



BUCHANAN BARRY LLP
CHARTERED ACCOUNTANTS

TAX NEWSLETTER
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- **2009 FEDERAL BUDGET IN BRIEF**
- **INDEXED AMOUNTS FOR 2009**
- **RRSP TIME**
- **TAXPAYER RELIEF PROVISIONS**
- **FLOW-THROUGH OF TRUST INCOME**
- **ALLOWABLE BUSINESS INVESTMENT LOSSES**
- **AROUND THE COURTS**

2009 FEDERAL BUDGET IN BRIEF

The federal budget was recently tabled in the House of Commons and contained a number of meaningful tax changes. Here is a brief summary of some the changes most relevant to our readers, each effective January 1, 2009 unless otherwise noted:

Measures for businesses

- Small business limit increased from \$400,000 to \$500,000;
- Extension (to 2011) of 50% straight-line calculation of capital cost allowance for manufacturing & processing equipment;
- No half-year rule and 100% capital cost allowance on eligible computers and system software acquired after January 27, 2009 and before February 2011;
- Changed the deemed timing of acquisitions of control to prevent accidental elimination of Capital Gains Exemption for acquisitions after 2005;
- Introduction of mandatory electronic return filing for corporations with gross revenue in excess of \$1-million for taxation years ending after 2009;
- Extension of work-sharing agreements by 14 weeks to 52 weeks for two years.

Measures for individuals

- Increased basic personal amount and income thresholds for the two lowest tax brackets by 7.5% (see below);
- Phase-out levels for Canada Child Tax Benefit (CCTB) and National Child Benefit Income Supplement (NCBS) increased in line with income threshold for lowest tax bracket;
- Age amount increased by \$1,000 to \$6,408 (see below). The income threshold at which the age amount is eliminated increased to \$75,032;
- Introduction of Home Renovation Tax Credit which is a non-refundable tax credit for eligible expenditures made in respect of eligible dwelling (generally, an individual's principal residence) after January 27, 2009 and before February 1, 2010 pursuant to an agreement entered into after the first date. Eligible expenditures include labour and materials for a renovation of an enduring nature. A tax credit of 15% applies to expenditures in excess of \$1,000 but not exceeding \$10,000;
- Increased withdrawal limit under the Home Buyers' Plan from \$20,000 to \$25,000 for withdrawals made after January 27, 2009;
- Introduction of First-Time Home Buyers' Tax Credit which is a non-refundable tax credit for first-time home buyers who acquire a qualifying home after January 27, 2009. A tax credit of 15% applies to an amount of \$5,000. The credit is also available on certain acquisitions of a home by or for the benefit of an individual who is eligible for the disability tax credit.



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INDEXED AMOUNTS FOR 2009

Indexation based on increases in the Consumer Price Index applies to the various tax brackets and the personal tax credit amounts. For 2009, most of these amounts have been increased from the 2008 amounts by 2.5%. Following the recent Budget, however, the basic personal amount increased by 7.5% to \$10,320 for 2009.

For the 2009 year, the federal tax brackets are as follows:

- 15% rate on taxable income up to \$40,726;
- 22% rate on taxable income from \$40,727 to \$81,452;
- 26% rate on taxable income from \$81,453 to \$126,263;
- 29% rate on taxable income from \$126,264 upwards.

Provincial tax brackets are also indexed, and vary from province to province.

For 2009, the federal credits equal 15% of the following amounts:

- Basic personal amount: \$10,320;
- Spousal or spousal equivalent amount: \$10,320;
- Age amount: \$6,408 (reduced if net income exceeds \$32,312);
- Employment amount: \$1,044;
- Disability amount: \$7,196;
- Children under age 18 amount: \$2,089;
- Medical expense threshold: lesser of 3% of income and \$2,011 (amounts above the threshold qualify for the credit).

Again, the provincial credit amounts are also indexed and they vary by province.

RRSP TIME

Readers are likely aware of the deadline for contributions to a registered retirement savings account (RRSP). In addition to getting a deduction for contributions made to your RRSP in 2008, you can claim a deduction for the 2008 year for contributions made within 60 days after the end of 2008. The deadline is March 2, 2009 (since March 1 falls on a Sunday).

The deductible amount of your contributions for 2008 is the lesser of \$20,000 and 18% of your earned income for 2007, minus your pension adjustment for 2007. Your earned income includes your income from employment, business, and rental property, certain royalties, and taxable spousal support payments received by you (or minus spousal support payments deductible by you). Your pension adjustment generally reflects amounts paid to or accrued in your registered pension plan in 2007, if any. Both your pension adjustment and RRSP contribution limit should be shown on your 2007 notice of assessment.

