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TAX LETTER

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CARRYING OVER LOSSES TO OTHER YEARS

Various types of tax losses can be used in the year in which they arise, subject to limitations as described below. Excess losses are then available to be carried forward and back to other years, with the details varying by the type of loss.

Non-capital losses (including business losses)

If you have a loss from business or property, the loss will be deducted against your income from other sources for that year. For example, if you carried on your own business but were also employed somewhere else as an employee, a loss from your business would reduce your income from the employment.

If these business or property losses exceed your positive income for the year, the excess becomes a "non-capital loss". The non-capital loss can be carried back 3 years or forward 20 years, to offset other sources of income in those years. (For non-capital losses of individuals that arose in 2004 or 2005, the carryforward period is 10 years, and for losses incurred before 2004, the carryforward period was 7 years.)

If you are carrying *back* a loss from a current year to a previous year, you must file Form T1A with your current year's tax return to claim the loss carryback.

Net capital losses

Half of a capital loss is an allowable capital loss (ACL), which serves to reduce your net taxable capital gains (half of your capital

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gains) in a year, if any. The ACL cannot reduce other sources of income in the year (except in the year of death and the immediately preceding year). However, the ACL can be carried back 3 years or forward indefinitely to offset taxable capital gains in those other years.

Allowable business investment losses (ABILs)

An ABIL is one-half of a business investment loss, which is a capital loss incurred on the disposition of debt or shares in small business corporations in certain circumstances (various criteria have to be met). Unlike an ACL, an ABIL can reduce other sources of income in a year (and not just taxable capital gains), so it is similar to a non-capital loss.

An unused ABIL in a year can be carried back 3 years or forward 10 years to offset all sources of income in those years. However, after the 10th future year, unused ABILs are converted to ordinary ACLs, which can be used to offset taxable capital gains in future years, but not other sources of income. (An individual's ABILs arising before 2004 – converted to regular ACLs after 7 carryforward years.)

Listed personal property losses

As discussed in the October 2013 *Tax Letter*, most capital losses from personal-use property cannot be used.

However, losses from "listed personal property" (LPP) such as artwork, rare books and folios, coins and stamps, can be used to offset gains from LPP in the same year. Any excess LPP losses can be carried back 3 years or forward 7 years to offset LPP gains only, and then any excess LPP gains are half included in income.

Limited partnership losses

If you are a limited partner of a partnership, your share of the losses from the partnership is generally limited to your "at-risk amount" in respect of your interest in the partnership. The at-risk amount is determined under a complex formula, but in very general terms it reflects your cost of purchasing the partnership interest, increased by your share of partnership income, reduced by your share of partnership losses and by distributions you have received, and further reduced by certain amounts that you owe to the partnership and by benefits or guarantees that you may be entitled to receive that are meant to reduce the impact of any losses from the partnership.

Your limited partnership losses in excess of your at-risk amount can be carried forward and used in future years, but again subject to your at-risk amounts in those future years. Limited partnership losses cannot be carried back.

Restricted farm losses

In general terms, if a farming business is not your chief source of income, a loss from the farming will be a restricted farm loss. The deduction for this type of loss is limited.

For restricted farm losses incurred in taxation years ending before March 21, 2013 (for individuals, this means 2012 and prior years), the maximum amount that can be deducted in a year is $2,500 plus half of the next $12,500 of the loss, for a maximum loss of $8,750 per year. For later taxation years, the maximum has been increased to $2,500 plus half of the next $30,000 of the loss, for a maximum loss of $17,500.

The remaining restricted farm losses incurred in a year can be carried back 3 years or forward 20 years. However, they can only be applied against farming income in those years and not other sources of income. (For restricted farm losses incurred before 2006, the carryforward period is 10 years).

The farm loss restrictions do **not** apply if farming, or farming in combination with another source of income, is your chief source of income. The 2013 Federal Budget has clarified this latter exception, such that the "other source" of income must be subordinate to the farming business, effective for taxation years ending after March 20, 2013. An exception, introduced in draft legislation released on September 13, 2013, is where the chief source of income is a combination of farming and of manufacturing or processing goods for sale, and substantially all the farming output is used in the manufacturing or processing.

EMPLOYER-PROVIDED EDUCATION PAYMENTS FOR YOUR CHILDREN

At one time, the Canada Revenue Agency (CRA) took the position that, if your employer paid for all or part of your child's education through an employer-provided scholarship or bursary, the payment was included in your income as a taxable benefit from employment.

However, as a result of court cases that decided otherwise, the CRA changed its position back in 2007. Under the new policy, such amounts provided to an employee's children (or other family members) from the employer are not taxable benefits to the employee. Instead, they are treated as scholarships for the family member. Scholarships are tax-free for full-time students (or part-time disabled students) attending university or college, while for other part-time students they are tax-free to the extent that they cover tuition and ancillary fees.

