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Tax Letter

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YEAR-END PLANNING

It's December, and time to think of some tax planning ideas. If you wait until your tax return is due next April or June, it will generally be too late to change your tax situation for this year.

1. PRIVATE COMPANIES — PAY OUT DIVIDENDS BEFORE THE TAX COST GOES UP

The so-called "gross-up" and dividend tax credit apply when you receive dividends from a Canadian corporation. The purpose of these rules is to put you in the same position as you would be if you earned directly the income earned by the corporation — taking into account that the corporation has already paid corporate income tax. The "**gross-up**" brings into your income an amount that theoretically reflects the pre-tax income earned by the corporation to pay you the dividend, and the **dividend tax credit** then gives you a credit for the corporate tax that the corporation theoretically paid on that income. This so-called "integration" is often not exact, especially when varying provincial tax rates are taken into account.

The federal corporate tax rate on small business active business income (up to $500,000 per year for most Canadian-controlled private corporations) will drop from 10% in 2018 to 9% in 2019, and the gross-up and dividend tax credit will be reduced to match. (But the 2019 changes to the gross-up and credit will apply to *all* dividends, even if the corporation originally paid tax at a rate higher than 9%.)

This means that the effective personal tax rate on "non-eligible" dividends from private corporations will increase for 2019. For example, if you are in the top bracket in Ontario, the rate will increase from 46.84% to 47.78%.

Other things being equal, **if you are planning to have your corporation pay out dividends in the near future, do it before the end of 2018**.

2. CHARITABLE DONATIONS

Charitable donations must be made by December 31 to be counted for this year.

Charitable donations receive special tax assistance. Donations that exceed $200 per year give you a significant tax credit. If you are in the top federal tax bracket (over $210,371 of taxable income after all deductions), the federal credit is 33% of the lesser of your donations over $200 and the amount of your taxable income in the top bracket. If you are not in the top bracket, the *federal* credit is 29%. As well, there is a provincial credit that typically increases the total credit to something in the range of 40-50%, or even higher.

If you are not in the top tax bracket, you can benefit by receiving income and donating it back to a charity. This may be possible if you volunteer for a charity. **If the charity pays you for your volunteer work**, and you donate the money back to the charity, you will come out ahead.

For example, suppose you are in a 30% tax bracket (including provincial tax), and you have already made over $200 in donations this year. If the charity pays you $10,000 for work you have done for it, your tax bill will go up $3,000 (maybe a bit higher, if you move up to the next bracket). If you donate the same $10,000 back to the charity, your tax bill will go down about $4,500 (varying by province). The net is a saving of about $1,500 after tax.

Of course, the income must represent real work you do for the charity, and your donation must be voluntary. You and the charity also need to determine whether you are an employee or an

independent contractor. If you are an employee, the charity must issue you a T4 and might have to withhold some tax at source. If you are an independent contractor, you may be able to deduct expenses from your "business income", providing you with even more tax savings; and if your total business revenues for the year exceed $30,000 you may need to charge GST or HST.

An even simpler technique is to have the charity **reimburse you for actual expenses** you have incurred as a volunteer (e.g., travel and parking costs). Such reimbursements, provided they are reasonable, are not taxable to you. You can then donate the reimbursed amount back to the charity and get a tax credit.

Another idea to consider is **donating publicly-traded shares** or mutual fund units to a charity. If you do this, you do not pay tax on any capital gain on the securities, but the donation is valued for tax purposes at its current fair market value. If you are considering making a donation to a charity, and you have some securities that have gone up in value, donating the securities will be very tax effective.

Overall, you can claim charitable donations up to 75% of your "net income" for tax purposes. Net income is basically your income after most deductions, but before claiming the capital gains deduction (capital gains exemption) or any loss carryovers from other years.

In every case, make sure to get a **tax receipt** from the charity that meets all of the conditions specified in section 3501 of the *Income Tax Regulations*, or you will not be entitled to the credit.