You can also deduct contributions made to your spouse's (or common-law partner's) RRSP. However, the total amount of deductible contributions to that RRSP and your own RRSP cannot exceed the limits described above. Note that your spouse's RRSP contribution limit is calculated separately, and is not affected by your RRSP limit or your contributions to his or her RRSP.

If you have unused RRSP contribution room, that is, you have not contributed the maximum deductible amount, it can be carried forward indefinitely and used in later years.



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If you transfer property other than cash to your RRSP, there will be a deemed disposition of the property at its fair market value, which may give rise to a capital gain if its fair market value exceeds your cost of the property. (You will normally need a self-directed RRSP to make such a transfer.) Therefore, although the fair market value of the property will count towards your deductible contribution, it may be accompanied by a taxable capital gain. Unfortunately, if you transfer property to the RRSP with an accrued loss (that is, the cost to you is more than its fair market value), the capital loss is denied on the transfer. Therefore, it is not normally advisable to contribute a property with an accrued loss to your RRSP.

TAXPAYER RELIEF PROVISIONS

Under the *Income Tax Act* there are certain rules known as the "Taxpayer Relief Provisions" (formerly called "Fairness Provisions"), which provide the CRA with the discretion to waive certain requirements of the Act. In particular, these provisions give the CRA the discretion to grant individuals refunds or reductions in tax that are requested after their normal reassessment periods, to waive or cancel interest and penalties, and to remedy missed or late elections or to revoke elections. These provisions, along with the CRA's administrative position as to when it may or may not apply them, are as follows:

Reassessments and refunds beyond normal reassessment period

An individual's "normal reassessment period" for a taxation year is the period that ends three years after the mailing of the notice of assessment for that year. It is during this period that the CRA may reassess an

individual's tax return for the year (the period is extended in certain cases, such as where the individual files a waiver or carries back a loss to the year). However, the CRA has the discretion to reassess an individual favourably beyond the normal reassessment period for the purpose of determining the amount of a refund or the reduction of an amount of tax payable. A request by the individual must be made within ten years after the end of the relevant year. Similarly, a refund of tax for a year may be provided if a tax return was not originally filed but is filed within ten years after the end of the relevant year.

The CRA has stated that it may issue a refund or reduce the amount owed if it is satisfied that such a refund or reduction would have been made if the return or request had been filed or made on time. The CRA further states that individuals can make a request if they were not aware of, or missed, claiming a deduction or a non-refundable tax credit that was available for the year. Individuals can also ask for refunds or reductions of amounts owing for refundable tax credits such as provincial tax credits that have not been claimed. Also, payroll deductions may have resulted in an overpayment of taxes for which a refund can be requested.

Cancellation or waiver of penalties and interest

The CRA has the discretion to waive or cancel all or any part of any penalty or interest payable under the Act. This discretion extends to all taxpayers and not just individuals. A request by the taxpayer must be made within ten years after the end of the relevant year.



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The CRA has stated that it may waive or cancel penalties and interest in extraordinary circumstances, such as those relating to natural or man-made disasters including flood or fire; civil disturbances or disruptions in services, such as a postal strike; a serious illness or accident; or serious emotional or mental distress, due to a death in the immediate family.

The CRA also provides that it may waive or cancel a penalty or interest that arose primarily because of actions of the CRA including: processing delays that result in the taxpayer not being informed, within a reasonable time, that an amount was owing; errors in material available to the public, which led taxpayers to file returns or make payments based on incorrect information; incorrect information provided to a taxpayer, such as where the CRA wrongly advises a taxpayer that no instalment payments will be required for the current year; or other errors in processing.

Furthermore, the CRA may cancel interest where the taxpayer has an inability to pay or is experiencing financial hardship. For example, it may cancel interest if the collection of tax has been suspended due to the taxpayer's inability to pay and substantial interest has accumulated or is expected to accumulate. The CRA may also cancel interest where a taxpayer's ability to pay requires an extended payment arrangement in respect of the taxes owing. It may also cancel interest if the payment of interest would cause a prolonged inability to provide basic necessities such as food, medical help, transportation, and shelter.

Late, amended or revoked elections

The CRA has the discretion to extend the time for making a "prescribed election" under the Act or to allow a taxpayer to amend or revoke a prescribed election already made. The taxpayer must make the request within ten years after the end of the year in which the election was made or should have been made. A list of "prescribed elections" is found at the end of CRA Information Circular 07-1, which can be found on their website at cra.gc.ca/E/pub/tp/ic07-1/README.html. Note that not all elections under the Act qualify for this treatment.

The only downside is that a taxpayer is liable to a penalty if the CRA accepts a late, amended, or revoked election. The penalty is \$100 for each complete month from the original due date for the election to the date of the taxpayer's request, to a maximum of \$8,000.

