BUCHANAN BARRY LLP
CHARTERED ACCOUNTANTS

TAX NEWSLETTER

July 2017

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EMPLOYER-PROVIDED CARS AND TAXABLE BENEFITS

If your employer provides you with a car, there are two potential taxable benefits that will be included in your income to reflect your personal use of the car. These benefits are added to your employment income and are fully taxable.

On the other hand, any employment use of the car should not be a taxable benefit for you since it does not benefit you personally.

The rules in the Income Tax Act use formulas to attempt to carve out your personal-use portion and benefit (taxable) from the employment-use portion (non-taxable). The formulas are used for the two main benefits: the standby charge, and the operating expense benefit.

For these purposes, driving from home to your employer's place of work and back is considered personal use of your car, but driving to another location such as a client location is not.

Standby charge

The standby charge is intended to reflect the value of having a car provided to you. Since this value is difficult to ascertain on a factual case-by-case basis, there is a formula to calculate the benefit.

The formula differs depending on whether the employer owns or leases the car.
If the employer *leases* the car, your taxable benefit for the year will be calculated as follows.

You begin with 2/3 of the employer' leasing costs (including GST/HST) for the time during the year that the car was provided to you (amount E in the formula).

Amount E is then reduced by a "reduction factor" **but only if** your work use of the car exceeds your personal use of the car for the year, **and** your personal kilometres driven are less than 1,667 per 30-day period in which you have the car available to you. If you meet these criteria, amount E is multiplied by the reduction factor A/B, where A is your personal kilometres driven during the year, and B is 1,667 per 30-day period. (If you have the car available for the entire year, B is 20,004.)

> *Example:*
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> Your employer provides you with a car for the entire year. The employer's lease cost for the year including GST/HST is $10,000. During the year, you drive 10,000 km personal and 15,000 km employment.
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> Your work kilometres driven exceed your personal kilometres, and your personal kilometres are less than 20,004. Therefore, your meet the "reduction factor" criteria discussed above, and your standby

charge benefit will equal E x A/B, which is (2/3 x $10,000) x 10,000/20,004 = $3,333 (approx.).

If you pay your employer any amount in the year for the use of the car (this will be rare), such amount reduces your standby charge accordingly. For example, if you paid your employer $1,000 in the year in the above example, your standby charge would be reduced to $2,333.

If your employer *owns* the car, the formula for the standby charge is different. In such case, the benefit is calculated using the formula 2% x C x D, where C is the employer's cost of the car including GST/HST and D is the number of 30-day periods (rounded to the nearest whole number) in which the car is available for your use. If you meet the reduction factor criteria discussed above, the benefit is reduced by multiplying this amount by A/B as noted above.

Operating cost charge

If your employer pays *any* of your personal-use car expenses such as gas, maintenance, insurance or licence fees, the operating cost charge will apply.

This taxable benefit is calculated using the annual prescribed amount for each personal kilometre in the year. For 2017, the amount is 25 cents per personal kilometre (22 cents for employees employed in selling or leasing automobiles).

However, if your work kilometres for the year exceed your personal kilometers for the year, you have the option of computing your operating cost charge using one-half of your standby charge. Obviously, you would make this election if it turned out to be less than the per-kilometre amount. If you wish to use this option, you must notify your employer in writing before the end of the year.

If you repay any of the expenses in the year or by February 15 of the next year, your repayment reduces the benefit. If you repay *all* of the expenses, there will be no taxable benefit.

Example:

During the year, your employer paid $2,000 of your personal-use car costs. However, since you drove 10,000 personal kilometres in 2017, the taxable benefit to you is 25 cents x 10,000, or $2,500 (before any repayment).

If you repay the $2,000 in the year or by February 15, 2018, there will be no taxable operating cost benefit.

CAPITAL DIVIDENDS

Capital dividends are a delightful thing to receive. They are completely tax-free. Generally speaking, a private corporation can pay a capital dividend out of its "capital dividend account". Public corporations and non-resident corporations cannot pay capital dividends.

The corporation paying the capital dividend must make an election on Form T2054 and file it with the Canada Revenue Agency (CRA) no later than when the dividend becomes payable. A late-filed election can be made, but with a late filing penalty which is generally $500 per year or 1% of the dividend (whichever is lower), prorated for the number of months of lateness.

Capital dividend account

Typically the corporation will make the election to the extent of its capital dividend account immediately before the dividend is declared. This notional account includes certain items that are normally exempt from tax such as the non-taxable half of the corporation's realized capital gains (only half of capital gains are included in income as taxable capital gains). The capital dividend account therefore includes the following:

- One-half of the corporation's capital gains in excess of one-half of its capital losses; plus
- Life insurance proceeds where the corporation was the beneficiary of the life insurance; plus
- Capital dividends that the corporation has received from other corporations; minus
- Capital dividends that the corporation has previously paid.

