Lionel Nolet
CPA, CA, partner

Tax Letter

Marcil Lavallée

Monthly Newsletter | **June 2016**

HST RATE CHANGES — DO YOU HAVE CUSTOMERS IN ATLANTIC CANADA?

Does your business have clients or customers in Atlantic Canada? Whether you ship goods or provide services to them, you may need to know about upcoming Harmonized Sales Tax (HST) rate changes.

The HST is part of the GST system and is fully integrated as part of the Goods and Services Tax which applies across Canada. In the non-HST provinces and the territories, the GST is 5 %. In the HST provinces, the tax rate is higher although the federal portion of the HST is the same 5 %.

In most cases, **the applicable GST/HST rate depends on the location of the customer.** There are some exceptions, but in general, goods shipped to an HST province must bear tax at that province's HST rate, and services provided to a customer in an HST province must bear tax at that province's HST rate — even if the supplier is in a non-HST province.

(Quebec is a special case. It has the Quebec Sales Tax which is "semi-harmonized" with the GST/HST in that it follows the same rules, but it is not integrated into the GST/HST system. So if you do not carry on business in Quebec, you need not register for QST and charge QST on sales you make to Quebec customers. You charge only the 5 % GST.)

From April 2013 through June 2016, the HST provinces and rates are:

Ontario — 13 %

New Brunswick — 13 %

Nova Scotia — 15 %

Prince Edward Island — 14 %

Newfoundland and Labrador — 13 %

(British Columbia was an HST province but withdrew in April 2013.)

Starting **July 2016**, both New Brunswick and Newfoundland & Labrador are raising their HST rate to **15 %**. (Technically the change will be made by federal regulations, passed by the federal Cabinet and published in the *Canada Gazette* before July 1.)

Starting **October 2016**, Prince Edward Island is similarly raising its HST rate to **15 %.**

Thus, as of October, all the Atlantic provinces will be at 15 %. Only Ontario will have a different HST rate, at 13 %.

Both New Brunswick and Newfoundland and Labrador have published transitional rules to explain the timing of the change. The regulations to implement these rules have not yet been released at time of writing. They will likely not be available to the public until they are published in the *Canada Gazette* shortly before July 1. However, you can find the details of the transitional rules at:

tinyurl.com/nb-hst-13-15 — New Brunswick

tinyurl.com/nl-hst-13-15 — Newfoundland and Labrador

In very general terms, if amounts are billed or paid before July 1, then the old (13 %) rate applies.

At time of writing, PEI had not yet released its transitional rules, but they are expected to be essentially the same except for the later date.

TAX BREAKS FOR PERSONS WITH DISABILITIES

The *Income Tax Act* (the "Act") provides many potential benefits, credits and tax breaks to persons with disabilities.

In most but not all cases, the test to qualify for these benefits is based on qualifying for the "Disability Tax Credit", which requires having a physician complete a Form T2201 (for some disabilities, other health-care providers also qualify), certifying that the person has a "severe and prolonged impairment" that affects the person's "activities of daily living" in a particular way. The Act and Form T2201 have detailed requirements which must be met to qualify.

Once a person qualifies for the Disability Tax Credit, here are some other benefits that are available:

- certain disability-related employment benefits (transportation, parking and an attendant) are non-taxable
- deductions are allowed for a wide range of "disability supports" required to enable the person to work, study or carry on grant-funded research
- medical expense credit for nursing home care, attendant, group home care or certain therapy
- 15 % Home Accessibility Tax Credit, for qualifying expenditures
- $750 Disability Home Purchase Credit
- higher education credit for part-time student (eliminated after 2016)
- higher Working Income Tax Benefit
- eligibility for a Registered Disability Savings Plan
- more flexible rules with a Registered Education Savings Plan
- enhanced Home Buyer's Plan (using RRSP to help fund a home purchase)
- reduced withholdings if using the Lifelong Learning Plan (using RRSP to help fund education)
- a "qualified disability trust" for the person can be taxed at low marginal rates not available to other trusts
- a trust for the person can make a "preferred-beneficiary election" to allocate income to the person without paying it (104(14))

Where the taxpayer's **child** has such a disability, the following are some of the available benefits:

- the Disability Tax Credit can be claimed by the taxpayer for the child
- higher Child Tax Benefit (called the Canada Child Benefit starting July 2016)
- higher child-care expense deduction limits
- higher children's fitness and arts credits (these are eliminated after 2016)
- there is a limited exclusion from the "kiddie tax" (tax on split income).