The CRA has stated that it will **not** accept a request if it is reasonable to conclude that the request was made for retroactive tax planning purposes (for example, trying to take advantage of changes to the law enacted after the due date of the election), if adequate records do not exist, or if it is reasonable to conclude that the taxpayer made the request after being negligent or careless in complying with the law.

FLOW-THROUGH OF TRUST INCOME

In general terms, income of a trust that is paid or payable to a beneficiary is deducted in computing the trust's income and included in the income of the beneficiary. For certain types of trust income, such as interest, rent, or business income paid or



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payable to the beneficiary, the amount is simply included in the beneficiary's income as income from an interest in a trust.

However, certain types of income of a Canadian resident trust (including a mutual fund trust) can retain their character when paid out to the trust's beneficiaries (or unitholders).

For example, taxable dividends received by the trust from a Canadian resident corporation and paid out to its beneficiaries can be designated as such by the trust, and if so, they are treated as taxable dividends to the beneficiaries. Furthermore, the type of taxable dividend also flows through to the beneficiaries. Thus, if the dividend was an "eligible dividend", it will remain as such to the beneficiary, who will include it along with the usual 45% "gross-up" and will be eligible for the enhanced dividend tax credit applicable to eligible dividends. If the dividend was a non-eligible dividend, it will remain as such to the beneficiary, who will include it along with the 25% gross-up for such dividends and the beneficiary will be eligible for the applicable dividend tax credit. (Note that in either case the beneficiary must be an individual and resident in Canada to claim the credit.)

Taxable capital gains of a trust can also be flowed out to a beneficiary, as can the non-taxable one-half portion of the capital gains (i.e. one-half of capital gains are taxable capital gains and the other half are not taxable). Furthermore, if the taxable capital gains result from dispositions of property that qualify for the lifetime \$750,000 capital gains exemption (qualified small business corporation shares, qualified farm property, or qualified fishing property), the amounts will be eligible for the exemption in the

hands of the beneficiary, assuming he or she is a Canadian resident individual.

Other amounts that retain their character when paid out to beneficiaries include foreign income for the purposes of computing the beneficiaries' foreign tax credits, and certain types of pension income from a testamentary trust (one made under a will, including an estate).

If you are a beneficiary (or unitholder) of a trust and receive income from the trust as described above, the trust will issue you a T3 slip indicating the amount and type of income.

Note, however, that income of a trust paid to a non-resident beneficiary is simply treated as income from the trust, and is subject to withholding tax of 25% (trust income is generally not reduced by an income tax treaty). In other words, the flow-through rules discussed above do not apply. One exception relates to taxable capital gains of a mutual fund trust, which generally retain their character as taxable capital gains for the non-resident beneficiaries.

ALLOWABLE BUSINESS INVESTMENT LOSSES

An allowable business investment loss (ABIL) is one-half of a business investment loss, which is a capital loss that meets the criteria described below. Unlike regular capital losses, an ABIL can be deducted against all sources of income. (Regular allowable capital losses are normally deductible only against taxable capital gains.)

A business investment loss includes a capital loss realized on a disposition of a



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share in the capital stock of a “small business corporation”. The disposition must be to an arm’s length person, or be a “deemed disposition” under subsection 50(1) of the Act (described below). A small business corporation is a Canadian-controlled private corporation (CCPC), all or substantially all of the fair market value of the assets of which is attributable to assets that are:

- (a) used principally in an active business carried on primarily in Canada by the corporation or a related corporation;
- (b) shares or debt of a “connected” small business corporation (a connected corporation is generally one controlled by the CCPC or one in which the CCPC owns at least 10% of the voting shares and shares that reflect at least 10% of the total value of all the shares in the corporation); or
- (c) a combination of assets in (a) and (b).

A business investment loss also includes a capital loss resulting from the disposition of a debt obligation in a CCPC that is:

- (a) a small business corporation;
- (b) a bankrupt corporation that was a small business corporation at the time it became bankrupt; or
- (c) a corporation that is insolvent and in the process of being wound up.

For the purposes of the ABIL rules, a corporation will qualify as a small business corporation at the time of the disposition of the share or debt if the corporation was a small business corporation at any time within the 12 months preceding the disposition.

As noted, a business investment loss can also arise if you have a deemed disposition

of one of the above-noted types of shares or debt under subsection 50(1). In order for the deemed disposition to apply, you must make an election in your tax return and the following criteria must be met. In the case of a debt, the deemed disposition will apply if the debt is established to have become a bad debt in the year. The deemed disposition also applies to a share of a small business corporation if

- the corporation has during the year become a bankrupt; or
- the corporation is insolvent and in the process of being wound up in the year; or
- at the end of the year, the corporation is insolvent, does not carry on a business, the fair market value of the share is nil, and it is reasonable to expect that the corporation will be dissolved or wound up and will not commence to carry on business.