In particular, the CRA's new position provides that the following amounts are not taxable benefits, but rather scholarships, to be reported on the T4A slip provided to the student (the slip is required even though the amounts are normally tax-free):

- If the employer is a post-secondary educational institution, any free tuition provided to the employee's family member;
- Amounts paid by the employer for tuition fees, books, and supplies related to post-secondary education for the employee's family member; and
- Other amounts paid to the family member under the employer's scholarship or bursary program.

(The CRA's administrative position on this issue can be found in the Income Tax Folio S1-F2-C3, "Scholarships, Research Grants and Other Education Assistance", available on the CRA website.)

Until recently, the new CRA position applied only to family members who attended post-secondary schools. Scholarships and bursaries and free tuition provided by an employer to an employee's children who attended elementary or secondary schools (e.g. private schools) were a taxable benefit for the employee and thus included in the employee's income.

However, by virtue of a recent amendment to the Income Tax Act, such payments or benefits received by a child of an employee to attend grade school or secondary school will no longer be taxable benefits for the employee, effective October 31, 2011. In order for this new rule to apply, the payment or benefit must not be a substitute for salary or other remuneration that the employee would otherwise receive. The payment or benefit will generally qualify as a scholarship for the child, and, as noted above, will be completely tax-free in most cases.

FOREIGN EXCHANGE GAINS

For Canadian income tax purposes, you must report gains and losses and tax payable in Canadian dollars, even if you receive income or gains or incur losses in a foreign currency.

In this regard, you can realize a foreign exchange gain (or loss) when you buy and sell a capital property using a foreign currency, or settle or pay off a liability in a foreign currency.

In the former case, you simply convert your purchase price and sales price into Canadian dollars, and the gain or loss is then computed in Canadian dollars.

> **Example**
>
> You purchased a capital property in the United States for US$100,000, at a time when the US and Canadian dollars were trading at par. As such, your cost in Canadian dollars was C$100,000.
>
> You sold the property in 2013 for US$110,000, at a time when the exchange rate was US$1 = C$1.03, such that your proceeds in Canadian dollars were C$113,300.
>
> Your capital gain will be ($113,300 – $100,000), or $13,300. Note that $10,000 of that amount is a "regular" capital gain, while the other $3,300 is effectively a foreign exchange gain (realized because the $US gained strength relative to the $C). You will include ½ of the total gain, or $6,650, in your income as a taxable capital gain.

In the case of a debt or other liability denominated in a foreign currency, you can realize a foreign exchange gain or loss when it is paid off.

> **Example**
>
> You borrowed US$100,000 to purchase a capital property when the exchange rate was US$1 = C$1.03 (the equivalent of C$103,000). You pay off the entire debt when the currencies are trading at par, such that it costs you C$100,000 to pay off the debt. You will have a capital gain of $3,000 because your repayment was $3,000 less than the amount that you borrowed (in Canadian dollars). Half of that amount will be a taxable capital gain, included in your income.

Lastly, you can also realize a foreign exchange gain or loss when you buy and sell the foreign currency itself. However, in this case, the first $200 of net gains or losses in a year are ignored (for individuals).

> **Example**
>
> Last year you bought US dollars when the US and Canadian dollars were trading at par. In 2013, you sold back US$10,000 of this amount for Canadian dollars when the exchange rate was 1US$ = 1.03C$, such that you received C$10,300. You had no other foreign currency transactions in the year. You will have a gain of $300, but only $100 will be a capital gain, and half of that amount or $50 will be a taxable capital gain.

SICKNESS, ACCIDENT OR DISABILITY INSURANCE PLANS FOR EMPLOYEES

These plans are typically arranged between employers and employees, and offer some payment of wages or income while an employee is off work owing to a sickness, accident or disability. The plans are typically made in writing but the CRA accepts that they can also be informal in nature, arising from an understanding that the employer will provide wage or income replacement payments while the employees are sick or injured. The plans can involve a contract of insurance with an insurance company, although the involvement of an insurance company is not necessary. If there is no insurance company, the CRA states that the plan must be based on insurance principles.

For income tax purposes, contributions (or premiums) made by the employer to the plan are not taxable benefits for the covered employees. Contributions by the employee to the plan are not deductible when they are made, although, as explained below, they may effectively be deductible against payments made out of the plan.

When an employee receives payments out of the plan in a taxation year (e.g. when the employee is sick, injured, etc.), the payment is included in the employee's income if the employer has made *any* contributions to the plan. However, the employee can deduct the employee's contributions made to the plan in that year or in previous years (to the extent they were not deducted in a previous year from another payment out of the plan).

On the other hand, if the employer makes *no* contributions to the plan – i.e., an "employee-pay-all plan" – any payments made out of the plan to an employee are tax-free. Since no employer contributions were made, and the employees' contributions were made without a deduction, there is no employee benefit in such a case.

