reported numbers not to be credible: salaries deducted were too low for the number of employees; utilities were too high for the reported revenues; and input tax credit (ITC) claims were for purchases that were 66-87%

of sales instead of the industry average of 30%. All of this led the auditor to apply a “markup” audit methodology: using liquor purchases from the Quebec Liquor Board (which could be reliably determined), calculating what that should map into in total meal and alcohol sales, and calculating GST and Quebec Sales Tax from those revenues.

RQ thus assessed the company for some $50,000 of unreported GST over four years, based on unreported revenues exceeding $700,000. On objection, this was reduced to about $44,000. When the company did not pay its assessment, had closed and had no assets, RQ assessed Syed personally, as director, for its GST debt.

The company had some cash when it closed. It paid $110,000 to Syed’s brother’s wife (Abida). RQ assessed her for the company’s unpaid liability under the “transfer of property” rule, which permits assessment of a person to whom a related person with a tax liability transfers property.

Syed and Abida both appealed. The Tax Court dismissed Abida’s appeal, and allowed Syed’s appeal only to reflect some minor concessions by RQ in the calculation of the company’s GST. The Court found that auditor’s method of calculating the unreported income to be reasonable. Syed as director did not meet the “due-diligence” defence. Abida was also liable, as the company had paid money to her while it owed GST.

Although the Court did not discuss it, this case raises a question about duplicate liability. If Syed is liable as director and Abida is liable under the “transfer of property” rule for the same corporate debt, will either one get credit once RQ has collected sufficient funds from the other? It appears not, because the two provisions do not interact with each other. One hopes that RQ will not proceed to collect the company’s debt twice. Unfortunately, the confirmation of the two appellants’ debts by the Tax Court leaves them each with an established liability that RQ Collections officials may well seek to collect without paying attention to the origins of that liability.

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This letter summarizes recent tax developments and tax planning opportunities; however, we recommend that you consult with an expert before embarking on any of the suggestions contained in this letter, which are appropriate to your own specific requirements.