Note that **donations of property will be valued at your cost of the property**, if you acquired the property within the past 3 years or if you acquired it for the purpose of donating it. (This rule does not apply to publicly-traded securities or certain other property.) This prevents the so-called "gifting" schemes which used to attract many taxpayers, who would purchase art or other goods for less than their appraised value and then donate the art to a charity for a high-value tax receipt. Note also that the CRA carefully audits donations of property to check whether the value that is provided on the tax receipt is correct.

3. RRSP CONTRIBUTIONS

If either you or your spouse are not yet 71 this year, then you can normally make contributions to a registered retirement savings plan (RRSP) and deduct them from your income for tax purposes. Your RRSP contribution limit for 2018 is based on your 2017 "earned income" as well as your pension adjustment (reflecting future pension credited to you in 2017 from your being a member of a company pension plan).

Your available RRSP contribution room should be printed on the Notice of Assessment that you received from the CRA after you filed your 2017 return in the spring of 2018. Your maximum contribution room for 2018 is:

18% of your 2017 earned income
(maximum $26,230 if your 2017 earned
income exceeded $145,722)
minus
your pension adjustment
plus
any contribution room from earlier years
since 1991 that you have not yet used up.

Your deadline for contributions for 2018 is **March 1, 2019**. However, if you have excess cash, you should **also consider making your 2019 contribution early in 2019**. You can make that contribution any time from January 1, 2019 through February 29, 2020. Putting funds into an RRSP will allow them to grow tax-free, rather than you having to pay tax on any interest that you earn during the year. (You can also put money into a tax-free savings account, or TFSA, for which you get no deduction but interest will not be taxable. As of 2018, your lifetime TFSA contribution limit is $57,500 if you were born before 1992, and will likely be $63,000 as of 2019.)

Consider also a contribution to a **spousal RRSP**. (This also applies to a common-law spouse or same-sex partner who meets the Income Tax Act's definition of "common-law spouse", even if you are not legally married.) Your maximum deductible contribution is the same regardless of whether you contribute to your RRSP or your spouse's, or some combination of the two. If your spouse is likely to have lower income than you in future years, then a spousal RRSP contribution will allow your spouse to take the income out down the road (once the last year during which you make any spousal contributions has passed, plus two more years). Your spouse will then pay tax on that income at a lower rate than you would if you withdrew the funds from your own RRSP.

A spousal RRSP is also useful if you are already over 71 but your spouse is younger. Once you reach the year in which you turn 71, you cannot contribute to your own RRSP and must convert your RRSP to an annuity or a registered retirement income fund (RRIF) from which you draw income every year. However, you can still make contributions to a spousal RRSP if your spouse is under 71 at year-end.

4. TRIGGER CAPITAL LOSSES

Capital gains are half-taxed; that is, half of the gain is included in your income as a taxable capital gain. Capital losses can be claimed only against capital gains (and can be carried back three years and forward indefinitely against such gains).

If you have capital gains this year — for example, from selling some shares for a gain earlier in the year — you may wish to trigger capital losses by selling securities that have gone down in value.

Make sure the sell order goes in by December 27, in time for the sale to "settle" before the end of the year. The settlement date for most stock trades in Canada is now two business days, and December 29-30 are Saturday and Sunday.

You should also ensure that you are not caught by the "superficial loss" rules. If you (or an "affiliated person", which includes a corporation you control) acquire the same (or identical) securities within 30 days of selling them, then your capital loss will be disallowed.

There are numerous other special rules for capital gains and losses. This is just a general overview.

5. PAY YOUR INSTALMENTS

If you have instalments to pay for the year, and you have not been paying them as per the notices you receive from the CRA during the year, now would be a good time to catch up. If you wait until next April, you will owe non-deductible four months' additional interest, and possibly penalties, on the late instalments.

