Marcil Lavallée

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TAX LETTER

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RRSP DEDUCTION LIMITS

If you haven't yet made your RRSP contribution for 2020 and are under 71, you can make it any time up to and including March 1, 2021 (60 days after year-end).

The maximum contribution for 2020 is **$27,230**, or 18% of your **2019** "earned income" if that "earned income" was less than $151,277. Earned income is generally your income from:

- employment
- carrying on business (but not through a corporation unless the corporation pays you a salary; dividends and shareholder benefits are not "earned income")
- net rental income (after expenses) from real estate
- CPP disability pension
- research grants
- taxable spousal support payments
- contributions to an "amateur athlete trust" on your behalf.

Your RRSP contribution room is reduced by your 2019 "pension adjustment" if you are a member of a registered pension plan. (This figure represents the value of employer pension benefits accrued to you during 2019.) The pension adjustment figure appears on the T4 slip for 2019 that you received from your employer in February 2020.

If you have the cash available, it is a good idea to make your contribution for each year as early in the year as possible. Then any income earned on those funds will grow tax-free in the RRSP. You could have made your 2020 contribution any time from January 1, 2020.

The maximum contribution for 2021 will be **$27,830**, or 18% of your 2020 "earned income" if that "earned income" is less than $154,611. Again it is reduced by your "pension adjustment" on your 2020 T4. If you have the cash available and you're able to determine your limit, consider making your maximum contribution for 2021 – or at least part of it – early in 2021. If you're a member of an employee pension plan, you will likely have to wait until you get your T4 for 2020 (in February) so that you know the pension adjustment; if not, you could make the contribution at the beginning of January.

TAX SHELTER DANGERS

Other than "approved" shelters such as RRSPs, TFSAs and flow-through shares, there are few if any tax shelters that still work to reduce your tax bill.

Taxpayers should be aware of some of the dangers of investing in a scheme designed to reduce income tax, quite aside from whether the scheme technically "works":

1. If the scheme is a "tax shelter" as defined in the Income Tax Act, the promoter is required to obtain a **tax shelter ID number from the CRA**, provide you with that number, and to report your name and Social Insurance Number to the CRA as an investor in the shelter. This **ensures that the CRA will audit your investment**, and if it doesn't like the effects, your tax benefits will be denied. (Note that the ID number does *not* mean that the CRA will allow the deductions claimed!)

   A "tax shelter" is defined, very generally, as any scheme where the promoter represents that the savings you can obtain for tax purposes will exceed the amount you invest in the scheme.

2. **If the promoter fails to register** the shelter, or **if you do not file a Form T5004** "Claim For Tax Shelter Loss or Deduction" with your return showing what shelter(s) you are using and how much you are claiming, then your **losses or credits will be denied** even if they would otherwise qualify.

   Note also that if the right forms are not filed to alert the CRA that you are claiming tax shelter benefits, the CRA **has no deadline** to reassess you to deny the benefits. The usual 3-year deadline is extended to 3 years *after* the promoter files the necessary forms identifying you as an investor in the shelter. So the CRA might decide 10 years later to reassess you to deny the deductions you claimed, and assess you a massive amount of interest on top of that.

3. If the scheme is not a "tax shelter" as defined, but has two of the three **"hallmarks" of a tax avoidance plan**, then again it must be reported to the CRA on a special form (RC312 "Reportable Transaction Information Return"). Again, if it is not reported, the tax benefits can be disallowed and the CRA may have unlimited time to reassess you. The "hallmarks" are:

   (a) contingent fees for the promoter (usually a percentage of the tax you save);

   (b) "confidential protection", meaning you are not permitted to disclose the details of the scheme to others; and

   (c) "contractual protection", such as insurance or a promise to defend the scheme if you are reassessed by the CRA to deny its benefits.