There are various other benefits and credits as well, which have varying requirements, many not as restrictive as qualifying for the Disability Tax Credit.

DO YOU MAKE DONATIONS TO U.S. CHARITIES?

Do you make donations to charities located in the United States? They may be eligible for a tax credit on your Canadian tax return in one of several ways.

First, donations to many foreign **universities** qualify as charitable donations in Canada. The institution must be listed in Schedule VIII of the *Income Tax Regulations*, which lists universities that are known to have significant numbers of Canadian students and that have applied to be on the list. Schedule VIII lists 552 institutions, of which 450 are in the United States. The list runs alphabetically from Abilene Christian University (Abilene, Texas) to Yeshiva University (New York, NY), and includes virtually every important U.S. university and college. You can find Schedule VIII at the end of the *Income Tax Regulations* on www.CanLii.org (which is a handy source of all Canadian laws, regulations and reported Court cases).

(The Canada Revenue Agency has a measure of control over foreign universities for purposes of Canadian donations. If the CRA determines that a foreign university is not complying with the requirements as to how the funds should be used, the CRA can "de-register" the university and it will no longer qualify for donations.

Thus, for example, if a U.S. university is involved in a scheme to issue donation receipts for "donations" that are really payments for tuition, are paid back to the donor, or are routed to causes that are not part of the university's normal function, it could be deregistered and no longer qualify for Canadian donations.)

Second, a donation to any other U.S. charity will generally qualify for Canadian credit **if you have U.S.-source income**. This rule is found in Article XXI, paragraph 6 of the Canada-U.S. tax treaty. The charity must be one that "could qualify in Canada as a registered charity if it were a resident of Canada". Donations can be claimed for up to ¾ of your "income arising in the United States". This could include business income from U.S. clients, or investment income arising in the U.S. such as dividends or interest on U.S. stocks or bonds within your Canadian brokerage account. The CRA may have a more restrictive interpretation (such as requiring you to be operating a business in the U.S.), but the Courts have yet to determine the scope of this rule.

The CRA has stated that any organization that qualifies under section 501(c)(3) of the U.S. Internal Revenue Code will qualify for this relief. If you want to know whether a particular organization you are donating to qualifies under section 501(c)(3), you can search for it on www.guidestar.org.

Third, some foreign charities have a "**Canadian Friends of...**" or similarly-named organization in Canada, which is registered as a Canadian charity. The "Canadian Friends" can receive donations and use them to operate projects that benefit the foreign charity, and will issue you a Canadian tax receipt which you can use on your Canadian tax return like any other Canadian charitable donation. If you are considering a donation to a U.S. charity and cannot obtain Canadian tax relief under either of the first two ways, ask the charity if it has a parallel Canadian charity that can accept donations for it, or check the CRA web site at cra.gc.ca/charities.

Fourth, if you **live near the border and commute** to a place of employment or business in the U.S., and that is your chief source of income from the year, then you can treat donations to U.S. charities as though they were to Canadian charities. This rule is found in subsection 118.1(9) of the Income Tax Act.

GASOLINE TAX REFUND FOR CHARITIES AND FOR PERSONS WITH PHYSICAL DISABILITIES

There is a little-known refund of excise tax on gasoline for persons with physical disabilities and for registered charities.