To avoid interest applying, instalments should be paid on March 15, June 15, September 15 and December 15. Overpaid or "early" instalments earn credit (called "offset interest") against interest that applies to late instalments for the same year.

You are allowed to calculate instalments based on any of three methods, without interest applying. The instalments can total your tax payable (on income from which tax is not withheld at source) for this year, or for last year, or based on the amounts that the CRA advises you. The CRA's notice to you for March and June is based on the total taxes you paid two years ago, and then for September and December the suggested instalments are adjusted so that the total for the year equals the amount you paid last year.

BUYING A TRUCK FOR YOUR BUSINESS NEAR YEAR-END?

If you buy a pick-up truck, van or similar light truck for your business, you do not want it classified as an "automobile" or "passenger vehicle" for income tax purposes. If it is, there are certain tax costs, such as the "standby charge" applying to your personal use of the vehicle, and a cost limit of $30,000 (before sales taxes) for purposes of claiming capital cost allowance.

To avoid it being an "automobile", you generally must be able to show that your vehicle meets one of the following conditions:

1. it is a van, pick-up truck or similar vehicle; *and* it has seating for not more than the driver and two passengers; *and* you used it in the taxation year in which it was acquired or leased "primarily" (more than 50%) for transporting goods or equipment in the course of your business

   or

2. it is a van, pick-up truck or similar vehicle; and you used it in the taxation year in which it was acquired or leased "substantially all" for transporting goods, equipment or passengers in the course of your business (CRA considers that "substantially all" means 90% or more)

   or

3. it is a pick-up truck that you used in the taxation year in which it was acquired or leased "primarily" (more than 50%) for transporting goods or equipment in the course of your business in a remote location that is at least 30 kilometres from the nearest urban area with a population of 40,000 or more.

All of these conditions refer to your usage in the taxation year in which the vehicle is acquired or leased. **This creates a trap**. Suppose you buy a pick-up truck on December 30, so that you can start

claiming capital cost allowance for this year. But you don't start using the truck until January. The truck will not be able to meet the "use" test, and you will be stuck with the negative effects of having what the Income Tax Act calls an "automobile" for the entire period you own the truck.

CHARITIES AND GST/HST

If you are on the board of a charity, or involved in helping a charity, you should make sure the charity knows about the special complications for charities in complying with the GST/HST.

(A "charity", for this purpose, means a registered charity for income tax purposes. However, it does *not* include a university, hospital, school, college or a local authority that has been determined by Revenue Canada to be a municipality — these are called "public institutions" under the GST/HST and are subject to different rules.)

There is a **Public Service Body rebate** for charities. Charities are entitled to claim a rebate of a portion of the GST/HST they pay on their purchases. For the 5% GST (or 5% federal portion of the HST), the rebate is **one-half of the 5%**. For the 8% or 10% provincial portion of the HST, the rebate is **82% of the 8%** in Ontario; **35% of the 10%** in PEI; and **50% of the 10%** in the other three Atlantic provinces. The total rebate can be quite substantial. For example, in Ontario a charity gets back 9.06 points of the 13% HST.

STAYING OUT OF THE GST/HST SYSTEM

A charity need not register for the GST/HST — or may choose to "de-register" — if its annual *taxable* sales do not exceed **$50,000**. (The limit for businesses generally is $30,000.) Below this level, a charity is a "small supplier", and can choose not to register, so that it does not charge GST/HST on taxable sales.

In addition, there is a "total revenue" threshold, below which a charity or public institution may choose to remain a small supplier and not register (even if it is over $50,000 in taxable sales). This "total revenue" threshold is **$250,000**. Total revenue for this purpose includes all sources — grants and donations as well as sales.

Due to the above rules, **many charities can choose not to register** and stay out of the GST/HST system entirely. Effectively, even their supplies that would have been taxable are exempt.

Note that if a charity is GST-registered and chooses to de-register, it may have to repay certain input tax credits it may have claimed in the past.

