[¶2373] Top-Up Disability Reimbursements

A deduction is provided to an individual who reimburses a top-up disability payment.[215] A top-up disability payment is a payment made to the individual by an employer or former employer to replace periodic disability payments that are not made to the individual because of the insolvency of an insurer, where the individual is required to reimburse the payment to the extent that he or she ultimately receives an amount from an insurer in respect of the disability payment.

[¶2375] Forfeited Amounts under a Salary Deferral Arrangement

A deduction is available where the right to receive benefits under a salary deferral arrangement has been forfeited in the year, provided that the forfeited amount has been included in computing income from employment.[216] The deductible amount is the amount by which the previous income inclusion exceeds the aggregate of:

(a) deferred amounts received in prior years;

(b) deferred amounts receivable in later years; and

(c) any forfeited amounts deducted under this rule in a previous year.

See also ¶2105.

[¶2380] Overseas Employment

Subject to the phase-out period described below, a tax credit is available to individuals resident in Canada working abroad for six or more consecutive months for a specified employer in connection with resource, construction, installation, agricultural, or engineering projects.[217] The amount of the credit will generally be equal to that portion of the employee's tax otherwise payable in the year that the lesser of:

(a) $80,000; and

(b) 80% of the employee's net overseas income taxable in Canada from that employment,

is of the employee's total income for the year. The effect of this formula is to provide a tax reduction in respect of a maximum of $100,000 of overseas employment income.

Beginning in 2013 the OETC is being gradually phased out over a three-year period so that it becomes completely eliminated after 2015. During the 2013–2015 phase-out period, the percentage applied to QFEI is reduced from 80% to 60% in 2013, 40% in 2014, and 20% in 2015. As a result, the maximum QFEI for those years is reduced from $100,000 to $60,000, $40,000, and $20,000, respectively.

See page ii for explanation of footnotes.

[215] CCH ¶3130aa; Sec. 8(1)(n.1).
[216] CCH ¶3131; Sec. 8(1)(o).
[217] CCH ¶19,320; Sec. 122.3.

The phase-out for the 2013–2015 taxation years does not apply to an individual's QFEI that is earned in connection with a contract that was committed to in writing before March 29, 2012. For example, if an employer has tendered an irrevocable bid in writing for a project before March 29, 2012, the employer will be considered to have committed in writing to the project irrespective of whether the bid has been accepted before March 29, 2012. In this case, the factor applied to an employee's QFEI in determining the employee's OETC will remain 80% for the 2013–2015 taxation years.

Beginning in 2016, the OETC is eliminated in all cases.

[¶2385] Musical Instruments

A deduction is available for taxpayers who are employed as musicians and who are required, as a condition of their employment, to provide their own musical instruments.[218] Deductible expenditures include costs of maintenance, insurance, and rental during the period or periods of employment. Capital cost allowance may be claimed in addition to these expenses, at a rate of 20% on a declining balance basis. The total amount deductible may not exceed the taxpayer's income from the year from employment as a musician.

In some cases, a Canadian resident individual, otherwise considered an employee of a non-resident employer, would incorporate a Canadian resident company to employ the individual and then contract out the services to the non- resident in order to take advantage of the credit. The credit will be denied in circumstances where the employer and the individual are not dealing at arm's length and the employer does not employ more than five full-time employees in the business.[219]

[¶2387] Artists' Expenses

A deduction is provided for employed artists in respect of actual expenses paid for the purpose of earning employment income from qualifying artistic activities.[220] The deduction is limited to the lesser of:

(a) $1,000; and

(b) 20% of the taxpayer's income as an employee from artistic activity.

The maximum amount deductible will be reduced by amounts deductible as motor vehicle and aircraft costs and in respect of musical instruments.

Any expenses paid in the year to earn employment income from qualifying artistic activities that are not deductible for the year because they exceed the above limit, and that are also not deductible under any other provision of the Act, are carried forward to the immediately subsequent year. In the subsequent year, the expenses carried forward plus any new

See page ii for explanation of footnotes.

[218] CCH ¶3140; Sec. 8(1)(p).
[219] CCH ¶19,320a; Sec. 122.3(1.1).
[220] CCH ¶3143; Sec. 8(1)(q); Interp. Bul. IT-525R.

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[¶2590] Transfer of Farm or Fishing Property to Child

In general, a taxpayer is permitted to pass a family farm or fishing property, including an interest in a family farm or fishing partnership, to his or her children on death without the consequences of a deemed realization (see ¶2555), if the following conditions are met:[344]

(1) The deceased taxpayer owned land in Canada or depreciable property in Canada of a prescribed class.

(2) Before the taxpayer's death, the property in question was used principally in a fishing or farming business in which the taxpayer, the taxpayer's spouse or common-law partner, or a child or a parent of the taxpayer was actively engaged on a regular and continuous basis. A child of a taxpayer includes a grandchild or great-grandchild and a person who, when under the age of 19, was wholly dependent on and in the custody and control of the taxpayer.[345] In the case of property used in the operation of a woodlot, the "actively engaged" and "regular and continuous" requirements are not necessary; it is sufficient that the relevant person (the taxpayer, the taxpayer's spouse or common-law partner, etc.) be engaged "to the extent required by a prescribed forest management plan". A prescribed forest management plan is a plan of the taxpayer that provides for the necessary attention to a woodlot's growth, health, quality, and composition. It should be noted that property owned by a taxpayer which is used by a family farm or fishing corporation or a family farm or fishing partnership is deemed to be used by the taxpayer in the farming or fishing business.[346]

(3) On or after the taxpayer's death, the property in question was transferred or distributed to a child of the taxpayer as a consequence of his or her death.

(4) The particular child was resident in Canada immediately before the taxpayer's death.

(5) Within 36 months of death, the property becomes indefeasibly vested in the child. The vesting period can be extended where the legal representative applies in writing to the Minister within the 36-month period and the Minister considers that a longer period is reasonable in the circumstances.

Under the current rules, if the deceased individual carried on the farming or fishing business, the property must have been used "principally" in either the farming or fishing business, as the case may be (but not a combination of both). "Principally" generally means 50% or more. If the property was a share in a family farm or fishing corporation or an interest in a family farm or fishing partnership, all or substantially all of the fair market value of the property owned by the corporation or partnership must have

See page ii for explanation of footnotes.

[344] CCH ¶9283, ¶29,332; Sec. 70(9); ITAR 26(18); Interp. Bul. IT-349R3.
[345] CCH ¶9295; Sec. 70(10) "child".
[346] CCH ¶9294; Sec. 70(9.8).

been attributable to assets used principally in a farming or fishing business, as the case may be.[347] "All or substantially all" is interpreted by the CRA to mean 90% or more.

The 2014 Budget proposes to clarify these rules such that property used principally in a combination of farming and fishing will be deemed to be used principally in a farming business and a fishing business.[348] Accordingly, if a property is used 40% of the time for farming and 35% of the time for fishing, the new rules will provide that the property qualifies for the used principally requirement and thus can be eligible for the tax-deferred rollover. This change has not yet been enacted.

The rollover to a child from a spousal or partner trust applies if:

(1) the deceased owned land in Canada or depreciable property in Canada of a prescribed class;

(2) the land or property has been placed in an *inter vivos* or testamentary spousal or partner trust;

(3) immediately prior to the spouse's or common-law partner's death, the property in question, or a replacement property on which the taxpayer has made an election under the provisions discussed at ¶5355, was used in the farming or fishing business;

(4) on the death of the spouse or common-law partner and as a consequence of that death, the property was transferred or distributed to a child of the taxpayer and within 36 months of death (or such longer period as allowed by the Minister), the property became indefeasibly vested in the child; and

(5) the child was resident in Canada immediately before the spouse's or common-law partner's death.[349]

If these conditions are met, a rollover is allowed on the death of a spouse or common-law partner unless an election is made to obtain only a partial rollover. The original transfer to the spouse or common-law partner would also be made on a tax-free rollover basis.

For *inter vivos* transfer of farming and fishing property to a child, see ¶2545. The re-transfer of property to a parent on the death of a child is discussed at ¶2600.

See page ii for explanation of footnotes.

[347] Sec. 70(9.2).
[348] Sec. 248(29).
[349] CCH ¶9284; Sec. 70(9.1).

