



## TAX LETTER

March 2010

**RRIF WITHDRAWALS WITHOUT SELLING STOCKS  
SIMPLIFIED PROCESS FOR SEPARATED PARENTS  
TO CLAIM CHILD TAX BENEFITS  
SOME GST RETURNS WILL HAVE TO BE FILED ELECTRONICALLY  
THE FIRST-TIME HOME BUYER'S CREDIT AND  
DISABILITY HOME PURCHASE CREDIT  
DID YOU HAVE U.S. SOURCE INCOME IN 2009?  
GST WRONGLY PAID ON INVESTMENT MANAGEMENT FEES?  
FOREIGN TAX CREDIT — MAKE SURE THE FOREIGN TAX IS MANDATORY  
AROUND THE COURTS**

### RRIF WITHDRAWALS WITHOUT SELLING STOCKS

If you have converted your RRSP to a Registered Retirement Income Fund (RRIF), as is now required by the end of the year in which you turn 71, then, as you know, you need to withdraw a certain percentage of the RRIF every year. The percentage increases each year until you turn 94, when it reaches 20%. These rules are designed to ensure that the RRIF is effectively used as a pension rather than simply to hold funds. The income is taxed each year in which you withdraw it.

Many seniors believe that the RRIF withdrawal must be done in cash. This is not true. You can withdraw shares, bonds or mutual fund units by arranging for the financial institution to transfer them to your regular (non-RRIF) account. This is called an “in-kind” asset transfer. You may still need cash to pay any tax payable on the withdrawal, but you do not have to sell the securities.

This is a useful point to know if your RRIF is holding securities that you do not yet want to sell. Rather than selling them, you can

consider transferring them to your regular account.

If you do not actually need to use the cash in your RRIF, make sure to consider the “in-kind transfer” option as one way of withdrawing the annual required minimum amount from the RRIF without selling the securities.

### **SIMPLIFIED PROCESS FOR SEPARATED PARENTS TO CLAIM CHILD TAX BENEFITS**

As you may know, the Canada Child Tax Benefit (CCTB) is available to parents of children under 18, where the couple’s income is low or modest. Although legally it is a credit under the *Income Tax Act*, the CCTB is actually paid out monthly by the government by way of cheque or Direct Deposit.

Because the CCTB is based on the couple’s income, taxpayers who are newly separated often find that they now qualify for the benefit, since their individual income becomes the test, rather the combined income of the couple.

The Canada Revenue Agency announced on May 12, 2009 that the application process for the CCTB will be simplified, to make it easier for recipients to confirm their living arrangements and marital status for eligibility purposes.

Under the new administrative process, CCTB recipients who worry that the CRA will not receive their former spouse’s information may immediately submit two letters from independent third parties to show that they live at a residential address different from their former spouse. The CRA will generally accept this evidence as the

basis for recalculating the CCTB entitlement. Of course, this is always subject to later audit; if you claim a CCTB to which you are not entitled, the CRA may come back months or years later and reassess you to recover the benefits plus interest (and, in some cases, penalties).

For more information on the Canada Child Tax Benefit, see [cra.gc.ca/cctb](http://cra.gc.ca/cctb).

### **SOME GST RETURNS WILL HAVE TO BE FILED ELECTRONICALLY**

In December 2009, Parliament passed legislation (Bill C-62) which will **extend the Harmonized Sales Tax (HST) to Ontario and British Columbia** beginning July 1, 2010. The provincial Retail Sales Tax in those provinces is being eliminated and replaced with an increase in the GST rate from 5% to 13% (Ontario) and 12% (B.C.).

As with the existing HST which has been in place since 1997 in Nova Scotia, New Brunswick and Newfoundland & Labrador, the GST and HST are one tax system, administered by the Canada Revenue Agency. Quebec is the only exception since the province administers both the GST and the Quebec sales tax. A business that is registered for GST is also registered automatically for HST. The GST return that a business files each month, quarter or year has actually been called a “GST/HST Return” since 1997, even in non-HST provinces.