MANY CHARGES ARE EXEMPT

The rules above apply only to *taxable* sales. Most supplies by a charity are exempt. However, certain supplies are taxable: e.g., most admissions, recreational activities, and most sales of goods in a charity's store.

Examples of a charity's supplies that are exempt include:

- hall rentals, room rentals, and other short-term leases or licences of real property (except where a special election on Form GST 26 makes them taxable)
- parking
- almost all services, including catering services.

EXAMPLE

A church has a hall that it rents out for weddings. It also supplies catering services at the weddings.

The hall rentals and catering charges are exempt. Even if the church is GST-registered, it should not collect GST or HST on these services.

SIMPLIFIED ACCOUNTING ON CHARITIES' GST/HST RETURNS

For charities that are registered, a special set of rules applies to the **calculation of "net tax"**, which is what any GST registrant must remit to the CRA.

Most charities must use "simplified accounting". Instead of the above formula, net tax is calculated as:

- 60% of GST/HST collected (or billed), with *no* input tax credits.

However, *all* GST/HST paid by the charity becomes eligible for the Public Service Body rebate, rather than only the tax paid on inputs to non-taxable activities.

There are some exceptions to this rule, most notably for purchases of real property (e.g., land and buildings) and capital property, for which input tax credits are available. As well, certain charities are permitted to elect out of the simplified-accounting rules and use the regular calculation.

KNOW WHETHER YOU'RE REGISTERED

Note that a charity can have a GST/HST number without being registered! Charities that apply for the Public Service Body rebate, but are not registered, are given a GST/HST number by the CRA, and the number looks *exactly* like a GST/HST registration number. It's in the format 123456789RT0001, where the first 9 digits are the charity's Business Number, "RT" is for a GST/HST account, and "0001" is for a charity that has only one branch filing returns.

But such a charity is not "registered". A charity that is "registered" will normally be asked by the CRA to file a GST/HST *return* (not a rebate application) at least once a year. If you are not sure whether your charity is registered, call the CRA or check on line to make sure you have a GST/HST account.

AROUND THE COURTS

DANGERS OF BUYING REAL ESTATE FROM A PERSON WHO MAY BE NON-RESIDENT

If you buy real estate — such as a house or condo — from a non-resident of Canada, you have an obligation to withhold 25% of the purchase price as tax unless the vendor provides you with a "section 116 certificate" from the CRA.

Non-residents generally are subject to Canadian income tax only on certain Canadian-source income. One such source is capital gains on "taxable Canadian property", which generally includes Canadian real property, shares of corporations whose value is primarily attributable to Canadian real property, and certain other items.

Of course, a non-resident who sells Canadian property might not have any other property in Canada, and so the CRA might not be able to enforce collection of the tax that is payable on the gain. To solve this problem, section 116 of the Income Tax Act makes the *purchaser* potentially liable for the vendor's capital gains tax.

If you buy taxable Canadian property from a non-resident without a certificate, then you are required to **withhold 25% of the purchase price** and remit it to the CRA. If you do not, you can be assessed for this amount.

To avoid having you withhold this 25%, the non-resident can apply to the CRA for a "section 116 certificate", which relieves you from the withholding obligation. The non-resident must calculate the amount of tax payable on the gain, and pay that amount to the CRA, in order to get the certificate.

In the recent *Kau* case (2018 TCC 156), Kau bought a condo from Yekta. Yekta's address was in California, and Yekta signed the closing documents in California, which should have raised a red flag. Yekta provided a one-line unsworn affidavit ("declared" before a California notary public) saying he was not a non-resident of Canada. Kau's lawyer, and thus Kau, accepted this, and paid the full balance to Yekta on closing.

When it turned out Yekta was indeed non-resident, the CRA assessed Kau for $92,000, which was 25% of the purchase price. Kau appealed to the Tax Court of Canada, but this appeal was dismissed. So be very careful about purchasing real estate from someone who might be non-resident!

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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