4. **Charity donation shelters** get special attention. These involve a mechanism whereby you get a tax receipt from a charity for much more than the cash you actually put into the arrangement. Even if the promoter assures you that

the scheme works and has been vetted by a law firm, note the following:

- The CRA does not accept *any* charity donation shelters as valid, other than simple donations of flow-through shares (for which special rules provide that a capital gain needs to be reported). In taxpayers' appeals to the Courts, the CRA invariably wins these disputes, with the judges agreeing that the donation shelter did not "work".
- If you do not report the shelter as a tax shelter on your return, then as per above your donation credit will be denied, and there is no limit to when the CRA can reassess you.
- Assuming you report the shelter, the CRA will refuse to issue your initial Notice of Assessment until it has audited the shelter, at which point it will deny the donation credit.
- Even if you appeal the CRA's assessment denying you the donation credit, you must still pay half of the amount in dispute while the appeal is underway.

5. Quite aside from all the special tax shelter rules, the CRA can and does use the **general anti-avoidance rule** to deny you any deduction or credit that is part of an "avoidance transaction" and is considered to constitute a misuse or abuse of the words of the Income Tax Act, Income Tax Regulations or any tax treaty.

BUSINESSES CLAIMING GST — HOW TO GUARANTEE AN AUDIT

If you operate a business (whether personally or in a corporation), you are likely claiming GST/HST **input tax credits** (ITCs) to recover GST or HST that the business pays on purchases. If you are not collecting and remitting GST or HST that exceeds these ITCs, then you will be claiming a "**net tax refund**" – in other words, asking the CRA (or Revenu Québec, in Quebec) to write your business a cheque.

There is nothing wrong with claiming a net tax refund, provided the business is entitled to one. Be aware, however, that claiming a refund that exceeds a basic threshold will trigger a CRA audit. You will get a letter from a "GST/HST Refund Integrity Officer" seeking copies of invoices documenting the GST or HST that you have paid, as well as an explanation as to why you have not collected GST/HST that exceeds your ITC claims.

There can be good reasons for a business to get net tax refunds every year or even every month. These are, in general:

- The business's sales are primarily exports of goods to outside Canada.
- The sales are primarily services provided to non-residents of Canada.
- The sales are primarily zero-rated goods, such as basic groceries, medical devices, certain drugs or certain farm equipment.
- The sales are primarily to status Indians and delivered to a reserve, in circumstances where no GST/HST applies.
- The sales are primarily to a provincial or territorial government that has not agreed to pay GST/HST on its purchases, so no GST is being charged (Alberta, Saskatchewan, Manitoba, Yukon or Northwest Territories).
- Expenses are incurred primarily with HST paid at 13% or 15%, while most of the sales are to the GST-only provinces (BC, AB, SK, MB), or the territories, with GST collected at only 5%.

- The business is a startup with high capital purchases, such as equipment.
- The business is losing money, with expenses exceeding sales.

However, to obtain your net tax refunds you must prove the entitlement to the CRA auditor. This means showing **invoices that meet all the documentary requirements** for the GST/HST (such as showing the supplier's GST number, and in most cases being addressed to your business). This also means explaining why your business has not collected more GST or HST than it has paid out, and how this complies with the law.

For example, businesses that supply "**exempt**" (not zero-rated) services or property are not entitled to ITCs for GST/HST paid on the costs of making those supplies. This includes residential landlords, certain health care providers, certain education providers, child-care services, and businesses supplying financial services, among others.

EMIGRATION FROM CANADA

If you are considering emigrating from Canada, tax considerations will be extremely important. The tax implications can be (and are) the subject of a whole book; below we review just some of the most important highlights. It is generally wise to obtain professional advice that is tailored to your specific situation.

Will you become a non-resident of Canada?

If you become non-resident, you will no longer be subject to Canadian tax on all of your worldwide sources of income. You will generally be taxed only on certain "Canadian-source" income (e.g., income from rent on property in Canada, dividends from Canadian corporations, capital gains on Canadian real estate). From a Canadian tax point of view, it is therefore often desirable to become non-resident (though you will lose benefits such as the Canada Child Benefit and the GST/HST Credit). Of course, taxes should not be the only consideration; other issues such as health care, cost of living, safety, political stability, civil rights and quality of life must not be overlooked.

