BUCHANAN BARRY LLP
CHARTERED ACCOUNTANTS

TAX NEWSLETTER

July 2016

- **DEDUCTING YOUR CAR EXPENSES**
- **EARNED INCOME FOR RRSP VS. CHILD CARE PURPOSES**
- **GAINS AND LOSSES FROM PERSONAL-USE PROPERTY**
- **TAX-FREE SAVINGS ACCOUNTS (TFSAs)**
- **AROUND THE COURTS**

DEDUCTING YOUR CAR EXPENSES

If you carry on a **business**, you can deduct car expenses incurred in the course of earning your business income.

In some cases, if you are an **employee** and are required under the terms of your employment contract to use your car for employment purposes, you can deduct your car expenses in computing your employment income. You must obtain Form T2200 from your employer, indicating that you meet the Income Tax Act's (Canada) requirements. You do not get a deduction if your employer reimburses you for the costs. Similarly, you do not get a deduction if your employer provides you with a tax-free car allowance.

In either case – whether you are carrying on business or employed − the car expenses that are normally deductible include the costs of gas, oil, insurance, licenses, repairs and maintenance, and car washes.

In terms of the cost of your car, tax depreciation or "capital cost allowance" ("CCA") is allowed at an annual rate of 30% on the declining balance. However, the CCA is subject to the one-half year rule in the year of acquisition, so only 15% is deductible in that year (so in the second year you can deduct 30% of the remaining 85%, and so on). Furthermore, the cost of the car that can be deducted is limited to $30,000 (plus any provincial retail sales tax, and GST/HST for employees or if you are not registered for GST/HST purposes). The limit is meant to prevent the deprecation of "expensive" cars, even though the limit has not changed since 2001 and is not reflective of an expensive car.

If you have a car loan (taken out to buy the car, not one you take after you already own the car), you can deduct interest on the loan, but it is limited to $300 per 30-day period in the year (roughly $300 per month).

If you lease your car, the lease costs are deductible but they are also restricted in some cases, and limited to the lesser of two amounts. The first amount is $800 (plus GST/ HST and provincial sales tax, if applicable) per 30-day period of the lease. The formula for the second amount is rather complex, but suffice to say it can reduce your deduction if the manufacturer's list price of the car exceeds $35,294 (plus the GST/HST (where you cannot recover it as a GST registrant) and any applicable provincial sales tax).

In each case, you can deduct only your business or employment use of the car, and obviously not the personal use of the car. The Canada Revenue Agency ("CRA") accepts a calculation based on:

(total car expenses for the year) x (business or work kilometres / total kilometres)

For these purposes, driving from home to work and back is considered personal driving and not employment or business driving. You

should keep records of your work and total travel.

Logbook acceptable for business

You can use a detailed logbook tracking your actual work and total kilometres travelled throughout the year. However, if you carry on business, the CRA allows a simplified method based on a 3-month sample logbook. In order to use this simplified method you must first complete one full year of a logbook of business travel to establish a "base year", which will be relevant for subsequent years. After the base year, you can use a three-month sample logbook in any subsequent year and use that sample to determine the year's business travel under the method illustrated below, as long as the usage is within 10% of the results of the base year.

The CRA provides the following example to illustrate the simplified method:

Example

An individual has completed a logbook for a full 12-month period, which showed a business use percentage in each quarter of 52/46/39/67 and an annual business use of the vehicle as 49%. In a subsequent year, a logbook was maintained for a three-month sample period during April, May and June, which showed the business use as 51%. In the base year, the percentage of business use of the vehicle for the months April, May and June was 46%. The business use of the vehicle would be calculated as follows:

(51% ÷ 46%) × 49% = 54%

In this case, the CRA would accept, in the absence of contradictory evidence, the calculated annual business use of the vehicle for the subsequent year as 54%.