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Where a taxpayer ceases to carry on a business, borrowed funds used for business purposes before the cessation are deemed to continue to be used in the business. The interest on the borrowed funds continues to be eligible for deduction. The amount of the borrowed funds is reduced to the extent that the funds are traceable to property that was used in the business and which has been disposed of by the taxpayer.

[¶3297] Capitalized Interest

A taxpayer who has acquired depreciable property in a particular taxation year may elect to capitalize any borrowing expenses, including annual financing fees, referable to that property to which the taxpayer would ordinarily be entitled to a deduction for that year.[262]

Where the taxpayer so elects, he or she may not claim a deduction for the year in respect of the borrowing expenses specified in the election. Instead, the expenses otherwise deductible are added to the taxpayer's capital cost of the property. An election will not be allowed, however, where the provisions respecting construction period soft costs (see ¶3249) would require that the interest be added to the capital cost of depreciable property. Where an election is made in respect of the year in which the property is acquired, any borrowing expenses referable to that property for the preceding three years may also be capitalized. For example, if the taxpayer was having a plant constructed over several years, he or she might incur standby fees in the early years which could then be capitalized when the plant became the property of the taxpayer.

The Minister is required to reassess the preceding three years to give effect to an election in respect of them.[263] A taxpayer who incurs exploration or development expenses or acquires a resource property in a particular taxation year is permitted to capitalize his or her applicable borrowing expenses otherwise deductible for that year.[264] To the extent that expenses are capitalized, they are treated as Canadian exploration and development expenses, foreign exploration and development expenses, Canadian exploration expenses, Canadian development expenses, or Canadian oil and gas property expenses, or foreign resources expenses (FRE) in respect of a country, as the case may be, and are deductible.[265]

The above elections apply only to the taxation year in which a depreciable property is acquired, or exploration or development expenses are incurred, or a resource property is acquired, and to the preceding three years. If the taxpayer wishes to capitalize borrowing expenses referable to a later year, the taxpayer must make a separate election.[266] It should be

See page ii for explanation of footnotes.

[262] CCH ¶5146; Sec. 21.
[263] CCH ¶5150; Sec. 21(5).
[264] CCH ¶5147; Sec. 21(2).
[265] CCH ¶8900 - ¶9079, ¶9083; Sec. 66 - 66.2, 66.4.
[266] CCH ¶5148, ¶5149; Sec. 21(3), 21(4).

noted that the taxpayer must elect in respect of each successive year after the property is acquired or the exploration or development expenses are incurred in order to be entitled to elect for further years. While an election may be made with respect to all or any portion of the borrowing expenses of the year to which the election relates, an election on a portion only precludes any election in a subsequent year.

A taxpayer may make an election by simply stating so in the return of income for the year.

[¶3300] Limitation on Interest on Borrowed Money

A taxpayer is prohibited from deducting financing charges on funds borrowed or property acquired for the "purpose" of contributing or making payments to certain deferred or partially deferred income plans.[267] If indebtedness is incurred in respect of a property, and the property or a substituted property is then used for the purpose of making such a contribution or payment, the indebtedness is deemed to have been incurred at that time for that purpose. Thus, the limitation on financing charges cannot be circumvented by incurring indebtedness upon the purchase of a property, using the property for one purpose, and subsequently contributing the property (or the proceeds therefrom) to the deferred income plan.

The financing charges that are not deductible are those on funds borrowed or property acquired in order to:

(a) make a payment for an income-averaging annuity contract (with certain exceptions);

(b) pay a premium on an RRSP, (including any contributions which are repayments of amounts withdrawn under the Home Buyers' Plan — see ¶10,393 *et seq.*);

(c) make a contribution to a registered pension plan or deferred profit sharing plan;

(d) purchase an annuity if the purchase price is deductible (see commentary below);

(e) make an employee contribution to a retirement compensation arrangement, where the contribution is deductible;

(f) make a contribution to a net income stabilization account;

(g) make a contribution to an account under a prescribed provincial pension (currently, the *Saskatchewan Pension Plan* is so prescribed);

See page ii for explanation of footnotes.

[267] CCH ¶4876; Sec. 18(11).

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Any depreciable property acquired by a corporation or a partnership of which the corporation is a majority interest partner in the 12 months preceding the acquisition of control of the corporation will be deemed not to have been acquired at that time, but rather to have been acquired immediately after the acquisition of control.[22] Accordingly, capital cost allowance will not be available for the taxation year that ends immediately prior to the acquisition of control. This restriction will not apply if the property was used or was acquired for use in a business that was carried on by the corporation 12 months prior to the acquisition of control or if it was owned by the corporation or an affiliated person for the period beginning 12 months prior to the acquisition of control and ending upon the acquisition of the property by the corporation.

If a taxpayer becomes resident in Canada, the taxpayer is deemed to dispose of any property at its fair market value just before becoming a Canadian resident and to reacquire it right after.[23] As a result, the capital cost of depreciable property owned by a taxpayer who becomes a Canadian resident is the fair market value of the property at the time the taxpayer becomes resident in Canada. This will not apply to assets already being used in a business in Canada and already subject to Canadian CCA rules.

[¶4012] Grants, Subsidies, and Other Incentives

Where a taxpayer receives (or is entitled to receive) government assistance in the form of a grant, subsidy, or other incentive from a government or a government agency to buy depreciable property, the amount of the grant, subsidy, or other incentive is subtracted from the property's capital cost.[24] The government assistance may be received from federal or provincial governments, municipalities, or other public bodies performing a governmental function in Canada. It may be in the form of a grant, subsidy, forgivable loan, deduction from tax, investment allowance, or any other form. An input tax credit or rebate for the GST or HST paid on depreciable property acquired for use in a proportion of at least 90% in the course of business activities is deemed to be government assistance,[25] as is the investment tax credit. The investment tax credit reduces the capital cost of the asset in the year after it is deducted by the taxpayer. For instance, an investment tax credit claimed or received in Year 1 will be subtracted from the undepreciated capital cost (UCC) of the class the property belongs to at the start of Year 2 and, if there is no property left in the class, the amount is included in income in Year 2. Other forms of government assistance reduce the capital cost in the year the taxpayer receives or is entitled to receive them.

See page ii for explanation of footnotes.

[22] CCH ¶4582, ¶4583; Sec. 13(24), 13(25).

[23] CCH ¶20,025b; Sec. 128.1(1)(b).

[24] CCH ¶4535; Sec. 13(7.1); Interp. Bul. IT-273R2.

[25] CCH ¶28,329l; Sec. 248(16).

Receipts of government or non-government assistance in respect of scientific research and experimental development (SR&ED) expenses are not treated as government assistance.[26] As well, grants received under a prescribed program of the federal government, and which are included in income, are not treated as government assistance. The Canadian Home Insulation Program and the Canada Oil Substitution Program are prescribed programs.[27] Depletion allowance can be earned in some cases by acquiring depreciable property (e.g., mining machinery). Depletion allowance is not, however, regarded as government assistance for purposes of determining the capital cost of the depreciable property.[28] Amounts received by the taxpayer as contributions towards the relocation of its natural gas pipelines from government corporations, as well as the private sector, were not government assistance so did not reduce the taxpayer's capital cost of the pipelines.[29]

Where a taxpayer receives any particular amount as an inducement, contribution, refund, reimbursement, or allowance in respect of the acquisition of an asset or otherwise in the course of earning income (to the extent that the amount has not otherwise been included in income or resulted in an assessment that reflected a reduction in the cost of a property or the amount of an outlay or expense), the amount must be included in income.[30] Alternatively, rather than including the inducement or other such amount relating to the acquisition of a depreciable asset in income, the taxpayer may elect to reduce the capital cost of the asset acquired in the year that the inducement was received or in any of the three immediately preceding years or the following year.[31] The taxpayer must file the election on or before the day that the taxpayer is required to file his or her tax return for the year during which the inducement was received or the following year if the property was acquired in the following year. The elected amount by which the capital cost of the depreciable property can be reduced cannot exceed the least of:

(a) the amount received by the taxpayer;

(b) the capital cost of the property as otherwise determined; and

(c) nil, where the taxpayer has disposed of the property before the year.

An increase in the capital cost of the property is provided in the event that a taxpayer repays all or a portion of the inducement in respect of which the taxpayer previously elected to reduce the capital cost of the property. The addition to the taxpayer's cost can only be made if the taxpayer owns the property at the time of payment. See ¶4387 for treatment of a repayment that occurs after the disposition of the property. See item (13), "*Grants, subsidies, etc.*", and item (21), "*Inducement payments*", at ¶5185 concerning

See page ii for explanation of footnotes.