Just because you are moving out of Canada does not automatically mean that you will become non-resident.

If no tax treaty applies

First, you have to establish that you have **taken up residency somewhereelse**. Canadian courts have held that you have to be resident somewhere. Generally, you are considered resident in the place where you regularly, normally or customarily live in the settled routine of your life. There are no precise rules to be applied; each case depends on its facts.

Second, since it is possible to be resident in more than one country at the same time, you must establish that you have "cut your residential ties" with Canada. Those ties are evidenced by such things as:

"Significant" residential ties

- keeping a home in Canada
- having your spouse remain in Canada
- supporting dependent children who remain in Canada

"Secondary" residential ties

- keeping personal property such as furniture, clothing, and automobiles in Canada
- having bank accounts with Canadian banks
- having credit cards issued by Canadian financial institutions
- social ties such as memberships in Canadian clubs and religious organizations (on a resident basis)
- maintaining provincial health care coverage

- keeping a Canadian driver's licence, or a vehicle registered in Canada
- professional memberships in Canada (on a resident basis)

"Minor" residential ties

- having a seasonal residence in Canada
- renting a safety deposit box in Canada
- renting a post office box in Canada
- keeping a telephone listing in Canada
- continuing to use stationery and business cards with a Canadian address

No one factor is conclusive, but in the CRA's view all of the "significant" ties and most of the "secondary" ties must be cut to establish non-residence. The CRA will also look at your general mode and routine of life, and whether you are making regular or extended visits to Canada.

> Examples
>
> *1. X is transferred from Vancouver to his company's Bermuda office for several years. He keeps his Canadian bank accounts and club memberships. His wife and children remain in Canada, and continue to live in his Vancouver home. He visits them regularly.*
>
> X will likely be considered by the CRA to remain resident in Canada throughout the time he is in Bermuda.
>
> *2. Y is transferred from Vancouver to her company's Bermuda office for a three-year posting. She and her husband sell their Vancouver home and buy a new home in Bermuda, where they move with their children. Y cancels her Canadian credit cards and closes most of her Canadian bank accounts, but keeps one savings account at a Calgary bank branch.*
>
> Y will likely be considered by the CRA to have become a non-resident of Canada. Keeping one Canadian bank account will not cause her to remain resident in Canada.

Note that certain people are deemed to be resident in Canada even though they are working abroad. This includes members of the Canadian Forces and Canadian diplomats posted outside Canada, as well as their spouses if the spouse was ever resident in Canada for tax purposes.

If a tax treaty applies: "tie-breaker" rules

Canada has tax treaties with over 90 countries, including of course the United States and virtually all of our significant trading partners other than tax havens. The tax treaties provide **tie-breaker rules for determining residence**, if a person would otherwise be considered resident in both countries under the domestic laws of each country. Most tax treaties follow the same model, though there are minor differences among them. (Tax Information Exchange Agreements that Canada has with many tax havens are not tax treaties, and the paragraphs below do not apply to them.)

Generally, under the tax treaty tie-breaker rules, a person is deemed resident in the country where he or she has a "**permanent home available**". A person who has a permanent home in both countries, or neither, is deemed resident in the country where his or her "**personal and economic relations**" are closer (also called "centre of vital interests"). If this cannot be determined, one looks to the "habitual abode", and if that does not answer the question, it is determined by citizenship.

In each case, the specific treaty between Canada and the other country needs to be examined carefully, as the specifics of the rules will vary.

If you are resident in another country under a "treaty tie-breaker" rule, then you are deemed by the Income Tax Act (subsection 250(5)) *not* to be resident in Canada, even if you have not cut your ties with Canada.