EARNED INCOME FOR RRSP VS. CHILD CARE PURPOSES

The term "earned income" can mean different things for income tax purposes. For individuals, the definition is important for at least two different issues, as noted below.
First, it is relevant for the purposes of determining your deduction room for a taxation year for contributions to your registered retirement savings plan ("RRSP"). Second, a different definition of "earned income" is relevant for the purpose of determining your deductible child care expenses.

RRSP

For RRSP purposes, one of the main components in computing your deductible contribution room for a taxation year is the lesser of your "earned income" for the previous year and 18% of the dollar amount for the current year (the dollar amount is $25,370 for 2016). Thus, for example, if you had no earned income in 2015, you will have zero new contribution room for 2016.

A person's earned income for RRSP purposes includes the following:

- Net income from employment,
- Net income from business, whether alone or through a partnership,
- Net rental income from real property,
- Royalties in respect of a work or invention of which the person was the author or inventor,
- Spousal support payments received,
- Net research grants, and

- A disability pension under the Canada Pension Plan ("CPP") or similar provincial plan,
- *Minus* the total of:
  - Loss from a business,
  - Loss from a rental real property, and
  - Spousal support payments paid.

Child Care Expenses

For child care expense purposes, the maximum amount of deductible expenses is generally limited to the lesser of 2/3rds of your earned income for the year and a fixed annual dollar amount per child ($8,000 under the age of 7, $5,000 if 7 to 16, and $11,000 per child eligible for the disability tax credit).

Usually the lower-income parent must claim the deduction based on that parent's earned income. (In some cases, the higher-income spouse can claim a limited deduction, such as where the lower-income parent is attending school, is physically or mentally infirm, or in prison.)

For child care expenses purposes, the definition of "earned income" is narrower than for RRSP contributions, and includes:

- Employment income and benefits before any deductible expenses,
- Net income from business,
- Net research grants,
- Employment insurance benefits, and
- A disability pension under the CPP or similar provincial plan.

Because of the earned income limitation, a married (or common-law) couple with one spouse who stays at home to care for the children and with no earned income cannot deduct child care expenses (except for the situation described above where the lower income spouse is in school, prison, or physically or mentally infirm).

GAINS AND LOSSES FROM PERSONAL-USE PROPERTY

As a general rule, dispositions of "capital property" give rise to a capital gain or a capital loss. One-half of a capital gain is included in income as a "taxable capital gain". One-half of a capital loss is an "allowable capital loss", which serves to offset taxable capital gains but normally does not offset other sources of income.

The rules are somewhat different for dispositions of personal-use property ("PUP"), at least with respect to losses. In general terms, PUP is defined as property that is used by you primarily for personal purposes rather than income-earning purposes. It can include property such as your home, furniture and appliances, your car, and so on.

Losses from PUP

Except for "listed personal property" (described below), any losses on the disposition of PUP are deemed to be zero. In other words, there is no capital loss allowed on the disposition of PUP. Therefore, for example, if you hold a yard sale and sell personal items such as furniture, clothing, toys, or bicycles at a loss, you cannot claim the loss for income tax purposes.

On the other hand, one-half of gains from the disposition from PUP are included in your income as taxable capital gains from PUP.

The only losses that can be claimed, and only against taxable capital gains from "listed personal property" ("LPP"), are one-half of losses sustained from the disposition of LPP, which consists of the following:

- Artwork,
- Rare books or folios,
- Jewelry,
- Stamps, and
- Coins.

If your losses from LPP in a year exceed your gains from LPP in a year, half of the excess losses can be carried back up to three years or forward seven years, but only to offset taxable capital gains from LPP in those years. Otherwise, the losses cannot be used for income tax purposes.

Minimum cost and proceeds

A special rule provides that any PUP that you sell is deemed to have a minimum cost of $1,000 and minimum proceeds of disposition of $1,000. This rule is meant to simplify record-keeping and tax reporting in respect of relatively nominal gains and losses.

Example

During this year, John sold a painting for $1,500. His cost of the painting was $800.

He also sold a sculpture for $800. His cost of the sculpture was $1,100.

Lastly, he sold his dining room table for $900. His cost of the table was $2,000.