[26] CCH ¶4535, ¶5900; Sec. 13(7.1), 37(1)(d).

[27] CCH ¶8070, ¶8072, ¶8073; Sec. 56(1)(s); Reg. 5500, Reg. 5501.

[28] CCH ¶4535, ¶8800; Sec. 13(7.1), 65.

[29] The Consumers' Gas Co. Ltd., 84 DTC 6058; The Consumers' Gas Company Ltd., 87 DTC 5008.

[30] CCH ¶4376c; Sec. 12(1)(x).

[31] CCH ¶4536; Sec. 13(7.4).

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applying to capital property (e.g., the "half-year rule") would apply equally to this new class.

In determining the expenses that qualify for this new class of property, special rules will be introduced in respect of goodwill and other expenditures (and receipts) that would otherwise be ECP under the existing regime but do not relate to a specified property. Every business will be considered to have goodwill, even if the goodwill has not been acquired. An expenditure not related to specific property would increase the capital cost of goodwill, while receipts would reduce it. Receipts in excess of existing goodwill would be treated as capital gains.

These changes could have a significant impact on taxpayers who hold significant business value in intangibles, such as farmers' quota, for example.

Although ostensibly presented as "consultations", Budget 2014 indicates that the government will be releasing draft legislation for public comment in the near future to effect this change.

[¶5002] How Capital Gains and Losses Are Taxed

A taxpayer includes in income the excess of all taxable capital gains other than from listed personal property (¶5310) plus the net gain from listed personal property minus allowable capital losses other than listed personal property losses and allowable business investment losses.[5] This excess is not taxable at any special rate or by a special computation, but is merely added in with other income and subjected to the ordinary income tax rates. The only separate treatment for capital gains is the reduced inclusion rate (see ¶5001); therefore, due to differences in marginal tax rates (see ¶8005 and ¶8310) there can be wide variations in the rate at which the gains are actually taxed, depending on the taxpayer's total income.

If, when applying the formula noted above, the allowable capital losses other than allowable business investment losses exceed the taxable capital gains and net gain from listed personal property, the result is called a net capital loss.[6] Provision is made for the carryover and carryback of losses both by individuals and corporations (see ¶3381).[7] In general, net capital losses of a taxpayer for a taxation year may be carried back three years and forward indefinitely to be deducted against net taxable capital gains.

Prior to 1985, an individual could apply allowable capital losses and net capital losses from other years against taxable capital gains and up to $2,000 per year of other income. This right was withdrawn upon the introduction of the capital gains exemption (see ¶5008). However, an individual is still permitted to deduct any pre-1986 capital loss balance against other income to a maximum of $2,000 per year.[8] The pre-1986 capital loss balance is defined generally to be capital losses realized before May 23, 1985, which

See page ii for explanation of footnotes.

[5] CCH ¶2003; Sec. 3.
[6] CCH ¶16,200; Sec. 111(8).
[7] CCH ¶16,003; Sec. 111(1).
[8] CCH ¶16,090; Sec. 111(1.1).

have not been applied, less any capital gains exemption claimed in previous years.[9]

Corporations may deduct allowable capital losses incurred in a year against taxable capital gains realized in the year, but any deductible excess cannot be applied against other income. Corporations may carry losses back three years and forward an indefinite number of years, but only against capital gains realized, until the losses are absorbed. A corporation cannot deduct losses incurred in a preceding year if the corporation undergoes a change of control[10] (see ¶3390).

[¶5005] Lifetime Capital Gains Exemption

[¶5008] Available Exemption over the Years

Prior to 2014, an individual was limited to claiming a lifetime $750,000 exemption in respect of capital gains realized on the disposition of qualified farm or fishing property (see ¶5021), or qualified small business corporation shares (see ¶5022). The exemption was extended to qualified fishing property in the 2006 federal Budget.

The lifetime limit was previously $500,000 and was increased to the current $750,000 amount in the 2007 federal Budget, effective for dispositions on or after March 19, 2007. In particular, the $750,000 amount applies to taxation years that begin after March 19, 2007, with a transitional provision[11] allowing the extra $250,000 amount for dispositions occurring on or after March 19, 2007 in an individual's 2007 taxation year.

The 2013 Budget introduced a long-overdue indexation of the lifetime capital gains exemption. Commencing in the 2014 taxation year this exemption was increased by $50,000 to $800,000 and will be indexed to inflation for taxation years after 2014. The new limit will apply to all individuals, even those who have previously fully used the lifetime capital gains exemption.

Since the capital gains inclusion rate is 50%, the current lifetime exemption for taxable capital gains is $400,000 (i.e., 50% of $800,000). The previous exemption limit was $375,000 (i.e., 50% of $750,000).

When the exemption was enacted in 1985, the $500,000 lifetime exemption was available to shelter *all* capital gains realized by an individual. As part of the 1988 Tax Reform, the capital gains exemption was capped at $100,000 for property other than qualified farm property and qualified small business corporation shares. The current $750,000 lifetime exemption applies only in respect of capital gains realized on dispositions of these latter properties, as well as qualified fishing property. In the 1994 Budget, the $100,000 capital gains exemption that applied to other capital properties was eliminated. The

See page ii for explanation of footnotes.

[9] CCH ¶16,200; Sec. 111(8).
[10] CCH ¶16,140; Sec. 111(4).
[11] CCH ¶15,976af; Sec. 110.6(2.3).

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[¶5255] Principal Residence

[¶5260] Principal Residence — Exemption for Gains on Sale

An individual's gain on the sale of property that was the individual's principal residence at any time since the acquisition date of the property is reduced by that portion of the gain otherwise determined that:

(a) one plus the number of taxation years ending after the acquisition date for which the property was the individual's principal residence and during which the individual was resident in Canada

is of:

(b) the number of taxation years ending after the acquisition date during which the individual owned the property (whether jointly or otherwise).[357]

In other words, where the home was the taxpayer's principal residence throughout the period of ownership (or all but one year), there should be no capital gains arising on the sale of the home. Where the home was a principal residence for some years but not for others, the calculation of the capital gain is prorated, based on the number of years the home qualified as the taxpayer's principal residence (plus one) versus the total years of ownership.

The acquisition date of property is defined to be the later of December 31, 1971, and the date on which the taxpayer last acquired or reacquired the property. The term "taxation years" in the numerator and the denominator includes a whole or any part of a taxation year.

The addition of one year in (a) above is to take into account the fact that a taxpayer can only designate one principal residence for a taxation year. But for the addition of this one year in the calculation, a complete exemption would not be available where an individual sells one principal residence and buys another in the same year, since the taxpayer would only designate one of the properties as his or her principal residence in that year. In this case, it will not usually matter which one is designated as the principal residence for that year, assuming the individual ordinarily inhabited the former and will ordinarily inhabit the latter throughout the respective periods of ownership. On the other hand, if the taxpayer has reason to believe that he or she may not always inhabit the new home while it is owned, the taxpayer may wish to designate it as the principal residence for the year of the move and preserve the "plus" year to cover a year of later absence.

See page ii for explanation of footnotes.

[357] CCH ¶6424; Sec. 40(2)(b).

Example:

On January 1, Year 1, John purchased a house in Calgary which he determines to have an adjusted cost base of $100,000. For Years 1 through 4, the house meets all the requirements of a principal residence and in Year 4 John sells the house for $120,000.

John's gain on the sale of the house in Year 4 will be exempt from tax under the formula, provided he designates the house as having been his principal residence for Years 1 through 4.

Note that it would not be necessary to designate the house as a principal residence for Years 1 through 4 because of the "bonus" year allowed in the formula. If John designates the house as his principal residence for Years 1 and 3(or for any three of the four Years 1 to 4inclusive) the exempt gains would be calculated as:

$$\frac{1+3}{4} \times \text{Gain } (\$20{,}000) = \$20{,}000$$

Where a transfer of property takes place between spouses/common-law partners, the disposition will be deemed to take place at the adjusted cost base of the property to the transferor (unless an election to the contrary is made). The transferee spouse/common-law partner will be deemed to have owned the property during the period that the transferor spouse/common-law partner owned the property and the property will be deemed to be the principal residence of the transferee spouse/common-law partner for those years for which the property was the principal residence of the transferor spouse/common-law partner.[358] See ¶5285.

