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TAX LETTER

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TAX BRACKETS AND CREDIT AMOUNTS FOR 2015

The federal income tax brackets and most personal credit amounts are indexed annually to inflation, using the Consumer Price Index. The 2015 amounts were recently announced by the Canada Revenue Agency (CRA). The 2015 amounts reflect a 1.7% increase from the 2014 amounts. Below is a summary of some of the main changes.

For 2015, the income tax brackets are:

- 15% tax bracket for the first $44,701 of taxable income (up from $43,953 in 2014);
- 22% tax bracket begins at taxable income above $44,701;
- 26% tax bracket begins at taxable income above $89,401 (up from $87,907); and
- 29% tax bracket begins at taxable income above $138,586 (up from $136,270).

For federal tax credits, the 2015 credit amounts include 15% of the following:

- Basic personal amount of $11,327;
- Spousal or common-law partner amount of $11,327*, reduced if your spouse or common-law partner has income;
- Age (65 and over) amount of $7,033, phased out beginning when your income exceeds $35,466;
- Canada employment amount of $1,146;
- Disability amount of $7,899;
- Caregiver credit amount of $4,608*, reduced if the dependant's income exceeds $15,735;
- Infirm dependant amount of $6,701, reduced if the dependant's income exceeds $6,720; and
- Medical expense amount of qualifying medical expenses exceeding the lower of 3% of your net income and $2,208.

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* Each of these amounts is increased by $2,093 if the dependant is infirm and the credit qualifies for the “family caregiver amount”

Other federal changes:

The amount at which the federal old age security “claw back” tax starts to apply is increased for 2015 to $72,809 of net income.

The lifetime capital gains exemption is increased to $813,600 (up from $800,000).

The annual maximum dollar amount for tax-deductible contributions to registered retirement savings plans (RRSPs) is increased to $24,930 (with indefinite carry-forwards for unused deduction room since 1991).

The annual contribution amount for tax-free savings accounts (TFSAs) remains at $5,500 (with indefinite carry-forwards for unused room since 2009), since it is rounded to the nearest $500.

PERSONAL USE PROPERTY

If you dispose of a personal-use property (PUP) and realize a gain, half of the gain is a "taxable capital gain" included in your income.

On other hand, if you dispose of PUP at a loss, no capital loss is allowed, unless the property is “listed personal property” (see below), in which case the loss is allowed only against gains on such property.

Listed personal property, for which losses can be recognized, includes: works of art; jewelry; rare books, manuscripts and folios; stamps; and coins.

If you incur a listed personal property loss in a year, half of the loss is deductible from your taxable capital gains from listed personal property, if any, in the year. If the remaining amount is positive, it is included in your income. If the amount is negative, the negative portion cannot be recognized in the year, but it can be carried back 3 years or forward 7 to offset taxable capital gains, but only from listed personal property in those years.

Special rules apply to determine the cost or proceeds of disposition of PUP. Basically, if your cost of the property is less than $1,000, it is deemed to be $1,000. Similarly, if your proceeds of disposition of the property are less than $1,000, they are bumped up to $1,000.

Note: The above rules do **not** apply if you are in the business of selling stamps, coins, art, etc. In such a case the property is not "personal-use property" to you, but simply inventory of your business, and any gains or losses are fully taxable or fully deductible as regular business profit or losses.

CARRYING LOSSES OVER TO OTHER YEARS

The main types of losses that cannot be used in a taxation year are non-capital losses and net capital losses for that year. However, as discussed below, these losses can be used in other taxation years. Other losses that can be carried over to other years are also summarized below.

Non-capital loss

Generally speaking, if you have a loss in a year from a source such as employment, business or property, the loss will reduce any income you have from other such sources. For example, if you have $50,000 of employment income and a $40,000 business loss in a year (and no other income or loss), your net income will be $10,000.

However, any excess loss cannot be used in that year. Reversing the numbers above, you must first apply a $50,000 business loss to offset the $40,000 of employment income so that your net income for the year would be zero. The remaining $10,000 loss would become a non-capital loss, which could not be used in that year.

However, a non-capital loss can be carried back 3 years or forward 20 years, as a deduction from net income in calculating "taxable income" in those years. (For losses in taxation years before 2006, the carry-forward period is either 10 or 7 years.)

Net capital loss

One-half of your capital losses in a year are called "allowable capital losses", which serve to offset your taxable capital gains for the year, if any. However, if your allowable capital losses exceed your taxable capital gains for the year, the excess amount is a "net capital loss", which cannot be used in that year.

A net capital loss can be carried back 3 years or indefinitely to future years, to offset taxable capital gains in those years. It cannot be used to offset other sources of income in those years, except in the year of your death or the immediately preceding year.

Allowable business investment loss (ABIL)

An ABIL is one-half of a "business investment loss", which is a capital loss incurred on the disposition of debt or shares in certain small business corporations (ABILs were discussed in our April 2014 Tax Letter). An ABIL is unique because, in contrast to regular capital losses, it can be used to offset all sources of income and not just taxable capital gains.

