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TAX LETTER

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INDEXATION OF PERSONAL TAX AMOUNTS FOR 2013

The increases in federal tax income brackets and tax credits for 2013 are 2.0% over last year's amounts. Some of the notable changes are as follows.

The 2013 federal tax brackets are:

- 15% tax bracket for the first **$43,561** of taxable income (up from $42,707 in 2012);
- 22% tax bracket begins at taxable income above **$43,561**;
- 26% tax bracket begins at taxable income above $**87,132** (up from $85,414); and
- 29% tax bracket begins at taxable income above **$135,054** (up from $132,406)

The 2013 federal tax credits are 15% of the following:

- Basic personal amount of $11,038;
- Spousal or common-law partner amount of $11,038*, and reduced if spouse or common-law partner has income;
- Age (65 and over) amount of $6,854, and reduced beginning when income exceeds $34,562;
- Child under age 18 amount of $2,234*;
- Caregiver credit amount of $4,490*, and reduced if dependant's income exceeds $15,334.

* Increased by $2,040 if the dependant is infirm and the credit qualifies for the "family caregiver amount"

The amount at which the old age security "claw back" tax starts to apply is increased for 2013 to $70,954 of net income, up from $69,562.

The provinces and territories also index similar amounts for provincial and territorial income tax purposes. The amounts are usually slightly different because they use the inflation rate for the province or territory each year.

TFSA LIMIT INCREASED FOR 2013

A tax-free savings account (TFSA) allows individuals 18 years or older to invest funds tax-free. The contributions to the TFSA are not deductible, but the income earned on the funds while in the account and all withdrawals from the account are exempt from tax.

The TFSA was introduced in 2009, and the annual contribution limit was $5,000, to be increased by inflation but only by incremental $500 amounts. From 2009 through 2012, the limit remained at $5,000. However, the Federal government recently announced that the limit will increase to $5,500 for the 2013 year, so the cumulative limit is now $25,500 for most taxpayers. If you do not fully use your limit in one year, it is carried forward until you use it in a later year.

In addition to the regular annual limit, withdrawals in one year add to your contribution limit for the following year. Thus, for example, if you withdrew $18,000 in 2012, $18,000 would be added to your 2013 contribution limit in addition to your regular $5,500 annual contribution limit (plus any unused carry-forward amount).

AUTOMOBILE STANDBY AND OPERATING CHARGE BENEFITS AND GST/HST

Standby Charge

Employers who provide an automobile to an employee that is used at least partly for personal purposes must compute a "standby charge" that is included in the employee's income for tax purposes. The charge is determined by formula and is meant to reflect the personal benefit that the employee enjoys by using the car during the year.

Basically, for an employer-owned car, the stand-by charge is 2% of the employer's cost of the car (including GST, HST, QST and/or PST as applicable), multiplied by the number of 30-day periods that the employee has use of the car.

(GST is the federal goods and services tax; HST is the Harmonized Sales Tax in the provinces that have harmonized with the GST; QST is the Quebec Sales Tax; PST is provincial retail sales tax.)

For an employer-leased car, the charge equals 2/3 of the lease costs including applicable GST, HST, QST and PST for the period in which the employee uses the car.

In either case, the stand-by charge is reduced if the employee's business-use kilometres exceed personal-use kilometres for the year and the personal kilometres do not exceed 1,667 per month. (Note that driving from home to the employer's office and back is considered personal use, while driving to a customer's office is normally business use.) There is also an optional reduced standby charge for employees employed principally in selling or leasing automobiles. The benefit is also reduced by any amount the employee pays in the year for the use of the car.

The standby charge including the GST/ HST/QST/PST component must be reported on the employee's T4 slip by the end of February of the following year. It forms part of the employee's income from employment and is subject to taxes and other payroll withholding.

Additionally, the employer is required to remit GST or HST on the standby charge benefit. The employer is deemed to have collected the GST or HST on the benefit at the end of February of the following year (the same as the T4 deadline noted above). This means it is deemed to be collected in the employer's reporting period that includes the end of that February. (See the example below.)

The GST or HST rate applied to the standby charge depends on the province where the employee last worked in the relevant year, and can be found in the CRA Guide T4130 *Employers' Guide – Taxable Benefits and Allowances*, which is available on the CRA website (cra.gc.ca). Each HST province has its own rate taking into account its portion of the HST – for example, for Ontario, New Brunswick and Newfoundland it is 12/112 of the standby charge. For non HST provinces, the rate is 4/104 of the standby charge (Quebec has an additional rate of 9.5/109.5 for the 2012 year, to reflect the QST).

Operating charge benefit

If the employer provides an employee with an automobile and pays any of the personal operating costs (e.g. gas, oil, insurance, maintenance and repairs), the employer must compute and record an operating expense benefit on the employee's T4 slip.

For 2012, the operating expense benefit is 26 cents per personal kilometre. For employees who are employed principally in selling or leasing automobiles, the benefit is 23 cents per personal kilometre. The benefit is nil if the employee repays *all* of the personal operating expenses by February 15 of the following year. If the employee repays only part of the expenses, the benefit is reduced by the amount of the repayment.

