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Tax Letter

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MOVING EXPENSES

BASIC RULES FOR AN "ELIGIBLE RELOCATION"

For income tax purposes, you may be able to deduct moving expenses in computing your "net income". A deduction is allowed if you pay the expenses in respect of an “eligible relocation”.

Generally, this is a move for the purpose of carrying on employment or business in a new work location, where your new residence is at least 40 kilometres closer to the new work location than was your former residence (to the new work location). The 40 kilometres distance is measured using the shortest normal route available for travel (which is typically further than “as the crow flies”).

Furthermore, if you are out of the country but still resident in Canada for income tax purposes, the homes can be either in Canada or outside Canada.

QUALIFYING EXPENSES

The moving expenses that qualify for the deduction include:

- travel costs, including a reasonable amount for meals and lodging, in the course of moving you and your family from the old residence to the new residence;
- the cost of transporting or storing household effects in the course of moving;
- the cost of meals and lodging near the old residence or the new residence for you and your family for up to 15 days (e.g., if you move out of the old residence and you cannot yet move into the new residence);
- if you rented your old residence, the cost of cancelling the lease;
- your selling costs (e.g. commissions) in respect of the sale of the old residence;
- **if your old residence was sold** as a result of the move, the cost of legal services in respect of the purchase of the new residence, plus any tax, fee or duty (other than GST/HST or Quebec Sales Tax) on the transfer or registration of title to the new residence. As noted, these costs are deductible **only if you owned and sold your old residence**, so they are not deductible if you rented your old residence;
- up to $5,000 of interest, property taxes, insurance premiums and the cost of heating and utilities in respect of the old residence, but generally only during the period (i) throughout which the old residence is not occupied by you or your family, and (ii) while you are making “reasonable efforts” to sell the old residence; and
- the cost of revising legal documents to reflect your new address, of replacing drivers' licenses and non-commercial vehicle permits, and of connecting or disconnecting utilities. For this purpose, utilities include telecommunication services such as cable TV, satellite TV, and internet connections. However, the cost of any equipment for such services (e.g. a satellite antenna) is not deductible.

Interestingly, the *Income Tax Act* provides that eligible moving expenses “include” the above expenses, which implies that other moving expenses incurred in an eligible relocation might be deductible. However, as discussed later under “Around the Courts”, house hunting expenses incurred while searching for a new residence and certain other incidental expenses do not appear to be deductible.

In practice the Tax Court seems to interpret the list in the Act as being exhaustive.

The deduction is allowed for the year in which you pay the expenses, but only to the extent of your income from the employment or business in the new work location in the year. Any excess expenses can be carried forward and deducted in the next year, subject to the same limitation.

If you have not paid the expense in the year of the move, you cannot deduct the expense for that year. For example, if you moved near the end of 2015 and paid your moving van costs in 2016, the earliest you can deduct the costs would be on your 2016 return.

SIMPLIFIED METHOD FOR TRAVEL AND MEAL COSTS

For any of your travel and meal costs described above, you have the option of claiming either your actual expenses or certain flat-rate amounts allowed by the Canada Revenue Agency ("CRA"). Obviously, you should claim the greater amount because that will save you the most tax.

For meals, the CRA's flat rate amount for many years has been $17 per meal per person per day, for up to three meals a day, so that the maximum amount per person was $51 per day. (It is possible this will increase for 2016.)

For driving expenses, the CRA flat rate depends on the province from which you move. For example, for 2015, the rate was 55 cents per kilometre for moves from Ontario, and 50.5 cents for moves from Quebec.

These rates are reviewed and revised annually. The CRA rates for meals and travel for moves in 2016 will be published at www.cra.gc.ca/travelcosts in early 2017.

If you cannot provide receipts to claim your actual costs, you may have to rely on the CRA flat-rate amounts.

EMPLOYER REIMBURSEMENT OR ALLOWANCE

In order to deduct your moving expenses, you must include in your income any reimbursement or allowance received in respect of the move. However, if they are not included in your income, the CRA will allow you to deduct the amount of your moving expenses in excess of the reimbursement or allowance.

LOSS CARRYOVERS

NON-CAPITAL AND NET CAPITAL LOSSES

Your losses from income sources can offset your positive income from such sources. However, they cannot bring your income below nil. For example, if you have $50,000 of employment income this year and a $60,000 loss from a business, your net income will be zero. The excess $10,000 loss amount becomes a "non-capital loss".

Non-capital losses can be carried back 3 years and forward up to 20 years to offset all sources of income in any of those years (for losses incurred before 2006, the carryforward period was either 10 or 7 years). If you are carrying losses back to a previous year, you can use CRA Form T1A to effectively amend an earlier year's return to account for the loss.