In conjunction with the changes that take effect on July 1, **certain businesses will be required to file their GST/HST returns electronically**, whether or not they are located in an HST province. This will apply to:

- all registrants with more than \$1.5 million in annual taxable sales, except for charities (in calculating the limit, the sales of all “associated” persons within the same control group are combined);
- registrants that are required to recapture input tax credits (ITCs) for the provincial portion of the HST on certain inputs in Ontario or British Columbia (this applies to certain financial institutions, and all businesses with group taxable sales exceeding \$10 million); and
- builders that are affected by any of the transitional housing measures announced by Ontario and British Columbia (such as a transitional tax payable and transitional RST rebate).

These new requirements will apply to reporting periods that end in July 2010 or later. Thus, for example, if your business files GST returns quarterly and has an October 31 year-end, it will normally have a “reporting period” that runs from May 1 to July 31. The return for that quarter, which is due by August 31, will have to be filed electronically if the business falls into one of the categories above.

Note that an electronic return requires that the registrant have an “access code”, which is provided by the CRA on a preprinted return. If a business is trying to file a return just before the deadline and is unable to find the access code, there might be no way to file the return without incurring a penalty! So advance preparation and planning for GST/HST returns will be necessary. (The penalty might not be applied for the first year or so, as businesses are getting used to the new system.)

For details see CRA news release 09-119, “New Reporting Requirements as of July 1, 2010, for GST/HST Registrants” (January 26, 2010), and GST/HST Notice 249, “Questions and Answers on the New Reporting Requirements for GST/HST Registrants” (January 2010), both available on the [cra.gc.ca](http://cra.gc.ca) web site.

### **THE FIRST-TIME HOME BUYER’S CREDIT AND DISABILITY HOME PURCHASE CREDIT**

The Home Renovation Tax Credit (HRTC), which was introduced in the January 27, 2009 federal Budget and expired on January 31, 2010, generated a lot of media interest and advertising hoopla, and helped stimulate the home renovation industry. The maximum credit, for a homeowner who spent \$10,000 or more, is \$1,350.

Another home-related tax credit, also introduced in the January 27, 2009 federal Budget, has received almost no media attention. This is the **First-Time Home Buyer’s Credit**. This credit has an alternate version which does not have an official name, but which we might call the **Disability Home Purchase Credit**.

The credit is worth **\$750**. It applies if you meet the following conditions:

- You buy (including as a joint owner) a **home**. It need not be a new home. It can be a single-family home, semi-detached home, townhouse, mobile home, condominium unit, or other apartment that you buy. It can also include a share in a cooperative housing corporation (i.e. a “co-op”) that gives you possession and an equity interest in a particular co-op unit.

- Your interest in the home must be registered in your name in the land registration system.
- The closing date is **after January 27, 2009**. There is no expiry date as there was for the home renovation credit; this credit will continue to apply until it is changed or repealed.
- You intend that either you or the disabled person described below will **“inhabit the home as a principal place of residence”** within one year after acquiring it.
- Either:
  - You or your spouse did not own (including owning jointly) a home that you lived in **during the same calendar year or any of the previous four years**. A common-law partner of either sex is treated the same as a spouse for this purpose. A co-op share can count as a home that was owned.

(Thus, this not really a “first-time buyer’s” credit. If you owned a home more than five years ago but not in the past five years, you qualify.)

or

- You intend for the home to be inhabited by a disabled family member (including yourself) who qualifies for the **Disability Tax Credit**, and the home is either more “accessible” for this person or provides an environment better suited to this person’s personal needs and care.

In other words, if the “disability” condition is met, the “not owned a home within the past 5 years” condition is not required.

Once you qualify, the federal credit is \$750. If more than one person qualifies in respect of the same home (e.g. you and your spouse jointly buy a home so you both qualify), either of you (but not both) can claim the \$750, or you can share it (e.g. each could claim \$375).

This credit is “non-refundable”, meaning that it can reduce tax for the year but cannot be used to create a refund if you do not have any tax for the year. Thus, for example, if you have a high income and your spouse does not have enough taxable income to be paying tax, then you would claim the credit on your own return.