For dispositions after 1990, all personal trusts, not only spousal trusts, are eligible to claim the principal residence exemption where an individual who is beneficially interested in the trust or the individual's spouse/common-law partner, former spouse/common-law partner, or child ordinarily inhabits the property. A person is beneficially interested in a trust if the person has a right to receive any of the income or capital of the trust either directly from the trust or indirectly through other trusts.[359]

No deduction is allowed for a loss on the disposition of a principal residence, since a residence is personal-use property and losses on personal-use property are allowed only for listed personal property. See ¶5305.

Only one residence per family unit (taxpayer, spouse/common-law partner, and unmarried children under 18) may qualify as a principal residence in any given year. See ¶5275.

See page ii for explanation of footnotes.

[358] CCH ¶6460; Sec. 40(4).

[359] CCH ¶7851, ¶28,200, ¶28,329v; Sec. 54 "principal residence", 248(1) "personal trust", 248(25).

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partner, the trust will be governed by the other preferred beneficiary provisions for the year of death and after.[208]

For 2000 and subsequent taxation years, the preferred beneficiary election will be available with respect to income allocations from: (i) an alter ego trust, to the settlor, during the settlor's lifetime; and (ii) a joint spousal or common-law partner trust, to the settlor and the settlor's spouse/common-law partner, during the lifetimes of the settlor and the settlor's spouse/common-law partner. Alter ego trusts and joint spousal or common-law partner trusts are defined in ¶7310.

For any other trust, the allocable amount for a preferred beneficiary for a taxation year is:

(a) the accumulating income of the trust for the year, provided the beneficiary has a right of any type to any portion of that income and such right is not entirely contingent on the death of another beneficiary who has a capital interest in the trust and who does not have an income interest in the trust, and

(b) in any other case, nil.

[¶7357] SIFT Deemed Dividend

As discussed at ¶7318, a SIFT trust is prohibited from deducting its non-portfolio earnings for a taxation year that are otherwise payable to its beneficiaries in the year. The amounts so payable, but not deductible, referred to in the aggregate as the trust's "non-deductible distributions amount" for the taxation year, are treated as taxable dividends in the hands of the recipient beneficiaries of the trust.[209] Accordingly, the non-portfolio earnings of the trust that are distributed to its beneficiaries are treated similarly to income earned by a public corporation and distributed to its shareholders as taxable dividends.

More particularly, each beneficiary of a SIFT trust to whom any amount became payable by the trust in the taxation year is deemed to have received a taxable dividend from a taxable Canadian corporation at that time, if the SIFT trust has a non-deductible distributions amount for the taxation year, which, as noted, effectively equals its after-tax non-portfolio earnings for the year that are payable to its beneficiaries in the year.[210] The amount of the deemed dividend for each such beneficiary is determined as the *pro rata* portion of the non-deductible distributions amount of the trust, based on the amount payable to the beneficiary divided by all amounts payable to all beneficiaries in the taxation year.[211] Since this *pro rata* fraction is determined using the amount payable to the beneficiary, and not just the non-portfolio earnings of the trust payable to the beneficiary (if any), it is

See page ii for explanation of footnotes.

208 CCH ¶13,480, ¶13,483; Sec. 104(15); Reg. 2800(3), 2800(4).
209 CCH ¶13,491; Sec. 104(16).
210 CCH ¶13,491; Sec. 104(16)(a).
211 CCH ¶13,491; Sec. 104(16)(b).

possible that a particular beneficiary will be deemed to have received a dividend, notwithstanding that the beneficiary did not receive any of the trust's non-portfolio earnings, nor, indeed, any of the trust's income.

The amount of the dividend deemed to have been received by a beneficiary of the SIFT trust is considered an "eligible dividend" (see ¶6052). As such, if the beneficiary is a Canadian resident individual, the beneficiary will be entitled to the enhanced dividend tax credit (see ¶8280). If the beneficiary is a Canadian corporation, it will be eligible for the inter-corporate dividend deduction (see ¶6030). If the beneficiary is non-resident, the deemed dividend is treated as a taxable dividend received from a corporation resident in Canada for the purposes of the Part XIII withholding tax, which may be reduced by an income tax treaty.[212]

This deemed dividend treatment of the distributed non-portfolio earnings of a SIFT trust came into force on October 31, 2006, but owing to the application of the definition of "SIFT trust", the earliest it can have practical effect is for a trust's taxation year ending after 2006. Furthermore, owing to grandfathering rules that apply to trusts that otherwise would have been considered SIFT trusts on October 31, 2006 (had the definition been applicable that date), this treatment does not apply to such trusts until the 2011 taxation year, provided they do not exceed certain "normal growth" guidelines issued by the Department of Finance.

[¶7360] Amounts Deemed Not Paid

A trust can designate all or part of the trust income payable to a beneficiary as not so payable. The designated amount is deemed not to be included in the income of the beneficiary. A trust might make such a designation if it has not deducted from its income the full amount paid or payable to its beneficiaries. The effect of the designation is that the amount designated will not be included in the income of the beneficiary and so will not be subject to double taxation, as the designated amount is included in the income of the trust and so taxed in the trust. A trust which is not resident in Canada throughout a taxation year cannot make a designation.[213]

[¶7365] Property Transfers to Spouse, Common-Law Partner, or Minor — Attribution

Where a taxpayer has transferred property to or for the benefit of the taxpayer's spouse or common-law partner, to a person who has since become the taxpayer's spouse or common-law partner, to a person under 18 years of age with whom the taxpayer does not deal at arm's length, or to the taxpayer's nephew or niece under 18 years of age by means of a trust or

See page ii for explanation of footnotes.

212 CCH ¶13,491; Sec. 104(16)(d).
213 CCH ¶13,400–13,405; Sec. 104(13)–(13.2).

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[¶8600] Carryforward and Carryback of Foreign Business Tax Credits

Foreign income or profits taxes on business income from a foreign country that are not claimed as credits against Canadian income tax in the particular year ("unused foreign tax credits") may be carried back and applied in the three preceding years and carried forward and applied in the ten succeeding years.[503]

The current system requires that the amount available for carryforward or carryback be determined separately in respect of each foreign country. Thus, any unused foreign tax credit in respect of a particular country will only be creditable against Canadian tax in the three previous years or the ten succeeding years to the extent that the taxpayer has income from business in that particular country which is subject to foreign tax.

It should be noted that, in order to have a valid carryback claim, the prescribed form must be filed at the time for filing the tax return for the year in which the unused credit arose.[504] Failure to file the prescribed form within the proper time frame will result in the unused credit only being available for the for the ten-year carryforward period.

The unused foreign tax credit is computed on a country-by-country basis. It is calculated as the amount of foreign business income tax paid for the year that was not deductible as a foreign business tax credit in the year. This excess could arise for instance in a case where the taxpayer's overall taxable income was low and the corresponding tax liability was less than the foreign taxes paid or where the effective rate of foreign tax on the foreign income was higher than the rate the taxpayer pays on his or her total income for Canadian tax purposes.

The first credit claimed is in respect of the tax paid for the current year for the particular country. Any additional claim for the year is then considered to come out of the prior or subsequent years' unused foreign tax credit pool.

The pool of unused foreign tax credits is reduced in a specific order. The pool of unused credits for each country is reduced by applying the earliest arising credits first. For instance, in utilizing an unused foreign tax credit in 2011, any 2009 unused foreign tax credits must be deducted before any 2010 or 2012 unused foreign tax credits.

Unused foreign tax credits claimed in one year cannot be claimed again in another year. This provision is necessary because the definition of "unused foreign tax credits" does not in itself provide for a reduction of the balance for amounts claimed.[505]

It should be noted that an individual taxpayer is entitled to utilize the unused foreign tax credits against income tax payable under Part I.

See page ii for explanation of footnotes.

[503] CCH ¶19,702, ¶19,722, ¶19,792; Sec. 126(2), 126(2.3), 126(7) "unused foreign tax credit"; Income Tax Folio S5-F2-C1.

[504] CCH ¶22,255; Sec. 152(6).

[505] CCH ¶19,722; Sec. 126(2.3).