If an ABIL exceeds your other net income for the year, the unused portion of the ABIL can be carried forward ten years to offset any source of income in those years. After the tenth future year, the ABIL becomes a net capital loss, which can be used only to offset taxable capital gains in future years.

Losses from listed personal property

As discussed earlier, half of your losses from listed personal property can serve to offset one-half of your gains from listed personal property. Any excess losses can be carried back 3 years or forward 7 to offset listed personal use-property gains.

Limited partnership losses

If you are a limited partner of a partnership, your losses from the partnership can offset your other sources of income. However, the partnership losses that can be applied to other sources in a taxation year are limited to your "at-risk amount" in respect of the partnership. Basically, the at-risk amount reflects your actual cost of your interest in the partnership, reduced by certain amounts that you owe to the partnership or 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 loss in excess of your at-risk amount for a taxation year is a "limited partnership loss". It can be carried forward and used in future years, subject to your at-risk amounts in those future years. Limited partnership losses cannot be carried back.

Restricted farm losses

If you carry on a farming business, your losses from the business for a taxation year can offset your positive sources of income for the year.

However, if the farming business is not your chief source of income, the deductible amount of farm loss is limited to $2,500 plus ½ of the next $30,000 of the loss, for a maximum loss of $17,500. (For farm losses incurred before 2013, the maximum loss was $2,500 plus ½ of the next $12,500 of the loss, for a maximum loss of $8,750 per year.)

The excess loss for the year, if any, is a “restricted farm loss”. It can be carried back 3 years or forward 20 years (for losses incurred before 2006, the carry-forward period is 10 years). However, it can only offset farming income in those years, not other sources of income.

MOVING FROM CANADA: TAX IMPLICATIONS

If you cease to be resident in Canada for income tax purposes, there may be significant and possibly adverse income tax consequences. The main culprit is a rule in the Income Tax Act that deems you to have disposed of most of your property for fair market value proceeds when you cease to be resident, with some exceptions as noted below. You are also deemed to re-acquire the property at a cost equal to the same fair market value.

The deemed disposition can result in capital gains or losses, depending on the current value of your property when you leave Canada relative to its cost to you. The income (or loss) resulting from the deemed dispositions is reported on your income tax return for the year of your departure from Canada. The resulting tax, if any, is sometimes referred to as Canada’s “departure tax”.

One piece of good news is that you can usually defer paying the departure tax until you actually dispose of the property (which could be years down the road). If the income resulting from the deemed disposition is $50,000 or less, you can defer paying the tax without providing security (technically, you can defer without security if the resulting tax is less than the tax that would be applied to $50,000 of taxable income, using the highest marginal rate of tax). If the resulting income (tax) is greater, you must provide acceptable security with the CRA in order to defer the payment of the tax. Either way, you do not have to pay interest on the tax owing.

As noted above, certain properties are exempted from the deemed disposition rule. Notable properties that are exempted include:

- Real property (real estate) in Canada (your gain will be taxed when you later dispose of the property as a non-resident);
- Property used in a business carried on through a permanent establishment in Canada (same);
- If your were a resident of Canada for 60 months or less in the 120 months before your departure from Canada, any property owned when you formerly became resident in Canada, and any property inherited by you during the period of residence; and
- Certain other “excluded rights or interest”, such as your interests in pension plan, RRSP, RRIF, and similar plans.

However, if you make an election in your tax return, any property in the first two categories (real property in Canada, property used in a business in Canada) can be subject to the deemed disposition rule. The election could be beneficial if the deemed disposition results in a loss, which could be used against other capital gains (whether incurred in the year or as a result of the departure tax). The election can also be beneficial if the disposition of property results in a gain, if you have losses that can be applied to offset the gain, as the rule will result in a higher cost of the property for future Canadian income tax purposes.

When you later sell property that was subject to the deemed disposition rule, you may be subject to tax in your new country of residence (foreign tax) if the sale results in a gain. In such case, you can claim a foreign tax credit for Canadian income tax purposes for the foreign tax in respect of the portion of the gain that was taxable in Canada on your departure (i.e. the accrued gain up to your date of departure). The tax credit is allowed if the property is not real property and you are taxed in your country of residence that has a tax treaty with Canada. Furthermore, a tax credit is allowed if the property is real property in another country and the tax is paid to the other country, or to the country in which you are resident and that country has a treaty with Canada.

Conversely, if you later sell the property at a loss and the property is "taxable Canadian property", the loss can be carried back to reduce or offset the gain that resulted from the deemed disposition of the property on your departure from Canada. Taxable Canadian property includes items such as real property in Canada, and shares or interests in corporations, partnerships, or trusts, where the value of your shares or interests is primarily attributable to real estate or resource properties in Canada.

If you subsequently return to Canada and become resident, you can elect to effectively override the gain from the deemed disposition of property that applied on your departure. Effectively, this means that the gain from the deemed disposition is ignored, and your original cost of the property is restored.