Dividend in excess of capital dividend account

If the dividend paid by the corporation exceeds its capital dividend account at that time, but the corporation still files the above-noted election, the entire dividend is still tax-free to the shareholders. However, the corporation may be liable to a severe penalty tax of 60% of the excess, plus interest. And although the shareholders receive the dividend tax-free, they are jointly liable to pay their relative proportions of the corporation's penalty tax!

Alternatively, instead of paying the penalty tax, the corporation can make a further election that deems the excess amount to be a separate *taxable* dividend in the hands of the shareholders. In such case, the first portion of the dividend (to the extent of the capital dividend account) will be tax-free, but the excess separate dividend will be included in the shareholders' income. This further election is available only if all shareholders who were entitled to the dividend and whose address is known to the corporation provide their consent.

NEW FAMILY CAREGIVER CREDIT

Until recently, there were two different tax credits that applied in similar situations – the in-home caregiver credit and the infirm dependant credit.

You could claim the *in-home caregiver credit* if a related infirm dependent 18 years or older was dependent on you and lived with you. A credit was also allowed if your non-infirm parents or grandparents lived with you and were 65 or over.

You could claim the *infirm dependant credit* if a related infirm dependent 18 years or older was dependent on you. However, unlike the caregiver credit, the dependant was not required to live with you.

Both of these credits were discussed in detail in our April 2017 Tax Letter. Both credits were repealed by the 2017 Federal Budget and replaced with one new "Canada caregiver credit", applicable to 2017 and subsequent years.

The new Canada caregiver credit applies where you have a related dependant 18 years of age or older who is dependent on you by reason of mental or physical infirmity. The credit amount is the same amount as the former credits (increased in 2017 because of inflation indexing, as happens automatically every year). The credit uses the higher income threshold of the former in-home caregiver credit; the credit is phased out when the dependant's income exceeds $16,163 (2017 amount). Like the former infirm-dependant credit, this credit applies regardless of whether the dependant lives with you. However, unlike the former in-home credit, this credit does not apply in respect of non-infirm senior parents or grandparents.

ALLOWABLE BUSINESS INVESTMENT LOSSES (ABILS)

An allowable business investment loss (ABIL) is one-half of a business investment loss (BIL). The BIL is a capital loss incurred on dispositions of certain types of shares or debt. An ABIL is more useful in tax terms relative to a capital loss, in that it serves to offset all sources of income and not just capital gains. (Regular allowable capital losses normally only offset taxable capital gains.)

A BIL can arise on a disposition in the following circumstances:

It occurs on a loss on a disposition of a share or debt in a "Canadian-controlled private corporation" (CCPC) to an arm's length person. The CCPC must be

(i) a "small business corporation" (see below),
(ii) a bankrupt corporation that was a small business corporation at the time of bankruptcy, or
(iii) a corporation that was insolvent and in the process of being wound up and was a small business corporation at the time that a winding up order was issued.

Alternatively, the BIL can arise on the disposition of this type of share or debt when there is a "deemed disposition" of the debt or share for nil proceeds at the end of a taxation year. In general terms, a deemed disposition for nil proceeds (thus triggering the BIL) will occur in the following circumstances:

- You make an election in your tax return for the year.
- In the case of a debt, the debt must have become bad in the year, generally meaning it is uncollectible and you have taken formal steps to write if off in your financial records.
- For a share, one of the following must be met: either (i) the corporation becomes bankrupt during the year; (ii) the corporation is insolvent and a windup-up order has been made in the year; or (iii) at the end of the year, the corporation is insolvent, it 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.

A small business corporation is a CCPC where, at the time of disposition or any time in the preceding 12 months, all or substantially all of the corporation's assets (on a fair market value basis) were (a) used principally in an active business carried on primarily in Canada, (b) shares or debt in other small business corporations (generally, it must own more than 10% of shares representing votes and value in the other corporation), or (c) a combination of assets described in (a) and (b).

A CCPC is generally a Canadian private corporation that is not controlled by non-residents, public corporations, or a combination thereof.

An unused ABIL from one taxation year can be carried forward ten years to offset taxable capital gains plus all sources of income in those years. After the tenth future year, the

ABIL becomes a net capital loss, which can be used only to offset taxable capital gains in future years.

ABIL reduced by previous capital gains exemption

If you claimed the capital gains exemption in a previous taxation year, the amount of your BIL in the current year is reduced. Basically, the amount of the BIL is reduced on a dollar-for-dollar basis by the total capital gains previously sheltered by the capital gains exemption.

The reduced portion of the BIL remains an ordinary capital loss, so one-half of it becomes an allowable capital loss that can be used against taxable capital gains.

Example:

In 2016, you claimed the capital gains exemption on $50,000 of taxable capital gains / $100,000 capital gains. In 2017, you dispose of small business corporation shares and the resulting $120,000 capital loss meets the qualifications of a BIL.