This refund is provided under the Federal Excise Gasoline Tax Refund Program, and is legislated in subsection 68.16(1) of the Excise Tax Act. It is a refund of **$0.015 per litre of gasoline purchased** (the CRA also allows $0.0015 per kilometre driven). The gasoline must have been acquired "for the sole use of the purchaser and not for resale".

Any registered charity (or registered Canadian amateur athletic association) can claim the refund. It is also available to "a person who has been certified by a qualified medical practitioner to be suffering from a permanent impairment of locomotion to such an extent that the use of public transportation by that person would be hazardous".

The rebate can be claimed for up to two years from the date of purchase. To apply for the rebate, download Form XE8 from the CRA's website, www.cra.gc.ca. The back of the form includes instructions and further details.

For more information on this program, one can also call the CRA's Gasoline Tax Refund Unit at 1-877-432-5472.

SPOUSAL SUPPORT — PAYMENTS TO THIRD PARTIES

Spousal support payments are normally deductible if they meet certain conditions, such as being required under a Court Order or written separation agreement, and being "periodic" payments. They must also be made to the spouse (or ex-spouse) in a way that that person has discretion over how to use the funds. Generally the same conditions that allow a support payment to be deducted mean that it will be included in the recipient's income.

In limited cases, **payments to third parties** can qualify for deduction or tax credit. Possible ways for such payments to be deductible are as follows:

- The payor is **directed** by the recipient to pay a third party, so that the recipient is still considered to have "discretion" as to the use of the funds. Thus, for example, where a wife directed that her husband make cheques payable to her landlord for rent and he delivered the cheques to her, they were held to qualify since she retained discretion over the use of the funds (*Arsenault* case, Federal Court of Appeal, 1999).
- Where the Court Order or agreement provides for periodic payment of an amount that would otherwise qualify for deducibility as spousal support, and provides for it to be "**for the benefit of**" the recipient and/or that person's children who are living with them, the payment is deemed to be a payment to the recipient (*Income Tax Act* subsection 60.1(1)). This rule can allow certain payments to third parties to qualify, though the recipient may still need to have discretion over how the funds are used.
- Where the Court Order or agreement specifies the particular third-party expense, and specifically states that it is to be **deductible under Income Tax Act subsection 60.1(2)** and included in the other person's income under subsection 56.1(2), it can be deductible. There are certain restrictions. For example, it can include mortgage payments, but only $^1/_5$ of the original principal is deductible in any one year. It cannot be for the cost of acquiring any tangible property (unless for medical or educational purposes). It cannot be related to the cost of a home in which the payor resides.
- Expenses paid for children's programs can qualify for credit under the C**hildren's Fitness Tax Credit** (up to $250 in expenses in 2016) and/or the **Children's Arts Tax Credit** (also up to $250 in expenses in 2016), even if the child does not live with the parent claiming the credit. This can be a way for limited payments to third parties to qualify for tax relief. The credit is only 15 % federally, but there is no income inclusion for the other spouse. Note that these credits are eliminated after 2016, though some provinces and territories have similar credits that may continue.

CAN YOU SUE THE CRA?

Taxpayers who have been treated badly by the Canada Revenue Agency often wonder whether they can sue the Agency.

The answer is yes. However, it is important to realize two things.

First, suing the CRA **does not necessarily have anything to do with contesting a tax assessment**, and the Agency's actions are almost always irrelevant when you are appealing your assessment. The fact that the auditor did things he or she should not have, or that Collections officials overstepped their authority, or that a supervisor did not return your calls before the assessment was issued, generally has *no bearing* on your appeal, and the judge will ignore these issues. The only thing that matters on an appeal to the Tax Court of Canada is whether the assessment is correct. (There are some situations where, if the CRA obtained information illegally, they cannot use that information in Court, but this is generally limited to criminal prosecutions where you are protected by the *Charter of Rights*.)

Second, if Agency officials were acting within the bounds of their authority and were not acting maliciously, you will not succeed in a lawsuit simply because they did something wrong. You will normally have to show **negligence or malice.**

A lawsuit against the CRA for negligent or malicious acts can be brought in either Federal Court or the province's superior court. Note that there may be short time limits within which you must start your lawsuit, and that these can vary by province (based on the *Crown Liability and Proceedings Act)*.