Similarly, allowable capital losses (one-half of capital losses) can offset taxable capital gains (half of capital gains), but only to bring the amount to zero. Excess allowable capital losses become "net capital losses", which can be carried back 3 years or forward indefinitely to offset taxable capital gains in any of those years.

ALLOWABLE BUSINESS INVESTMENT LOSSES

An allowable business loss (ABIL) is one-half of a capital loss incurred on the disposition of shares or debt in certain types of small business corporations (see our February 2016 Tax Letter for details).

An ABIL, unlike regular allowable capital losses, can be deducted against all sources of income and not just taxable capital gains. An unused ABIL can be carried forward up to ten years to offset all sources of income in those years.

However, after the tenth-carryforward year, any unused ABIL becomes a regular allowable capital loss. From that point onward, it can only offset taxable capital gains and not other sources of income.

PERSONAL-USE PROPERTY

Normally, losses from the disposition of personal-use property are denied for income tax purposes. However, losses from listed personal property ("LPP") can be used to offset gains from LPP. LPP includes artwork, rare books and manuscripts, stamps, coins, and jewelry. (See the July 2016 Tax Letter for details.)

If LPP losses in a year exceed the LPP gains in a year, the excess losses can be carried back three years or forward seven years to offset gains from LPP in any of those years. If a net gain remains, one-half of the gain is included in income as a taxable capital gain.

RESTRICTED FARM LOSSES

If you are a full-time farmer carrying on a farming business, any losses from the farming business for a taxation year can offset your other positive sources of income for the year, if any. For these purposes, you will be considered a full-time farmer if your chief source of income is from your farming business.

If the farming business is *not* your chief source of income, the deductible amount of your farm business loss is limited to $2,500 plus ½ of the next $30,000 of the loss, for a maximum loss of $17,500. The excess loss for the year, if any, is a "restricted farm loss". It can be carried back 3 years or forward 20 years (for losses incurred before 2006, the carry-forward period was 10 years). However, it can only offset farming income in those years, and not other sources of income.

AFFILIATED PERSONS (FOR SUPERFICIAL LOSS RULES)

In general terms, a superficial loss occurs where a person disposes of a capital property at a loss, and either the person or an "affiliated person" acquires the same property or an identical property in the period beginning 30 days before the disposition and ending 30 days after the disposition, if the person or affiliated person owns (or has a right to acquire) the property at the end of the period.

The loss is deemed to be nil and therefore cannot be claimed at that time.

INDIVIDUAL'S LOSS

If the disposing person is an individual, the amount of the denied loss is added to the cost of the new property acquired by that person or the affiliated person. In other words, the accrued loss becomes embedded in the cost of the new property to that person. As a result, on a later disposition of the property, the loss can be triggered, or serve to offset a gain that would otherwise result but for the addition to the cost of the property.

CORPORATION'S OR TRUST'S OR PARTNERSHIP'S LOSS

If the disposing person is a corporation or trust, or a partnership, the superficial loss is treated differently. The amount of the denied loss can be claimed by the corporation or trust or partnership at a later time, generally when the property is disposed of by the affiliated person and no affiliated person reacquires the property within 30 days after that subsequent disposition.

MEANING OF "AFFILIATED PERSON"

The meaning of "affiliated person" is fairly simple when dealing with individuals only. Only spouses and common-law partners are affiliated. Therefore, for example, if you transfer a property with an accrued loss to your child or other relative, the superficial loss rules do not apply to deny your loss.

When dealing with corporations, the issue can become more complex. For example, a corporation is affiliated with the person that controls the corporation. A corporation is also affiliated with each member of an "affiliated group of persons" that controls the corporation. An affiliated group of persons means a group in which every person is affiliated with each other person of the group. In either case described above, the spouse or common-law partner of the person or member of the affiliated group that controls the corporation is also affiliated with the corporation.

More examples: Two corporations are affiliated if they are controlled by the same person, or one is controlled by one person and the other is controlled by a person affiliated with the first person. Additionally, two corporations are affiliated if each **corporation** is **controlled** by a group of **persons**, and each member of each group is affiliated with at least one member of the other group.

A partnership is affiliated with each "majority interest partner" of the partnership. In general terms, a majority interest partner is a partner whose share of partnership income from all sources of the partnership, plus the share of the partnership income of any person affiliated with the taxpayer, exceeds one-half of the total partnership income from all sources for the relevant period. Additionally, two partnerships are affiliated if each member of a **majority-interest group of partners** of each partnership is affiliated with at least one member of a **majority-interest group of partners** of the other partnership.

Confused yet? You're not alone. The affiliated person rules are complex. When dealing with the superficial loss rules and not-so-obvious affiliated persons, it is important to get advice from a tax professional.

STOCK DIVIDENDS

Most dividends paid by corporations are paid in cash. However, there are times when a corporation will pay a stock dividend. This occurs where a corporation issues new shares as dividends to existing shareholders.