[¶8605] "Non-Business Income Tax" Defined

The term "non-business income tax", for the purposes of foreign tax credits, is defined[506] as the total of non-business income or profits tax paid to a foreign country or to a political subdivision of that country for the year, minus any part of this tax that is deductible or deducted, as described below.[507] Non-business income tax paid to a foreign country does not include:

- tax that can be reasonably attributed to an amount that relates to employment income from that country for which the taxpayer has claimed the overseas employment tax credit;
- any tax that relates to capital gains from that country for which the taxpayer or taxpayer's spouse or common-law partner has claimed the capital gains deduction;
- any tax reasonably attributable to an amount that was taxable in the foreign country because the taxpayer was a citizen of that country, and that relates to income from a source within Canada;
- the portion of any tax that the foreign country is refunding to any other person or partnership;
- any foreign tax relating to interest received or receivable in respect of an eligible loan of an international banking centre;
- a foreign tax relating to an amount that was deductible by the taxpayer under a tax treaty.

Any amount of tax paid to a foreign government in excess of the amount the taxpayer had to pay according to a tax treaty is considered a voluntary contribution and does not qualify as foreign taxes paid.

A trust can designate foreign trust income to be included in a beneficiary's income causing the beneficiary to qualify for a foreign tax credit on any foreign tax paid by the trust in respect of this income. The business and non-business tax of the trust for the year is deemed to be reduced by the amount in respect of which a designation is made on behalf of the beneficiary. The amount of business income tax that is reduced because of this cannot be reclassified as non-business income tax.[508]

Income or profits taxes paid by an individual on income from property other than real property to a government of a foreign country in excess of 15% of the income from that property may be deducted in computing income.[509] Accordingly, foreign income or profits taxes paid to a government of a foreign country in excess of 15% of the foreign income will not be available to an individual for a foreign tax credit but rather may be deducted in computing income. Foreign tax up to 15% of the amount of such income would be deductible as a foreign tax credit from tax otherwise payable. Foreign income or profits tax on income from real property are excluded

See page ii for explanation of footnotes.

[506] CCH ¶19,770; Sec. 126(7) "non-business-income tax".

[507] CCH ¶5139, ¶5140; Sec. 20(11), 20(12); Interp. Bul. IT-506.

[508] CCH ¶13,563; Sec. 104(22.3).

[509] CCH ¶5139; Sec. 20(11).

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treated as having been made immediately before the cessation of enrolment for the purposes of applying the EAP limits.[143]

In a family plan, the beneficiary must not have reached 21 years of age when he or she is named as beneficiary and contributions are made in the plan for his or her benefit. In the case of a transfer from one family plan to another, if the beneficiary is 21 years of age or older, the beneficiary must have been a beneficiary under the old plan.

Under technical amendments passed in June 2013, an education savings plan will not permit an individual to be designated as a beneficiary under the plan and not allow a contribution for a beneficiary under the plan, unless the individual's SIN has been provided to the promoter of the plan and the individual is resident in Canada. The residency requirement does not apply when the designation is made in conjunction with a transfer of property from another RESP under which the individual was a beneficiary immediately before the transfer. However, subject to two exceptions (described below), the individual's SIN has to be provided to the promoter in order for the individual to be designated as a beneficiary under the transferee RESP.

The first exception to the SIN condition allows an education savings plan that was entered into before 1999 to not require that an individual's SIN be provided in respect of a contribution to the plan. Such contributions, however, continue to be ineligible for the Canada Education Savings Grant and Canada Learning Bond (see ¶10,400). It should be noted that this exception is only relevant for contributions made for existing beneficiaries under such plans. An individual without a SIN is prevented from being designated as a new beneficiary under such a plan.[144]

Under the second exception, an education savings plan may permit a non-resident individual who does not have a SIN to be designated as a beneficiary under the plan, provided that the designation is being made in conjunction with a transfer of property into the plan from another RESP under which the individual was a beneficiary immediately before the transfer.

As well as amending their RESP specimen plan(s) to comply with the changes for new contracts, RESP issuers may also need to amend existing contracts so that they may maintain their registered status and eligibility for the Canada Education Savings Grant. The CRA will require that the amendments be submitted a year from June 26, 2013. However, the plans must be administered as if they were amended as of January 1, 2004.

See page ii for explanation of footnotes.

[143] CCH ¶21,385h; Sec. 146.1(2.22).

[144] Sec. 146.1(2.3).

[¶10,400] Canada Education Savings Grant and Canada Learning Bond

The Government of Canada provides grants of up to 20% of annual contributions made to RESPs for beneficiaries up to and including age 17, to a maximum grant of $500 ($400 before 2007) per year per beneficiary. Starting in 2005, the CES grant was increased to 40% of the first $500 of annual contributions (up to an extra $100 grant) for families with adjusted incomes (used for the purposes of the child tax benefit) equal to or less than $35,000 (indexed annually for inflation); for families with adjusted incomes between $35,000 and $70,000 (indexed annually), the CES grant was increased to 30% of the first $500 of annual contributions (up to an extra $50 grant). The lifetime limit for CES grants that can be paid into an RESP in respect of an individual beneficiary is $7,200. The CES grants made to an RESP do not reduce the annual and lifetime RESP dollar contribution limits.

When the CESGs are paid out of the plan to the beneficiary-student, they are considered educational assistance payments and included in the beneficiary's income.[145] The CESG cannot be withdrawn by the subscriber under the plan. If the beneficiary does not pursue higher education, the RESP is revoked, or if RESP funds are withdrawn for non-educational purposes, the CESG normally must be repaid to the government.

In addition to the CESG, the government initiated the Canada Learning Bond (CLB) in 2004. Generally speaking, the CLB is an initial $500 supplement made in respect of a child if the child's family is entitled to the National Child Benefit (NCB) supplement, and an additional $100 annual supplement for each year up to and including the year in which the child turns 15 years of age in which the family is entitled to the NCB supplement. The CLB is paid into an RESP in which the child is a beneficiary. The CLB does not affect the RESP or the CES grant contribution limits.

Beginning in 2007, the RESP provisions were amended to ensure that similar amounts paid to an RESP under a designated provincial program, such as the education saving incentive program introduced by Quebec in its 2007 Budget, are not considered contributions to the RESP and, therefore, do not affect the RESP contribution limits. Before 2009, only amounts paid under a "designated provincial plan" (DPP) were excluded from the definition of "contribution". Beginning in 2009, amounts paid into an RESP under any program that is similar to a designated provincial program and that is funded by a province will not be considered to be a contribution under the plan.[146] However, payments made by a public primary caregiver, including a children's aid or child welfare agency, will continue to be treated as private contributions.

See page ii for explanation of footnotes.

[145] CCH ¶21,395; Sec. 146.1(7).

[146] CCH ¶21,383ab; Sec. 146.1(1) "contribution".

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A trust is a master trust if, since its creation: it was resident in Canada; its sole undertaking was the investing of funds; it has borrowed no money except for a term of 90 days or less; it has never accepted deposits; and each beneficiary is a registered pension plan or a deferred profit sharing plan.[51]

[¶11,583] Trust Governed by Eligible Funeral Arrangement

A trust governed by an "eligible funeral arrangement" (EFA) is exempt from tax.[52] Such arrangements are established for the purpose of pre-funding an individual's funeral or cemetery services. Up to a limit of $15,000 for funeral services, $20,000 for cemetery services and $35,000 for a combination of funeral and cemetery services, the contributions to such a trust accumulate tax-free until they are distributed for funeral services, cemetery services, or as a distribution to the taxpayer or the taxpayer's estate. See ¶10,530.

[¶11,584] Cemetery Care Trust

The income earned by a trust established for the care and maintenance of a cemetery (sometimes known as "perpetual care funds") is exempt from taxation.[53] However, under the definition of EFA (see ¶11,583), contributions to such trusts are relevant for the purposes of determining whether an arrangement with a cemetery operator is considered to be an EFA. If an arrangement with a cemetery operator is not an EFA, any income earned under a pre-needs cemetery contract that is part of such an arrangement would be subject to taxation. Thus, if an arrangement does not qualify or ceases to qualify as an EFA, income that accumulates under the arrangement could be included, for example, in the income of a contributor or a trust governed by the arrangement, depending on the facts of the case. However, income earned in a cemetery care trust is still exempt from Part I tax, even if the arrangement (under which contributions are made to the cemetery care trust) is not an EFA.[54]

[¶11,585] Registered Education Savings Plans

A trust governed by a registered education savings plan is exempt from Part I tax.[55] However, Part XI.1 penalty tax is imposed on the fair market value of all property held by the trust that is not a "qualified investment". See ¶13,525.