Thus, if you move to a country with which Canada has a tax treaty, it is easier to become non-resident, by means of a "permanent home" (which can be an apartment you rent) in only that country, or by having your "personal and economic relations" stronger in the other country.

Departure tax payable if you become non-resident

If you become non-resident for Canadian tax purposes (including due to a treaty tie-breaker rule as per above), you may be required to pay tax as a result. This is sometimes called the "departure tax". In fact, it is ordinary income tax payable on capital gains that are deemed to be triggered just before you become non-resident. These capital gains must be reported on your Canadian tax return for the year in which you become non-resident.

On becoming non-resident, you are deemed to dispose of much of your property at its **fair market value**. Thus, capital gains may be triggered, depending on your cost base in each property. However, this rule generally does *not* apply to certain property, including:

- real property (e.g., land and buildings) in Canada, which will instead be taxed when you eventually sell it
- interests you have in RRSPs, RRIFs, RESPs, RDSPs, TFSAs and a whole alphabet soup of other plans and arrangements
- various rights you may have, such as under an employee stock option agreement
- property used in carrying on an active business through a permanent establishment in Canada.

This is only a very general overview; the departure tax has many complications, and you should obtain professional advice relating to your specific situation.

Note that if you do not pay your Canadian tax liability, the CRA can, under Canada's tax treaties with *some* countries, arrange for the local tax authority to enforce collection of the Canadian tax you owe. This can happen in the United States (if you are not a US citizen), the United Kingdom, Germany, the Netherlands, New Zealand, Norway and Spain.

Passive income — withholding taxes

Once you are non-resident, Canada will impose a withholding tax on most kinds of "passive" income, other than interest (which since 2008 is taxed to non-residents only in limited circumstances). It is called "withholding" tax because the payer is required to withhold the tax, send it to the CRA, and send you only the balance after deducting the tax.

The income this applies to includes:

- dividends from Canadian corporations
- rent on real estate in Canada
- royalties paid from Canada
- pension income, including OAS and CPP/QPP payments
- RRSP/RRIF withdrawals

The withholding tax rate is 25%. However, if you are resident in a country with which Canada has a tax treaty, the rate may be reduced to 15%, 10%, 5% or even zero. The tax on dividends, pension payments and some royalties is generally reduced by treaty; the tax on other amounts may not be. In each case you must check the details of the particular tax treaty as it applies to that kind of income. Note also that, in many cases, whatever Canadian withholding tax you are charged will be allowed as a foreign tax credit in the country of which you are resident, so the withholding tax will not represent a real cost to you.

AROUND THE COURTS

Business losses denied as not (yet) being a real business

In the recent *Tremblay* decision of the Tax Court of Canada (2020 TCC 100), the CRA denied business expenses on the basis there was no real "business", and the Court agreed.

Mr. Tremblay was an engineer with over 25 years of experience. He had been involved in developing new products and technologies related to mining and metallurgy, including processes for chemical treatment of sewage. From 2010-2013, while he was working for SNC-Lavalin, he also claimed substantial losses each year ($50,000 - $75,000) from a business he claimed to be running, trying to market sewage treatment technology.

The CRA reassessed Mr. Tremblay to deny his business losses, and he appealed to the Tax Court.

The judge concluded that Mr. Tremblay's "business" had not yet begun to operate during the years in question, and so he had no "source" of business income against which to deduct his expenses. The Court did not believe that the activities he undertook really were marketing activities. There was little evidence beyond Mr. Tremblay's own testimony (which was vague), and there was virtually no documentation such as a business plan or correspondence with his potential clients. As a result, the expenses, totalling over $230,000 over four years, were denied.

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.

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

GATINEAU
100-200 rue Montcalm St
Gatineau QC J8Y 3B5
T 819 778-2428
F 613 745-9584

Marcil-Lavallee.ca
Marcil Lavallée, S.E.N.C. | G.P.
Société de comptables professionnels agréés
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