The amount of a stock dividend is generally the paid-up capital ("PUC") of the issued share. Although PUC will sometimes be the same as the value of the share at the time it is issued, in many cases the PUC will differ from that value. Regardless, the PUC, not the value, determines the amount of the dividend for purposes of reporting the dividend as income.

If the stock dividend is received from a taxable Canadian corporation, it will be subject to the usual gross-up / dividend tax credit mechanism, which results in the dividend being subject to a lower rate of tax relative to other types of income such as interest.

Your cost of the issued share also is determined by the PUC of the share. The cost is then averaged out with the cost of your existing shares to determine your cost per share.

Example

You own 100 common shares in X Ltd., with an aggregate cost of $900 or $9 per share. X Ltd. pays a 1% stock dividend on its common shares. This means you receive 1 common share as the dividend. The PUC of that share is $20.

You must include $20 in income, plus the applicable gross-up amount, and then proceed to compute your tax using the dividend tax credit.

The cost to you of the issued share is deemed to be $20, which must be averaged with the cost of your other 100 shares. The total cost of your 101 common shares is $920, which means you now have an average cost of $9.11 per share.

PRESCRIBED INTEREST RATES

The CRA recently announced the new prescribed interest rates that apply to amounts owed to the CRA and to amounts the CRA owes to individuals and corporations. The amounts are subject to change every calendar quarter. The following rates are in effect from July 1, 2016 to September 30, 2016, and remain unchanged from the last several quarters.

- The interest rate charged on overdue taxes, CPP contributions, and Employment Insurance premiums is 5%, compounded daily.
- The interest rate paid on late refunds paid by the CRA to corporations is 1%, compounded daily.
- The interest rate paid on late refunds paid by the CRA to other taxpayers is 3%, compounded daily.
- The interest rate used to calculate taxable benefits for employees and shareholders from interest-free and low-interest loans is 1%.

AROUND THE COURTS

SOME MOVING EXPENSES DISALLOWED

As discussed earlier in this letter, you can deduct certain moving expenses incurred in an "eligible relocation". The *Income Tax Act* sets out specific expenses that qualify for the deduction, but the list is not exclusive.

In the recent *Nazih* case, the taxpayer moved in an eligible relocation and thus was entitled to deduct qualifying moving expenses. Many of her expenses were those specifically set out in the Act, and were therefore allowed. However, since she did not have all of the receipts relating to her meals, she was required to use the CRA flat rate method of $17 per meal per day per person.

In addition, Ms. Nazih attempted to deduct house-hunting costs, the cost of a new central vacuum, fees paid to the Canada Mortgage and Housing Corporation in respect of her mortgage, and inspection fees for the new residence. The CRA disallowed the deduction of these fees, and she appealed to the Tax Court of Canada.

The Tax Court sided with the CRA and disallowed the additional expenses. Basically, the Court held that these expenses were only "incidental" to the move and were not incurred in respect of the eligible relocation. Accordingly, they were not eligible moving expenses.

RECTIFICATION ORDER ALLOWED CAPITAL DIVIDEND

A capital dividend paid by a Canadian private corporation and received by a Canadian resident is tax-free. The capital dividend is paid out of the corporation's "capital dividend account", which reflects, among other things, the non-taxable portion of capital gains previously realized by the corporation.

In the recent *Non Corp Holdings* case, the corporate taxpayer sold its assets in 2012 and realized capital gains. On November 1, 2012, it paid a dividend to its shareholders, which was intended to be out of the capital dividend account (CDA) and therefore a tax-free capital dividend.

However, because of error, the director's resolution declaring the dividend and the appropriate CRA election form were dated October 31, 2012. The corporation did not have sufficient CDA balance on that day. As a result, the corporation was subject to a penalty tax in respect of the dividend. In contrast, the dividend would have been a tax-free capital dividend if it had been payable on November 1, 2012.

The taxpayer applied to the Ontario Supreme Court for a rectification order, to amend the date of the director's resolution and CRA form to November 1, 2012. The Court agreed that the intent was always to pay a capital dividend once the CDA account had been increased, and that the directors simply chose wrong date by accident. In particular, the Court held:

"There was a specific intention to allocate specific proceeds of a specific transaction to a specific tax account – the capital dividend account – to achieve a specific tax goal. A very minor mistake, in human terms at least, was made. The date chosen to insert on the resolution and the election form was the wrong date from the point of view of the intended plan. There was a clear and specific intention throughout and a simple mistake as to the correct means of implementing that intent."

As a result, the Court provided the rectification order and amended the date such that the dividend was a tax-free capital dividend. This effectively becomes binding on the CRA, which for tax purposes must accept the Order determining that the dividend was not payable until November 1, 2012.

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.

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