Also, if the employee's employment-related kilometres exceed the personal kilometres for the year, the employee can elect that the benefit be calculated as half of the employee's stand-by charge for the year (rather than the per-kilometre benefit).

As with the standby charge, the employer must report and remit GST or HST on the operating benefit. The GST or HST rate applied to the operating charge benefit depends on the province where the employee last worked in the relevant year. Again, each participating province has its own rate – for example, in 2012 in Ontario, New Brunswick and Newfoundland it is 9% of the benefit (in Ontario, 6% for certain large businesses). For non-participating provinces, it is 3% of the benefit (for Quebec, plus 5.4%).

Example of remitting GST/HST in participating province

The CRA provides the following example in its T4130 Guide (with some modifications):

Assume that the last establishment to which the employee ordinarily reported in the 2012 year for the corporation was located in New Brunswick, with the benefits as noted below**.** In this case, you would calculate the HST remittance as follows:

Standby charge benefit		
Taxable benefit reported on T4	$4,800	
HST considered to have been collected on the benefit	$4,800	x 12/112 = $514.29
Operating charge benefit		
Taxable benefit reported on T4	$600	
HST considered to have been collected on the benefit	$600	x 9% = $54.00
Total		$568.29

You are considered to have collected HST in the amount of $568.29 at the end of February 2013. You have to include this amount on your GST/HST return for the reporting period that includes the last day of February 2013.

No GST or HST Remitted

In some cases, the employer does not have to remit GST or HST on the automobile standby charge and operating cost benefits. For example, the employer does not have to remit the GST or HST if the employer is an individual or partnership and the owned automobile is used less than 90% in the business, or if the employer is a corporation and the automobile is used 50% or less in the business. This is because such an employer will not have been able to claim an input tax credit (ITC) on acquiring the vehicle. (However, the benefit is still included in the employee's income for income tax purposes.)

An employer can make an election that deems the automobile to be used exclusively in non-commercial activities, which also means that the employer will not have to remit GST/HST in respect of the standby charge or the operating expense benefit. The election is allowed if the employer leases the automobile and it is used 50% or less in commercial activities. However, the employer will not be allowed to claim an ITC for the GST/HST paid for the automobile or on any operating costs relating to the automobile.

CHILD CARE EXPENSES

If you incur child care expenses that enable you to work or carry on business or attend school, they are deductible for income tax purposes, subject to certain monetary limits.

There are three general limits, in that you can deduct the least of the following three amounts for a taxation year:

- 2/3 of your "earned income" for the year;
- the total annual dollar limits per child, which are $7,000 per child under 7 years of age at the end of the year, $4,000 per child 7 to 16 years of age, and $10,000 per disabled child; and
- the qualifying child care expenses paid in the year.

For this purpose, your "earned income" for the year includes gross employment income, net business income, the taxable amount of fellowships and research grants, and disability pensions under the Canada Pension Plan or Quebec Pension Plan.

Qualifying child care expenses include amounts paid for baby-sitting, day care, nursery, and nanny services rendered in the year. They do not include amounts paid to the child's mother or father for the services (i.e. you can't pay your spouse to look after your children and claim the amount) or paid to a related person under the age of 18. However, they do include amounts paid to other adults such as aunts, uncles, grandparents, and so on. The recipient will include the amount in income.

Furthermore, although amounts paid for boarding schools and camps qualify as child care expenses, they are limited to the following amounts:

- Children under 7 at the end of the year: $175 per week of attendance
- Children 7 through 16: $100 per week
- Disabled children: $250 per week

For couples (including common-law partners), the individual with the lowest income for the year must normally claim the deduction. Thus, for example, if one spouse stays at home and has no earned income while the other spouse works, there will be no deduction allowed (because 2/3 of the stay-at-home spouse's earned income will be nil).

However, the higher-income spouse can claim a deduction in a year in the following circumstances:

- The lower income spouse attended school in the year;

- The lower income spouse was certified by a medical doctor as incapable of caring for children because of a mental or physical infirmity that confined the spouse to a bed or wheelchair or a hospital for at least 2 weeks, or incapable of caring for children for a long, continuous and indefinite period because of mental or physical infirmity; or

- The lower income spouse was in a prison or similar institution for at least 2 weeks in the year.

In these circumstances, the higher-income spouse's deduction is limited to the lesser of the three limits discussed above, and is further limited to a maximum amount per week in which the other spouse attended school, was incapable owing to the infirmity, or in prison, as the case may be. Under this further limit, the maximum amount per week is $175 per child under the age of 7 at the end of the year, $100 per child age 7 through 16, and $250 per disabled child. If the lower-income spouse attended school on a part-time basis, these dollar amounts apply per month, rather than per week.

Any remaining expenses can be claimed by the lower income spouse, subject to the regular limits discussed above.