[¶11,585a] Registered Disability Savings Plans

A trust governed by an RDSP is exempt from Part I tax.[56]

[¶11,585b] TFSAs

A trust governed by a TFSA is exempt from Part I tax.[57]

See page ii for explanation of footnotes.

[51] CCH ¶21,796d; Reg. 4802(1.1).
[52] CCH ¶21,803e; Sec. 149(1)(s.1).
[53] CCH ¶21,804a; Sec. 149(1)(s.2).
[54] Interp. Bul. IT-531.
[55] CCH ¶21,806; Sec. 149(1)(u).
[56] CCH ¶21,806; Sec. 149(1)(u.1).
[57] CCH ¶21,806; Sec. 149(1)(u.2).

[¶11,585c] Registered Education Savings Plans

In conjunction with the passing of the *Pooled Registered Pension Plans Act*, a trust governed by a PRPP is exempt from Part I tax.[58]

[¶11,586] Amateur Athlete Trusts

Amateur athlete trusts are exempt from Part I tax.[59] The rules governing the taxation of these trusts are discussed at ¶10,005 *et seq.*

[¶11,587] Trusts Providing Compensation

A mutual insurance corporation that receives its premiums wholly from the insurance of churches, schools, or charitable organizations, is exempt from tax.[60]

A trust established to compensate persons for claims against the owner of a business who cannot or will not pay compensation himself or herself is exempt from tax.[61] An example of such a trust would be a trust established to provide compensation to travellers who have paid for their trips in advance but had them cancelled because of the bankruptcy of the travel agent involved.

[¶11,588] Registered Retirement Income Funds

A trust governed by a registered retirement income fund is exempt from Part I tax.[62] Such trust is, however, subject to Part XI.1 penalty tax on non-qualified investments.

[¶11,589] Vacation-With-Pay Trusts

A trust established pursuant to the terms of a collective bargaining agreement for the sole purpose of providing for the payment of employees' holiday pay is exempt from tax, as long as the property of the trust (after payment of reasonable expenses) is available after 1980, or paid after December 11, 1979, only to employees (or their heirs) and to labour organizations described in ¶11,564.[63]

[¶11,590] Qualifying Environmental Trusts

A qualifying environmental trust (see ¶7497) is exempt from tax under Part I but must pay a special tax under Part XII.4 equal to 28% of its income under Part I (see ¶13,645).[64] The 2011 Budget provides that the Part XII.4 rate of tax to the trust will, starting in 2012, be reduced from the former general corporate tax rate of 28% to the general corporate tax rate for the relevant year.

See page ii for explanation of footnotes.

[58] CCH ¶21,806; Sec. 149(1)(u.32).
[59] CCH ¶21,807; Sec. 149(1)(v).
[60] CCH ¶21,791; Sec. 149(1)(m).
[61] CCH ¶21,808; Sec. 149(1)(w).
[62] CCH ¶21,810; Sec. 149(1)(x).
[63] CCH ¶21,810b; Sec. 149(1)(y).
[64] CCH ¶21,810c; Sec. 149(1)(z).

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interest as a beneficiary under a trust is a qualified investment is required to furnish a return in prescribed form within 90 days after the end of the taxation year to which it refers (Form T3F).

(20) *Tax-free savings accounts (TFSAs).* A TFSA information return must be filed by the issuer.

(21) *Canadian Home Insulation Program and Canadian Oil Substitution Program.* Where an amount has been paid to a person under the Canadian Home Insulation Program and the Canadian Oil Substitution Program, the payor must file a return.

(22) *Certified films and video tapes.* When the principal photography or taping of a film or tape has been completed, a return must be provided to any person who owns an interest in the film or tape.

(23) *Scientific research tax credits.* Corporations designating an amount in respect of scientific research tax credits, traders or dealers in securities, banks, credit unions, and trust companies involved with scientific research tax credits are required to file a return.

(24) *Share-purchase tax credits.* Corporations designating an amount in respect of share-purchase tax credits, traders or dealers in securities, banks, credit unions, and trust companies involved with share-purchase tax credits are required to file a return.

(25) *Resource flow-through shares.* Corporations renouncing expenses pursuant to a flow-through share arrangement are required to make an information return in respect of the renounced expenses. Under such arrangements, the renounced expenses are deemed to have been incurred by the holder of the share and the holder becomes entitled to the tax benefits in respect of the renounced expenses.

(26) *Partnerships.* Every member of a partnership that carries on business in Canada or that is a Canadian partnership must make an information return in prescribed form. An information return made by any member of the partnership is deemed to have been made by each member. An information return must also be filed by any person who holds an interest in a partnership as nominee or agent for another person. The Minister may exempt the members of any partnership or class of partnerships from these requirements. Information Circular 89-5R, paragraph 11 indicates that partnerships with five or fewer members will not be required to file the annual information return. A filing date of March 31st applies for partnerships where all the members are individuals. Where all the members of a partnership are corporations, the filing-due date for the information return is within five months after the end of the fiscal period. For partnerships that have both individuals and corporations as members, the filing date is the earlier of those two dates (Regulation 229(5)). Form T5011 is to be used when applying for a partnership identification number.

(27) *Security transactions.* Every trader or dealer in securities who purchases a security as principal or sells a security as agent must make an information return in prescribed form. A return must also be filed whenever a person redeems, acquires, or cancels any of that person's securities (subject to exceptions for certain transactions); makes a payment in respect of a sale of any precious metals in the form of certificates, bullion, or coins; or is a nominee or agent carrying out certain transactions in his or her own name.

(28) *Tax shelters.* Information returns must be filed in respect of the acquisition of an interest in a tax shelter. The prescribed form is Form T5003.

(29) *Workers' compensation benefits.* Every person who pays an amount in respect of workers' compensation benefits is required to file an information return.

(30) *Social assistance payments.* Every person who makes social assistance payments is required to file an information return unless the payment in respect of medical expenses, child care expenses, funeral expenses, legal expenses, job training or counselling, is part of a series of payments the total of which does not exceed $500, or is not part of a series of payments.

(31) *Farm support payments.* Every government, municipality or municipal or other public body or producer organization or association that makes a payment of an amount that is a farm support payment (other than an amount paid out of a net income stabilization account) to a person or partnership is required to file an information return.

(32) *Treaty exemption to non-resident corporations.* Non-resident corporations are required to file an information return where they claim a treaty tax exemption.

(33) *Construction contract payments.* Construction businesses are required to record payments they make to subcontractors who provide construction services, and to report these payments to the CRA within six months of the end of their reporting period. Goods-only payments do not have to be reported. Mixed service and goods payments have to be reported if there is a service component of $500 or more.

In most cases, two copies of these returns must be sent to the taxpayer whose income the return concerns, at the taxpayer's last known address, or delivered to the taxpayer in person, on or before the date the return is required to be filed.

On December 7, 2013 draft proposed regulations were issued that would require mandatory electronic filing of certain information returns of the same type where the more than 50 returns are required to be filed for a

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[¶13,070] Purchase of Shares

If a corporation or any non-arm's length person purchase shares, directly or indirectly, and a dividend has been declared but not paid at the time of purchase, special rules apply.[40] The amount that may reasonably be considered to be the consideration for the dividend will be deemed to have been paid as a substitute for dividends that would otherwise have been paid in the normal course by the corporation (notwithstanding that the dividend may be paid afterwards) and Part II.1 tax will apply to that amount.

[¶13,075] Indirect Payments

In the event that a person receives a payment from a corporation or a non-arm's length person in consideration for paying an amount to any other person as proceeds of disposition of any property, the corporation will be deemed to have paid the amount indirectly to the other person.[41] For example, if a company pays an amount to Mr. X (assume that he deals at arm's length) on condition that he purchase a property from Mr. Y, a shareholder of the company, the amount will be considered to have been paid indirectly by the corporation to Mr. Y.

[¶13,080] The Purpose Test

Part II.1 tax will not apply where it can be established that no transaction or series of transactions was done to enable shareholders who are individuals or non-resident persons to receive an amount as proceeds of disposition of property instead of as a dividend on shares listed on a stock exchange or traded in the open market.[42]

This exception will override the test in ¶13,060 even where, on an objective basis, the proceeds of disposition are received as a substitute for dividends. For example, the exception would apply where none of the shareholders is an individual or where the shares are not listed or traded. It might also apply where a corporation has declared a dividend and purchases its shares in the open market purely for business reasons.