His gain from the painting will be $500, (that is, $1,500 minus the minimum cost of $1,000), and his loss from the sculpture will be $100 (that is, $1,000 minus $1,100). Half of his $400 net gain from the properties, or $200, will be included in his income.

The loss from the dining room table is denied because it is not "listed personal property".

TAX-FREE SAVINGS ACCOUNTS (TFSAs)

A TFSA is a type of deferred income plan. Any income earned in the TFSA is completely exempt from tax. Withdrawals from the TFSA are completely exempt from tax. However, unlike RRSPs, you do not get a tax deduction for contributions into the plan.

The TFSA funds can be withdrawn at any time and for any purpose. They are not specifically targeted towards funding retirement or any other life event. Simply put, they allow you to earn tax-free investment income for any purpose.

Like other deferred income plans, there are monetary limits for contributions. The TFSA rules began in 2009, when the annual limit was $5,000. The limit is increased by inflation but in $500 increments only. Therefore, the annual limits are

- $5,000 for 2009 through 2012;
- $5,500 for 2013 and 2014;

BUCHANAN BARRY LLP
CHARTERED ACCOUNTANTS

- $10,000 for 2015 (the Conservative government implemented this increase); and

- $5,500 for 2016 and indexed thereafter (the new Liberal government overturned the previous increase, but did not change the figure for 2015).

Any unused contribution room carries forward indefinitely. For example, if you have not yet made any contributions, you will have a total contribution room of $46,500 in 2016, provided you were born before 1992 so that you were at least 18 during 2009.

In addition, when you withdraw funds, the amount of the withdrawal adds to your contribution room beginning with **the year following** the year of withdrawal. This rule allows you to take out funds temporarily and add them back later without detrimental tax consequences. But make sure you do not try to use the extra contribution room sooner than the next January 1, or you could be hit with penalties!

Example

You have contributed the maximum amount of $46,500 to your TFSA. In September 2016, you withdraw $12,000. Beginning January 2017, your contribution room will be $17,500: the regular $5,500 annual limit plus the amount of the 2016 withdrawal.

The TFSA is available for all Canadian resident individuals 18 years of age or older.

Since there is no income inclusion upon the withdrawal of funds from a TFSA, the income attribution rules do not apply. Therefore, for example, you can give funds to your spouse for his or her TFSA and the investment income earned in the TFSA will not be subject to attribution in your hands. However, if your spouse withdraws the funds from the TFSA, attribution may apply to later earnings on those funds.

TFSA vs. RRSP?

One question that often arises is whether you should contribute to your RRSP or TFSA. Of course, if you have sufficient income and funds, you should try to contribute the maximum amount to both.

But what if you have to choose between the two? As a rule of thumb, the two plans will give you the same result if your tax rate is the same in the year of contribution as in the year of withdrawal.

Example

This year you are in a 40% tax bracket. You contribute $100 of your income to your RRSP, which, because of the tax deduction and $40 savings in tax, costs you the net amount of $60. Assume the $100 grows ten-fold to $1,000 several years later when you withdraw the amount. If you are in the same 40% tax bracket, you will net $600 ($600 net of $400 tax upon the RRSP withdrawal)

If instead you invest the net amount of $60 in your TFSA (i.e. $100 of your income net of $40 tax paid on that income) and it grows ten-fold to $600 upon withdrawal, you will have the same result as with the RRSP.

It is thus apparent that if you are in a lower tax bracket in the withdrawal year relative to the contribution year, you will come out ahead with an RRSP as compared to a TFSA. Conversely, if your tax bracket is higher in the withdrawal year than in the

contribution year, you are better off with a TFSA.

Of course, we typically will not know our future tax rates. If you do not have a good idea of your future tax rates, you might contribute equally to both an RRSP and a TFSA. And, as mentioned, if you can afford to max out both contributions you should do so.