Information reporting for year of departure

In order to provide the CRA with information with respect to the departure tax, you may be required to file Forms T1161 and T1243 with a list of your properties by the filing-due date for the year of departure (April 30 of the following year, or June 15 if you or your spouse carry on business). Form T1161 is required only if the fair market value of your "reportable properties" at the time of departure exceeds $25,000. Reportable properties do **not** include Canadian cash, most "excluded rights or interests" (see above), and personal-use property worth less than $10,000.

Incidentally, you should not think that because you have left Canada, you can safely ignore your Canadian tax obligations. If you have an unpaid tax debt, there are several ways the CRA can collect the debt. These include: (1) seizing any assets or financial accounts you have left in Canada; (2) garnishing any debts owed to you by anyone in Canada, including pension payments; (3) assessing any family member to whom you transfer assets, including assets transferred to your heirs on your death; and (4) asking the tax authority of another country to enforce the Canadian tax debt under its tax collection mechanisms, if Canada's tax treaty with that country permits it (currently the US, UK, Germany, Netherlands, Norway and New Zealand – and this list keeps expanding with retroactive effect).

TESTAMENTARY TRUSTS: LAST YEAR FOR PREFERENTIAL TAXATION

Testamentary trusts are trusts that arise on your death, such as those made under your will.

Historically, testamentary trusts have been taxed preferentially relative to *inter vivos* trusts (trusts set up during your lifetime). The tax preferences include:

- Testamentary trusts are subject to the same graduated tax rates that apply to other individuals (whereas *inter vivos* trusts are subject to a flat tax at the highest marginal rate). Thus, for example, if you set up multiple trusts under your will, you can engage in post-mortem income splitting;
- Testamentary trusts can have an off-calendar fiscal period and taxation year;
- They are not required to make quarterly tax instalments;
- They are allowed a $40,000 exemption under the alternative minimum tax; and
- They can flow out investment tax credits and certain other amounts to their beneficiaries.

Unfortunately, this is the last taxation year that these tax preferences will apply. Beginning in 2016, the tax preferences will not apply to testamentary trusts (other than "graduated rate estates", below). As such, testamentary trusts will generally be subject to the same tax rules that apply to inter-vivos trusts.

The tax preferences will continue to apply to graduated rate estates. Basically, a graduated rate estate is the estate of an individual for up to 36 months after the individual's death. After the 36 months, the tax preferences will no longer apply. An individual can have only one graduated rate estate.

In addition, a testamentary "qualified disability trust" will continue to be subject to graduated tax rates. A trust can qualify as such if a beneficiary under the trust is eligible for the disability tax credit (certain other criteria apply).

PRESCRIBED INTEREST RATES

The CRA recently announced the prescribed interest rates that apply to amounts owed to the CRA and to amounts the CRA owes to individuals and corporations. The amounts are subject to change every calendar quarter. The rates in effect from January 1, 2015 to March 31, 2015 are as follows, and remain unchanged from all 4 quarters of the 2014 year:

- The interest rate charged on overdue taxes, Canada Pension Plan contributions, and Employment Insurance premiums is 5%, compounded daily.
- The interest rate paid on late payments by the CRA to corporations is 1%, compounded daily.
- The interest rate paid on late payments by the CRA to other taxpayers is 3%, compounded daily.
- The interest rate used to calculate taxable benefits for employees and shareholders from interest-free and low-interest loans is 1%.

AROUND THE COURTS

Rectification allowed to maintain CCPC status

Legal documents and relationships are applied and respected for income tax purposes. A taxpayer can apply to a provincial superior court for a "rectification order", if the written content of the documents do not accurately reflect the actual intent of the involved parties. A rectification order was granted by the Ontario Superior Court of Justice in the recent *Kaleidescape* decision.

The case involved a corporation that was set up as a Canadian-controlled private corporation (CCPC), and the incorporating and related documents were drafted with an intent to maintain the CCPC status. Basically, a private corporation in Canada will qualify as a CCPC if it not controlled by non-residents or public corporations. In the case at hand, the CCPC status was crucial for the corporation to claim certain investment tax credits.

For several years, the corporation qualified as a CCPC – its voting shares were equally split between a Canadian resident and a non-resident so, it was not controlled by a non-resident. However, the resident shareholder was replaced by a trust, and after a corporate re-organization, the CRA took the position that the trust deed effectively gave a non-resident the authority to direct the trust how to vote its shares. According to the CRA, the corporation was then controlled by a non-resident and therefore no longer a CCPC.

The corporation applied for rectification and the Court granted the order. The corporation's lawyer argued that the corporation always intended to remain a CCPC and that voting control not be ceded to non-residents. The Court agreed that the intention to be a CCPC remained throughout the relevant transactions. The Court further held that the wording of one of the paragraphs of the trust documents (on which the CRA relied) was chosen by mistake and not to intentionally give a non-resident legal control over the corporation. The offending paragraph was "rectified", and the corporation therefore qualified as a CCPC for the taxation years in question.

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