As noted, one-half of an investment business loss is an ABIL and is deductible against all sources of income. An unused ABIL may be carried back three years or forward ten years and deducted in computing your taxable income in those years. However, in the eleventh forward year, the unused ABIL, if any, becomes a net capital loss, at which point it is deductible only against taxable capital gains but subject to an indefinite carry-forward period.

Lastly, your business investment loss in a year will be reduced to the extent of your capital gains from a previous year, if any, that were sheltered by the capital gains exemption. The capital gains exemption, currently available in respect of \$750,000 of capital gains during your lifetime, applies to



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capital gains from the dispositions of qualified small business corporation shares (which are shares in small business corporations that meet conditions specified under the Income Tax Act), and certain qualified farm or fishing property.

AROUND THE COURTS

Attribution scheme shut down by Supreme Court

In the recent *Lipson* case, the Supreme Court of Canada applied the general anti-avoidance rule (GAAR) under the Income Tax Act to certain transactions of the taxpayer. The case involved the taxpayer and his wife who deliberately used the income attribution provisions under the Act to attribute interest expense and resulting losses from the taxpayer's wife to the taxpayer.

The facts of the case were as follows. The taxpayer's wife, Mrs. Lipson, took out a bank loan and used the proceeds to purchase shares in a family company from the taxpayer Mr. Lipson. The transfer of shares took place on a "rollover" basis, such that Mr. Lipson did not include any capital gain on the sale of the shares. Mr. Lipson used the sale proceeds to purchase a family home. The couple then borrowed money against a mortgage on the home and used the money to repay Mrs. Lipson's original bank loan. An interest deduction was claimed in respect of the interest payable on the mortgage loan on the grounds that the loan was effectively being used for the purpose of earning income from property (i.e. the shares). The interest deduction led to a loss in respect of the shares for Mrs. Lipson, namely, the interest expense on the mortgage loan in excess of the dividends

received on the shares, but owing to the apparent application of the attribution rules, the loss was attributed to Mr. Lipson, who reported the loss for income tax purposes. Mr. Lipson was in a higher tax bracket than Mrs. Lipson, so the transactions allowed the couple to reduce their overall tax payable.

The only issue in the case was whether the transactions resulted in an abuse or misuse of the provisions of the Act for the purposes of GAAR, and in particular, whether the interest deduction provisions or attribution provisions were abused or misused. The Supreme Court felt that the transactions did not abuse the interest deduction provisions on their own (such that debt can otherwise be re-arranged to obtain an interest deduction), but what they did resulted in an abuse of the attribution provisions. The Court noted that the purpose of those provisions was to prevent spouses from reducing their overall tax by transferring property between themselves. The transactions were contrary to that purpose, since they resulted in the attribution provisions applying to reduce tax (rather than preventing the reduction of tax). As the Court noted, "a specific anti-avoidance rule is being used to facilitate abusive tax avoidance". As such, the taxpayer's interest deduction was denied and it was attributed back to Mrs. Lipson.

Cost of new deck for rental property deductible

For income tax purposes, current expenses are normally deductible in full in the year in which they are incurred, whereas capital expenses are depreciated or amortized over time under specific provisions of the Act (assuming in both cases that the expenses are incurred for income-earning purposes).



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The distinction between current and capital expenses is based on the judge-made income tax laws. In general terms, an expense that provides a lasting or enduring advantage or value will be a capital expense, while an expense that has relatively short-term value will be a current expense.

However, for repair and maintenance costs, the courts have been somewhat more lenient in allowing current expense treatment. For example, they have generally allowed a current deduction for costs incurred to replace part of a property or to restore a property to its original condition, even if the replacement or restoration provides long-term value.

In the recent *Lewin* case, the taxpayer owned a residential rental property with a deck attached to the property. The deck was 20 years old and needed to be replaced. The taxpayer paid to have it replaced with a new deck. The new deck was much the same as the former deck was in its original condition, with a few minor differences – for example, the new deck had concrete steps and aluminum railings, whereas the original deck had wooden steps and railings.

The taxpayer argued that the cost of the deck was a current expense and therefore deductible in full in the year in which it was incurred. The CRA argued that it was a capital expense and should have been added to the capital cost of the building. The Tax Court of Canada agreed with the taxpayer and allowed the current deduction. The Court based its decision largely on the grounds that the new deck was substantially the same as the original deck in its original condition, and that the new deck did not

constitute a separate asset but was instead a relatively minor part of the rental building.

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Should you have any questions regarding the foregoing or other tax matters, please do not hesitate to contact members of our tax group at (403) 262-2116.

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This letter summarizes recent tax developments and tax planning opportunities. We recommend that you consult with an expert before embarking on any of the opportunities in this letter, which may not be appropriate to your own specific circumstances.