Lastly, in terms of your tax rate in the year of an RRSP withdrawal, if you plan to withdraw funds when you are 65 years or older, you should consider how the resulting income inclusion will affect items like your age credit, which is phased out starting with income over $35,927 (2016 figure, indexed for inflation), or your Old Age Security, which is effectively clawed back and phased out once your income is over $73,756 (2016 amount). These items can make your effective tax rate upon withdrawal significantly higher than the apparent income tax rate. On the other hand, since withdrawals from a TFSA are not included in income, these items are not affected by TFSA withdrawals. Depending on your situation and how you will be affected by these items, the decision may tilt a little more towards the TFSA contribution.

AROUND THE COURTS

Foreign property reporting required even if no tax return

A Canadian resident person is required to file CRA Form T1135 for each taxation year in which the person owns foreign investment property with a total cost of over $100,000 at any time during the year. The requirement does not extend to personal property such as a foreign home that is not used for income-earning purposes.

Interestingly, and as confirmed in the recent *Samson and Hillard* case, the filing requirement applies even if you are not required to file an income tax return for the year (say, because you do not owe any tax for the year). The taxpayers in that case were a husband and wife who each owned foreign investment property over the $100,000 threshold in the four taxation years at issue. They were not required to file income tax returns for those years owing to significant loss carryovers from their foreign and Canadian rental properties. Nonetheless, the Tax Court of Canada held that the T1135 filing requirement applied, and the penalties assessed by the CRA to the taxpayers for the failure to file was upheld.

The taxpayers argued that a “due diligence” exception should apply in their case because they were reasonable in their belief that the T1135 filing was not required because they were not required to file income tax returns. The Tax Court did not allow the exception. Basically, the Tax Court found that the taxpayers were relatively sophisticated investors who had significant dealings with income tax matters in the past, including correspondence from the CRA that indicated the filing requirement. Their appeal was dismissed.

Calculation of stock option benefit with US company shares

Under the employee stock option rules, an employment benefit arises when you exercise the option and acquire the underlying shares. Generally, the benefit equals the amount by which the value of the shares when you acquire them exceeds the amount paid by you to acquire them (the “exercise price” under the option). In many cases, you can deduct one-half of the benefit in computing your taxable income (so that

BUCHANAN BARRY LLP
CHARTERED ACCOUNTANTS

the benefit is effectively taxed at the same rate as a capital gain). The benefit is normally included in income in the year of exercise (or in the year in which you sell the shares if they are shares in a “Canadian-controlled private corporation”).

In the recent *Ferlaino* case, the taxpayer was an employee of a Canadian subsidiary of a US parent corporation. The US parent granted him some stock options, which he subsequently exercised. Since the shares were denominated in US dollars, he had to convert the relevant amounts to Canadian dollars to report the benefit on his Canadian tax return.

The taxpayer computed the Canadian dollar value of the shares at the time he acquired them using the Canada-US exchange rate in effect at that time. The CRA agreed that this was appropriate. However, the taxpayer computed his Canadian cost of acquiring the shares using the Canada-US exchange rate in effect at the time the option was granted. The CRA re-assessed the taxpayer, arguing that the appropriate method was to use the exchange rate in effect at the time the taxpayer acquired the shares (which resulted in a greater stock option benefit).

On appeal, the Tax Court of Canada sided with the CRA. The Court reviewed the relevant rules in the Income Tax Act (Canada) and concluded that the exchange rate in effect at the time the shares were acquired was the correct rate.

* * * * *

Buchanan Barry LLP has served the Calgary business and non-profit community since 1960. We are a full-service chartered accounting firm providing accounting, audit, assurance, advisory, tax and valuation services to clients in the oil and gas sector, the service industry, real estate, the retail and wholesale trade, the manufacturing industry, agriculture, the non-profit sector and professionals.

If you have any questions regarding the foregoing or other tax matters, please contact our tax group at (403) 262-2116.

Buchanan Barry LLP
Chartered Accountants
800, 840 – 6th Avenue SW
Calgary, Alberta T2P 3E5

Tel (403) 262-2116
Fax (403) 265-0845
www.buchananbarry.ca

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.