"FIRST TIME DONOR SUPER CREDIT"

Individuals who donate to registered charities or similar "qualified donees" receive a tax credit. For the first $200 of donations, you receive a credit at the lowest marginal rate –15% for federal tax purposes, and a provincial rate that varies by province. However, for the amount of donation above $200 in a year, you receive a credit using the top marginal rate of 29% for federal tax purposes, and again the provincial rates vary (it is highest in Alberta, at 21%).

Note that you qualify for the top marginal rate credit (for over $200 of donations) even if you are not in the top marginal tax bracket.

In addition, the 2013 Federal Budget introduced a new "first time donor super credit". This credit provides an additional 25% credit for a first-time donor on up to $1,000 of donations. In other words, when added to the regular credits, a first-time donor will receive a 40% federal credit on the first $200 of donations in a year, and a 54% federal credit for the excess donation over $200 up to $1,000.

For these purposes, you will be considered a first-time donor if neither you nor your spouse (or common-law partner) claimed a charitable tax credit in any taxation year after 2007. As with the regular charitable credit, the super donor credit can be shared between couples.

The donor super credit can be claimed only once, either in 2013 or a later taxation year up until 2017. If you qualify for this credit but have not reached $1,000 in donations for the year, you may wish to save it up and claim it in a later year to maximize the credit.

Lastly, only donations of money qualify for the donor super credit. For the regular charitable credit, donations of money or property can qualify.

FAMILY CAREGIVER TOP-UP CREDIT

There are various tax credits that you can claim for dependants, including

- the spousal credit – if you support your spouse or common-law partner;
- the equivalent-to-spouse credit – generally where you are single and support a child or other relative who lives with you;
- the child credit – available where you have a child under 18;
- the caregiver credit – in respect of certain infirm dependants aged 18 or over, or your parents or grandparents 65 or over, who live with you; and
- the infirm dependant credit – in respect of certain infirm dependants 18 or over.

In most cases you can claim only one of these credits in respect of the same dependant. However, the child credit can be claimed in combination with one of the others, if applicable.

For federal tax purposes, the credit in each case is 15% of the applicable amount, which is indexed each year. The provincial rates vary by province.

For example, for 2013, both the spousal and equivalent-to-spouse federal credits equal 15% of $11,038, although this latter figure is reduced by the dependant's income for the year.

In addition to these regular credits, a "family caregiver credit" amount of $2,040 (for 2013) is added to the applicable dollar amount if the dependent person is dependent upon you by reason of physical or mental infirmity (so it is added automatically to the regular infirm dependent amount).

Thus, for example, for the spousal or equivalent-to-spouse credits, the family caregiver amount would increase the credit to 15% of $13,078, although the latter figure would still be reduced by the dependant's income.

PRESCRIBED INTEREST RATES

The CRA recently announced the prescribed annual interest rates that will apply to any amounts owed to the CRA and to any amounts the CRA owes to individuals and corporations for the fourth quarter of 2013. These rates are calculated each calendar quarter. The new rates are in effect from October 1, 2013 to December 31, 2013**.** The interest rates have increased across the board by one percentage point, for the first time since 2009.

- The interest rate charged on overdue income taxes, Canada Pension Plan contributions, and Employment Insurance premiums is 6%, compounded daily.
- The interest rate to be paid on late refunds paid by the CRA to corporations is 2%, compounded daily.
- The interest rate to be paid on late refunds paid to other taxpayers is 4%, compounded daily.
- The interest rate used to calculate taxable benefits for employees and shareholders from interest-free and low-interest loans is 2%.

AROUND THE COURTS

Gains from sales of shares found to be business income

Most individuals who buy and sell shares will report the gains as capital gains, which are only one-half taxed. However, if you spend a significant amount of time in the activity and your trades are very frequent, you could be found to be in the business of buying and selling shares. If so, your gains will be fully included in income.

This happened to the taxpayer in the recent *Wong* case. During the 5 taxation years in question, the taxpayer engaged in more than 600 share trades. Most of the shares were sold either on the same day of purchase or within a few days. The CRA assessed the taxpayer and included his gains from the trades as business income rather than capital gains.

On appeal to the Tax Court of Canada, the CRA position was upheld. The Court did not accept the taxpayer's testimony that he spent little time on trading, or that he was only a casual investor who relied on television business shows to makes his trading decisions. To the contrary, the Tax Court Judge held that "the number of securities which he traded during the period and the duration of the holdings do not support his statement…the number of trades, the short duration of the holdings, the number of shares purchased and sold definitively indicate that he was engaged in trading in securities during the period." As such, the taxpayer's gains were held to be business income.

Although it is not clear whether this affected the Judge's decision, the taxpayer had completed Levels I and II of the Canadian Securities Program and at some time in the past he held a mutual funds license. Such factors could, depending on the facts, be relevant in determining whether a taxpayer is in the business of trading shares or simply a "regular" investor.

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