[¶13,090] Information Return, Interest, Assessment, Payment, etc.

A corporation liable to pay Part II.1 tax must file a return (Form T2141) on or before the day the corporation is required to file its Part I tax return for the year.[43] Part I's general provisions pertaining to assessment, payment, interest, penalties, refunds, objections, and appeals are made applicable to Part II.1.[44] There is no requirement to pay instalments in respect of Part II.1 tax.

See page ii for explanation of footnotes.

[40] CCH ¶24,158; Sec. 183.1(4).
[41] CCH ¶24,159; Sec. 183.1(5).
[42] CCH ¶24,160; Sec. 183.1(6).
[43] CCH ¶24,165; Sec. 183.2(1).
[44] CCH ¶24,166; Sec. 183.2(2).

[¶13,095] Additional Tax on Excessive Elections (Part III)

[¶13,100] Excessive Election by Private Corporation

In certain circumstances a private corporation may elect to distribute as a capital dividend a portion of its net capital gains and certain tax-free receipts. Such a distribution will not be included in the incomes of the shareholders.

In the event that the amount that a private corporation has elected to be treated as a capital dividend exceeds the amount available to be paid as such a dividend, a penalty tax equal to 60% of the excess is imposed as a result of recent technical amendments (the rate was 75% for capital gains dividends paid before the corporation's 1999 taxation year).[45]

If the private corporation obtains the consent of its shareholders, it can avoid this special tax by treating the excess amount as a separate taxable dividend. See ¶13,120.

[¶13,110] Mortgage Investment Corporation — Excessive Capital Dividend Election

The purpose of a mortgage investment corporation is to act as a conduit for passing interest income earned on residential mortgage loans to its shareholders. A mortgage investment corporation may designate dividends paid within a prescribed period as capital gains dividends.[46] Capital gains dividends so designated are received by shareholders as a capital gain and not as a regular dividend.

In the event that the amount that a mortgage investment corporation has elected to be treated as a capital gains dividend exceeds the amount available to be paid as such a dividend, a penalty tax equal to 60% of the excess is imposed, as a result of recent technical amendments (the rate was 75% for capital gains dividends paid before the corporation's 1999 taxation year).[47] This tax is levied on the corporation, not on the shareholder who receives the elected dividend as a capital gains dividend. However, with its shareholders' consent, a mortgage investment corporation may avoid this special tax by treating the excess amount as a separate taxable dividend (see ¶13,120).

See page ii for explanation of footnotes.

[45] CCH ¶24,305; Sec. 184(2).
[46] CCH ¶20,095; Sec. 130.1(4).
[47] CCH ¶24,305; Sec. 184(2).

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[¶14,165] Home Insulation or Energy Conversion Grants

Grants paid to non-residents of Canada under a prescribed program of the government of Canada relating to home insulation or energy conversion are subject to withholding tax.[101]

[¶14,168] Pensions and Deferred Income Plan Benefits

A non-resident to whom a resident of Canada pays or credits a superannuation or pension benefit is required to pay Part XIII tax thereon at the rate of 25%.[102] A person who was a member of a registered pension fund or plan and retires to a foreign country would, for example, be required to pay Part XIII tax on his/her pension receipt. Where part of his/her receipt is attributable to services rendered by him/her in taxation years during which he/she was not resident in Canada at any time and throughout which he/she was not employed in Canada or only occasionally employed in Canada, that part is exempt from Part XIII tax. Whether employment in Canada qualifies as occasional employment will be a question of degree depending on the number of instances of employment and their duration. It should be noted that most of the treaties which Canada has with foreign countries exempt pension payments from Canadian tax.

Receipts under the *Old Age Security Act* (or similar receipts under provincial law), and under the *Canada Pension Plan* and *Quebec Pension Plan* are subject to Part XIII tax, subject to whatever protection a particular tax treaty may provide. These receipts are also subject to 100% withholding for OAS clawback tax, as discussed at ¶13,015.

Worker's compensation, receipts from an employees' profit sharing plan, certain social assistance payments, income derived from property acquired as a personal injury award, and other receipts are excluded from Part XIII tax to the extent that they would not be included in income if the recipient were resident in Canada.

A payment of a pension benefit will be exempt from Part XIII tax if it is transferred directly to a registered pension plan or to the taxpayer's RRSP or RRIF, pursuant to an authorization in prescribed form and pursuant to the direct transfer provisions, on the assumption that the non-resident is resident in Canada.

Also exempt from the withholding tax are superannuation or pension benefits which would be transferable to a registered pension plan (RPP) or an RRSP, if the non-resident were a resident of Canada.

See page ii for explanation of footnotes.

[101] CCH ¶26,104ac; Sec. 212(1)(s).
[102] CCH ¶26,083; Sec. 212(1)(h).

A non-resident is not subject to Part XIII tax on payments of certain worker's compensation and social assistance payments which could constitute superannuation or pension benefits if he or his spouse or common-law partner would have been able to deduct those payments had they been resident in Canada.[103]

[¶14,169] Amateur Athlete Trusts

Tax is payable on certain amounts received by or on behalf of individuals who are amateur athletes. Withholding tax will apply to any amount paid by an amateur athlete trust to a non-resident beneficiary that would have been included in the beneficiary's income for a year if Part I of the *Income Tax Act* were applicable.[104]

[¶14,170] Eligible Funeral Arrangement

An amount that is distributed to a taxpayer from an eligible funeral arrangement, other than as payment for funeral or cemetery services, is included in the taxpayer's income (see ¶10,540). The amount referred to is the residual of income earned by the contributions while in the plan that may be paid out to the taxpayer's estate after the funeral or cemetery services have been covered, or paid out to a taxpayer on the cancellation of such an arrangement. If such an amount is received by a non-resident, the payment is subject to withholding tax.[105]

[¶14,171] Employee Life and Health Trusts

Payments out of an employee life and health trust (ELHT) made to non-residents after 2009 are subject to withholding tax, except to the extent that they are payments of designated employee benefits.[106] The designated employee benefits will generally be health and insurance benefits. For more details on ELHTs, see ¶10,317 in Chapter 10.

[¶14,172] Tax on Dividends

Withholding taxes are payable on taxable dividends paid or deemed to have been paid, and on capital dividends paid or deemed to have been paid by a private corporation (being dividends out of one-half of a private corporation's accumulated capital gains and certain other amounts which are distributable tax-free to Canadian shareholders).[107]

A taxable dividend does not include a qualifying dividend paid by a public corporation to shareholders of a prescribed class of tax-deferred preferred shares.[108]

See page ii for explanation of footnotes.

[103] CCH ¶26,083; Sec. 212(1)(h).
[104] CCH ¶26,104c; Sec. 212(1)(u).
[105] CCH ¶26,104d; Sec. 212(1)(v).
[106] Sec. 212(1)(w).
[107] CCH ¶26,105; Sec. 212(2).
[108] CCH ¶11,209; Sec. 89(1) "taxable dividend".

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A person who is convicted will not be liable for the penalties for late filing of a return[206] (¶15,270) or for contravention of the withholding provisions[207] (¶15,070), unless those penalties were assessed or demanded before the information or complaint giving rise to the conviction was laid or made.[208] An employer was convicted for failing to remit withholding taxes by a specified date, with the offence commencing from the expiry of the specified date.[209]

A taxpayer may be subject to multiple convictions for each failure to comply with multiple demands for the same information. Each demand creates fresh time periods within which the taxpayer is required to comply and fresh offences for failure to comply with those periods.[210]

[¶15,270] Penalties for Evasion of Tax

A person who attempts to evade payment of tax by making, participating in, assenting to, or acquiescing in the making of false statements in any return, or who alters, secretes, or disposes of books or records, or who makes false entries or omissions in books of account, or who conspires to do any of these acts, or in any other manner attempts to evade payment of tax is guilty of an offence and is liable, in addition to any other penalties, on summary conviction to a fine of not less than 50% and not more than double the amount sought to be evaded, or to both fine and imprisonment for a term not exceeding two years.[211] An offence is also created for making false statements, altering documents, etc. for the purpose of obtaining or increasing a tax refund or credit. Such wilful contravention by a person who has no tax payable will, on summary conviction, attract a fine of not less than 50% and not more than twice the refund or credit sought to be obtained, or to both fine and imprisonment for a term not exceeding two years.[212]

Effective in 2014, new penalties were added for the use of electronic suppression of sales software or devices. In addition to the above penalties, persons are liable, on summary conviction, to a fine of not less than $10,000 and not more than $500,000.[213] These fines apply both to those using the software in their business, as well as those developing, supplying, or maintaining such software or devices.