The BIL is reduced by the $100,000 capital gains previously sheltered by the capital gains exemption, from $120,000 to $20,000. Therefore, your ABIL is $10,000 and this amount will offset all sources of income. The remaining $100,000 loss becomes an ordinary capital loss, and half of that, or $50,000, is an allowable capital loss that can only offset taxable capital gains.

CHARITABLE DONATIONS ON DEATH

The Income Tax Act provides a fairly generous income tax credit for donations to registered charities (as well as other “qualified donees” such as the federal and provincial government, many foreign universities and colleges, municipalities and others).

The federal credit is 15% of your first $200 of donations in the year, plus 29% of your donations above that amount. However, if your taxable income is higher than $202,800 (2017 year) so that you are paying 33% federal tax on the taxable income over that level, then you get a credit of 33% of your donation (over the first $200) to the extent of your taxable income over $202,800. For example, if your 2017 taxable income is $220,000 and you donate $2,000, $200 of the donation qualifies for the 15% credit and $1,800 qualifies for the 33% credit amount. On the other hand, if your taxable income is $120,000, the $1,800 portion qualifies for the 29% credit amount.

In addition, there is a provincial tax credit that varies widely by province. The combined credit for total donations over $200 is generally in the 40%-50% range.

On your death and for the year of death, there are special rules that apply. First, any donations you made in the year of death qualify for the credit in that year or the immediately preceding year.

Donations made in your will or by your estate (“testamentary donations”) are subject to different rules. Basically, they work as follows.

If the testamentary donation is made while your estate is a graduated rate estate (“GRE”) (during the first 36 months after death), the credit can be claimed in your return for the year of death or that of the immediately preceding year. Alternatively, the credit can be claimed by the estate in the year of donation, an earlier year of the estate, or carried forward and claimed up to 5 years later. Note that if the estate claims the credit, it is the estate's tax, and not the deceased's personal tax, that is reduced by the credit.

An estate can qualify as a GRE for up to 36 months after death, subject to certain conditions.

The above rules also apply if the donation is made within 60 months after your death, if your estate would qualify as a GRE but for the fact that more than 36 months have passed after your death.

In the above situations, the credit can be split amongst the different eligible years, but you cannot double up or otherwise multiply the credits.

> _Example:_
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> Your GRE estate makes a $100,000 donation in its second taxation year. It can claim the $100,000 amount in that year or its first taxation year, or carried forward up to 5 years. Alternatively, the $100,000 could be claimed in your return for the year of death or preceding year. Or, for example, the estate might claim $50,000 in its first taxation year and $50,000 could be claimed by you in the year of death, and so on.

Furthermore, for donations made by your estate at any time, your estate can alternatively claim the credit in the year of donation or its subsequent five taxation years.

Donations of publicly-traded securities, ecological property and cultural property

The donation of these properties trigger no capital gains tax, although the full fair market value of the property qualifies for the charitable credit. For example, if you donate shares listed on the Toronto Stock Exchange with a cost of $10,000 and fair market value of $100,000, you will report no taxable capital gain but the $100,000 value will qualify for the donation credit.

If this type of property is donated to a charity under your will or otherwise on your death, special rules ensure that the gain on the deemed disposition of the property upon your death is nil. (Normally, accrued capital gains are taxed on death.) The subsequent donation to the charity will also have a nil taxable capital gain.

AROUND THE COURTS

No capital loss upon losing former client base

In the _Martin_ case (2015 FCA 204), the taxpayer was a financial advisor and broker for several years. He was quite successful and established a large and loyal client base. However, his employment with his employer brokerage firm was terminated when the firm was taken over. The taxpayer was unable to become an independent financial advisor or to establish his own firm. As a result, his former clients did not continue business with him and instead stayed with his former firm.

Afterwards, the taxpayer’s financial position worsened to the point that he subsequently had to claim insolvency and lost many of his personal assets.

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For income tax purposes, the taxpayer made the interesting claim for a capital loss on the "disposition" of his client base. His position was that the client base was a valuable asset, which was "taken" from him by his former employer. He computed the loss, using an assumed cost base equal to the estimated present value of his lost future revenues, and nil proceeds of disposition. In addition, he increased the amount of the loss, claiming that his disposition costs included the value of his assets that were seized by creditors upon his insolvency. His total claimed loss was a whopping $14.8 million.

The CRA disallowed the entire loss. On appeal, the Tax Court confirmed the CRA position and also denied the loss. The Tax Court Judge held that the taxpayer did not own the client base, and therefore it was not his property to dispose of. In any event, since the taxpayer did not pay for the client base, it had a cost to him of zero, and it was not appropriate to estimate the cost using an estimated value.

The taxpayer appealed further to the Federal Court of Appeal. The three judges who heard the appeal upheld the Tax Court decision, and disallowed the taxpayer's loss.

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