Example

Jack and Jill are married and have two children aged 4 and 9. Jill had earned income of $90,000 and Jack had earned income of $15,000 in the year. Jack attended university on a full-time basis for 26 weeks in the year.

They paid $15,000 of child care expenses for the year.

Jill's deduction:

The least of

- 2/3 of $90,000 earned income = $60,000
- $7,000 + $4,000 annual amounts = $11,000
- $15,000 actual child-care expenses
- 26 weeks that Jack was in school x ($175 + $100) = $7,150

Therefore, Jill can deduct $7,150.

Jack's deduction:

The least of

- 2/3 of $15,000 earned income = $10,000
- $11,000 annual amounts (see above)
- $15,000 expenses – $7,150 claimed by Jill = $7,850

Therefore, Jack can deduct $7,850.

Unused expenses in one year cannot be carried forward to future years.

ADOPTION TAX CREDIT

The adoption tax credit is meant to help prospective parents with the costs of adopting minor children (under 18 years of age). The federal credit is 15% of the "eligible adoption expenses", the latter of which is capped for 2012 at a maximum of $11,440 per adopted child. For 2013, the maximum amount of eligible adoption expenses is increased to $11,669.

For the purposes of the credit, "eligible adoption expenses" include:

- fees paid to an adoption agency licensed by a provincial government,
- court costs and legal and administrative expenses related to the adoption order,
- reasonable and necessary travel and living expenses for the child and the adoptive parents,
- document translation fees,
- mandatory fees paid to a foreign institution,
- mandatory expenses paid in respect of the immigration of the child, and
- other reasonable expenses required by a provincial government or an adoption agency licensed by a provincial government.

The eligible adoption expenses cover adoptions of either Canadian or foreign children.

A single individual can claim the entire credit. For couples (including common-law partners), the credit can be claimed by one parent or alternatively split between the two adoptive parents. If both parents make a claim, the combined eligible adoption expenses for the adopted child cannot exceed the maximum annual limit described above.

The credit can be claimed only in the taxation year in which the "adoption period" ends. Generally, the adoption period ends at the later of the time at which the adoption order is issued or recognized by a government in Canada, and the time at which the child begins to permanently reside with the adoptive parent.

CPP CONTRIBUTION RATES FOR 2013

Each year, employees, employers and self-employed individuals must pay Canada Pension Plan (CPP) premiums equal to a percentage of earnings up to the "maximum pensionable earnings" for the year.

The CRA recently announced that the maximum pensionable earnings for 2013 will be increased to $51,100, up from $50,100 in 2012. The maximum amount is calculated according to a formula that takes into account the growth in average weekly wages and salaries in Canada.

The basic exemption amount for 2013 remains $3,500, meaning that only pensionable earnings above that amount are subject to CPP contributions.

The employee and employer contribution rates for 2013 will remain unchanged at 4.95%, and the contribution rate for self-employed individuals will remain unchanged at 9.9%.

As a result, the maximum employer and employee contribution to the plan for 2013 will be $2,356.20 (4.95% of ($51,100 – $3,500)), and the maximum contribution for self-employed individuals will be $4,712.40. The maximum contribution amounts in 2012 were $2,306.70 and $4,613.40, respectively.

PRESCRIBED INTEREST RATES

The prescribed rates for 2013 applied throughout 2012 and 2011.

- The interest rate charged on overdue income taxes, Canada Pension Plan contributions, and Employment Insurance premiums is 5%.
- The interest rate to be paid on late refunds to corporate taxpayers is 1%.
- The interest rate to be paid on late refunds to non-corporate taxpayers is 3%.
- The interest rate used to calculate taxable benefits for employees and shareholders from interest-free and low-interest loans is 1%.

AROUND THE COURTS

Deceased's capital gains exemption allocated amongst three farm properties

The capital gains exemption allows individuals to realize up to $750,000 of capital gains ($375,000 of taxable capital gains) on certain types of property without tax. One such type of property is qualified farm property. The exemption can be applied to any disposition of such property by the individual, including the deemed disposition at death (on your death, you are deemed to dispose of most of your capital properties at fair market value).

In the recent case of *Fournie v Cromarty*, the deceased left three qualified farm properties under his will to three different parties – one to his niece, one to his nephew, and one to the applicants Mr. and Mrs. Fournie (the "Fournie property"). Under the will, the capital gains tax payable on the properties left to the niece and nephew (owing to the deemed disposition at death) was payable out of the residue of the estate. The capital gains tax "attributable to" the Fournie property was payable by Mr. and Mrs. Fournie.

The applicants in the case argued that the exemption should be applied against all three properties on a pro rata basis, which would reduce their capital gains tax payable attributable to the Fournie property. The niece and nephew argued that the exemption should not be applied to the Fournie property.

The Ontario Superior Court of Justice held in favour of the applicants and applied the capital gains exemption pro rata against the gains of all three properties. The Court held that the scheme of the Income Tax Act contemplates that the exemption be applied to the total taxable capital gains of all qualified farm properties that are disposed of, and not on a piece-meal basis.

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