In calculating the amount of tax sought to be evaded, no deduction was made for taxes paid to a foreign government on the unreported income after the charge was laid.[214] A taxpayer who certifies as to full disclosure on the T1 return when he or she knows that relevant facts have been omitted is guilty of wilful evasion.[215] So is a taxpayer who understates income even if he or she knew the regular audit would uncover the unreported income. The fact that the taxpayer did not sign the return was no defence to the charge of

See page ii for explanation of footnotes.

206 CCH ¶22,846; Sec. 162.
207 CCH ¶27,250; Sec. 227.
208 CCH ¶27,668; Sec. 238(3).
209 Sakellis, 70 DTC 6202.
210 Grimwood, 88 DTC 6001.
211 CCH ¶27,680; Sec. 239(1).
212 CCH ¶27,681; Sec. 239(1.1).
213 Sec. 239.1(2).
214 Collins, 85 DTC 5174.
215 Campbell, 60 DTC 1039.

evasion.[216] Negligence did not constitute wilful tax evasion when a taxpayer did not have the required knowledge of wrongfulness; evidence established that the taxpayer's knowledge of bookkeeping and income tax procedure was nil.[217]

A charge for an offence involving wilful contravention for the purpose of evading tax payable or obtaining tax refund/credit may be prosecuted by indictment, in which case an accused may be liable to a larger fine or a longer term of imprisonment. If convicted, an accused will be liable to a fine of not less than 100%, and not more than 200%, of the tax sought to be evaded or refund/credit sought to be obtained, and to imprisonment for a term of up to five years.[218]

It is an offence for a person to wilfully provide to another person an incorrect identification number for a tax shelter and, in addition to any penalty otherwise provided, that person is liable on summary conviction to a fine at least equal to, and up to double, the cost to the other person of his or her interest in the shelter and/or imprisonment for up to two years.[219]

Every official or authorized person who knowingly violates the non-disclosure rules pertaining to information received for the purposes of the *Canada Pension Plan*, the *Unemployment Insurance Act* or the *Employment Insurance Act*, except as authorized, is guilty of an offence and is liable on summary conviction to a fine not exceeding $5,000 and/or imprisonment for up to 12 months.[220] See also ¶15,275.

Communication of taxpayer information may be provided by an official to any person for the purpose of administering or enforcing the Act, e.g., in order to locate tax debtors or to determine if an amount that could be garnished is owing to a tax debtor, or for the purpose of supervision, evaluation, or discipline of a federal civil servant. Safeguards are in place to prevent misuse or unauthorized disclosure of information.[221]

Every person to whom an individual's Social Insurance Number or a taxpayer's or partnership's business number has been provided who knowingly uses or communicates it for other purposes is guilty of an offence and is liable on summary conviction to a fine of up to $5,000 and/or imprisonment for up to 12 months.[222] This prohibition also extends to the officers, employees, and agents of the person who was provided with the number. Use or communication of the number that is required or authorized by law or that occurs in the course of a person's duties in connection with the administration or enforcement of the Act is permitted.

A person who has been convicted of wilful contravention for the purpose of evading tax or obtaining a tax refund or credit cannot be penalized

See page ii for explanation of footnotes.

216 Kidd, 74 DTC 6574.
217 Metke, 76 DTC 6313.
218 CCH ¶27,684; Sec. 239(2).
219 CCH ¶27,651, ¶27,686; Sec. 237.1, 239(2.1).
220 CCH ¶27,686ac, ¶27,720, ¶27,742; Sec. 239(2.2), 241(1), 241(4).
221 CCH ¶27,742, ¶27,745; Sec. 241(4), 241(4.1).
222 CCH ¶27,644, ¶27,687; Sec. 237(2), 239(2.3).

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property, real property, or services. In general terms, prepayments and some agreements made before the transitional release date will not be subject to newly harmonized HST in the province. Between this date and the pre-implementation date (which is typically two months before implementation), suppliers will not be required to collect HST from customers. However, in this period, certain business customers may be required to self-assess the provincial component of the tax in respect of prepayments for supplies to be provided after implementation. Between the pre-implementation date and the implementation date, suppliers will need to collect the HST on prepayments from all customers.

Tangible personal property: The general rule for tangible personal property (TPP) is based on the transfer of ownership or possession of the TPP. If one occurs before the implementation date, HST will not apply; if both occur after implementation, HST will apply. Also, the transitional rule respecting imports into Canada is based entirely on the date of delivery; if after implementation, HST will apply. In most cases, when a province is harmonizing, there will be a pre-existing provincial sales tax (which applied to tangible property) being repealed. Transitional rules are necessary to address the phase-out or wind-down of the PST tax regime. The rules complement the HST transitional rules, such that when the PST ceases to apply to a taxable item, the HST will apply to the supply. The rules are intended to ensure that there is not a situation where both taxes will apply.

Services: The applicable HST rate applies to services performed and payments due on or after implementation date. This general rule ties the application of the HST rate to the date when "all of the consideration for the supply becomes due or is paid", which is typically the billing date of individual invoices. The HST rate is applied to each individual supply unless the override rule applies to a particular supply. This rule overrides the general rule by providing that, even if the billing takes place on or after implementation, the higher HST rate is not applicable if 90% of the invoice relates to services performed before implementation. It is important to emphasize that this rule is not to be considered first or in isolation; it is only to be considered in respect of those supplies for which the general rule would result in the application of the HST rate. Special rules apply in respect of prepayments. Where prepayments for services take place before the transitional release date HST will not apply regardless of when the services are performed. For services to be performed on or after implementation, with prepayment between announcement and the specified pre-implementation date, HST may apply to prepayments from certain "business" customers, but only the GST applies to prepayments from an individual (i.e., a consumer). Transitional tax payable during this period is to be self-assessed by certain businesses subject to the self-assessment rules. For prepayments due during the two-month period between the specified pre-implementation date and implementation, the portion of the prepayment relating to services performed after implementation will be subject to HST collectible by the supplier. Special transitional rules apply to unique services such as funeral/cemetery services, and passenger and freight transportation services.

Intangible Personal Property: The general rule for intangible personal property is based on when consideration is due; if before implementation date, only the GST applies; and if after implementation, the HST will apply. The timing of transfer of the intangible property is not relevant to this transitional rule. Special rules apply in respect of memberships, admissions, and passenger transportation passes.

Real Property: Where either ownership or possession of real property transfers before implementation, HST will not apply. Hence, only one form of transfer need take place before implementation to avoid the full HST rate. If both ownership and possession transfer after implementation, HST will apply.

Residential Real Property: Additional special rules apply in respect of the sale or rental of residential property, including the provincial component new housing rebate. The rebate is intended to ensure that new homes will not be subject to higher tax compared to the PST previously embedded in the price of a new home. Hence, the transitional rules must also address the transition to the rebate mechanism.

[¶16,205] Selected Listed Financial Institutions

The GST issues applicable to financial institutions are discussed at ¶16,305. With the introduction of HST, more goods and services in participating provinces became taxable at the combined HST rate. In order to prevent an exodus from participating provinces of office locations of financial institutions, which cannot claim ITCs for GST paid in respect of exempt activities, the ETA provides for such institutions to account for a tax assessment calculated by formula. The formula applies to "Selected Listed Financial Institutions", national financial institutions that are required to allocate taxable income to at least one participating province and at least one non-participating province for income tax purposes for the current and prior taxation years.

Applied in respect of each participating province, this formula, in general terms, first grosses up unrecovered GST paid in a fiscal year, for example, by a factor of $^{8}/_{5}$ for a participating province with a provincial component rate of 8%. This uses the unrecovered federal tax at the federal rate to approximate a proportionate provincial tax cost at the provincial rate. Next, the formula applies the percentage allocation to the participating province that is used in allocating taxable income to that province for income tax purposes. This result is then compared to the total of the provincial component of HST actually paid on purchases in the year. If the calculated value is greater, the excess must be remitted; if less, the difference is refundable. Since the additional tax assessment replaces an HST cost, the rules requiring the self-assessment of the provincial component of HST with respect to imports discussed in ¶16,185, ¶16,195, ¶16,207, and ¶16,210 are not applicable to these institutions.

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