Examples of lawsuits that have succeeded include the following:

- *Chhabra* (1989 — Federal Court of Appeal). The Court awarded damages (including exemplary damages, which are similar to punitive damages) for **malicious action** on the part of Revenue Canada Collections officials in trying to collect taxes owing.
- *Luo* (1997 — Ontario Superior Court). An employee of the Unemployment Insurance Commission negligently provided an individual with **wrong information** about entitlement to benefits, and the individual relied on that information to his detriment. The government was foundliable.

- *Groupe Enico and Archambault* (2016 — Quebec Court of Appeal). This was a lawsuit against Revenu Québec (RQ), which administers the GST and Quebec Sales Tax in Quebec. RQ Collections officials **proceeded with collection action** to seize hundreds of thousands of dollars from a company, even though the Audit group which had issued the assessments **had advised Collections that the assessments were wrong and were going to be substantially reduced.** RQ was found to have been negligent and malicious in various ways. The total damage award to Archambault and his company was $3 million, including $1 million in punitive damages, plus legal fees. This case was decided under the Quebec *Civil Code*, unlike the common law which applies in all other provinces, so it is uncertain how applicable it is to other provinces.

Of course, there have been many other lawsuits where the taxpayer was not successful.

AROUND THE COURTS

High management fees to owners' companies were reasonable

6051944 Canada Inc. v. The Queen, 2015 TCC 180, was a GST appeal, on an issue that is relevant to both income tax and GST. It was an appeal of denied input tax credits (ITCs) on management fees paid by a company to its parent holding companies.

For GST purposes, a business can normally claim ITCs for all GST it pays as inputs to making taxable sales. However the costs in question must be "reasonable".

The company in question was in the residential construction business. It was run by its two owners, father and son. Each one held his shares in the company through a holding company (Holdco). The two Holdcos each held 50 % of the company's shares.

Over 2008-2010, the company paid management fees ranging from $1 million to $1.8 million per year to the Holdcos, essentially "bonusing out" its profits, which was advantageous for creditor-proofing purposes — getting the money out of the company while still keeping the funds at the corporate level to benefit from income tax deferral. It also meant a small deferral of corporate tax, as the company had a December 31 year-end and the Holdcos had January 31 year-ends.

Each Holdco collected and remitted GST on the fees it charged the company.

The Canada Revenue Agency did not disallow the company's deduction of the management fees for income tax purposes. However, Revenu Québec (RQ), which administers the GST in Quebec, denied $41,000 of the company's ITC claim for 2009, taking the position that the level of management fees was not "reasonable" as required. The company appealed to the Tax Court of Canada.

The Tax Court judge allowed the appeal. On the evidence, the father and son were wholly responsible for the company's profits, and it could not operate without them. Thus, it was not unreasonable for it to pay the management fees.

The Court's decision is a sensible one. Payment of management fees to a holding company is a legitimate way to extract corporate profits. After all, the holding company pays income tax on the fees and remits all GST it collects from the operating company, so there is no loss to the government.

The Court's decision is consistent with the 2000 decision under the *Income Tax Act,* in *Safety Boss Ltd.*, where a $3 million bonus to a company's owner was held to be "reasonable" because the company's profits were all attributable to his work.

Marcil Lavallée

OTTAWA
400-1420 place Blair Place
Ottawa ON K1J 9L8
T 613 745-8387
F 613 745-9584

GATINEAU
125-1160 boul. St-Joseph Blvd.
Gatineau QC J8Z 1T3
T 819 778-2428
F 613 745-9584

Marcil Lavallée, S.E.N.C. | G.P.
Société de comptables professionnels agréés
Partnership of Chartered Professional Accountants

BHD / IAPA
Nos partenaires canadiens et internationaux
Our Canadian and International Partners

Marcil-Lavallee.ca