This credit is unrelated to the Home Buyer’s Plan, which allows you to borrow up to \$25,000 per person from your RRSP to help with the cost of a new home and repay the loan over the following 15 years. However, the “not owned a home within the past 5 years” condition is the same as that for the Home Buyer’s Plan.

#### **DID YOU HAVE U.S. SOURCE INCOME IN 2009?**

If you had income from sources in the United States in 2009, consider what **exchange rate** to use when reporting that income on your 2009 tax return. This is particularly important because of the large swings in exchange rates during the year.

If you earned income at various times in the year, one generally acceptable method is to use the official average exchange rate for the

year. For 2009, this was **C\$1.1420** to the U.S. dollar.

However, depending on when in 2009 your income was earned (generally the invoice date for self-employment income, or the date of receipt for employment income or investment income), the applicable rates could be very different. For example, on October 14, 2009 the U.S. dollar was worth only \$1.0292 Canadian, while on March 9, 2009 it was exactly \$1.30 Canadian.

For example, suppose some work you did for U.S. clients in 2009 was billed on October 14 for US\$10,000. If you use the average exchange rate for the year, you'll report the income as \$11,420 for purposes of your Canadian tax return, while if you use the October 14 rate you'll report the same income as \$10,292. That's a \$1,128 difference; if you're in the top tax bracket, you can save **more than \$500, simply by choosing the best method of reporting.** (The exact amount you save will depend on your province of residence, as provincial tax rates vary.) Conversely, if you billed US\$10,000 on March 9, it would be reported as \$13,000 if you use that date's rate, so you'll save \$700 or more by using the \$1.142 average exchange rate.

See [bankofcanada.ca/en/rates/exchange-look.htm](http://bankofcanada.ca/en/rates/exchange-look.htm) to look up the exchange rate for any date, or any range of dates. For example, if you received weekly amounts of rent from a U.S. property from October 1 through December 31, 2009, you can put in that date range and instantly get the average exchange rate over that period, which would be much better to use than the average for the year.

## **GST WRONGLY PAID ON INVESTMENT MANAGEMENT FEES?**

In our September 2009 Tax Letter, we reported that, based on the recent Federal Court of Appeal decision in *Canadian Medical Protective Association* (CMPA), you might be able to recover GST paid on certain investment management fees paid over the past two years.

The CMPA obtained a rebate of GST it had paid on discretionary investment management fees, as "GST paid in error". The Federal Court of Appeal ruled that the investment management services were "arranging for" the transfer of securities, which is an exempt financial service under the GST.

We advised in September that, if you had paid a significant amount of GST on this type of investment management service over the past two years, you might want to make a rebate claim.

Unfortunately, this rebate will not be available, even if you have already claimed it. On December 14, 2009, the Department of Finance announced that the **GST legislation will be amended retroactively to make investment management fees taxable** for GST and HST purposes, even in situations where the Courts held that they were exempt. Only if the investment manager did not charge or collect GST on pre-December 14, 2009 fees will this rule not apply. This change validates what the CRA calls its "longstanding policy intent".

Thus, if your investment manager charged GST, as most did, the amendment to the legislation will make the fees taxable (thus confirming that the GST should have been

charged), and this change will be retroactive to 1991 when the GST was first introduced.

Since this change is only a news release from the Department of Finance, the CRA will reject all rebate claims until the legislation is passed by Parliament.

Fighting the government on tax issues is a challenge when they can change the rules after the fact!

### **FOREIGN TAX CREDIT — MAKE SURE THE FOREIGN TAX IS MANDATORY**

As you may know, Canada provides a “**foreign tax credit**” (FTC) to Canadian residents, to reduce double taxation on foreign-source income.

The FTC rules are complex. In general terms, Canada allows a credit to a Canadian resident for **foreign income tax paid on foreign-source income**, up to a limit of the Canadian tax payable on that income.

The effect is that you pay total tax equal to the higher of the two rates of tax (Canadian and foreign) on the foreign-source income.

Thus, for example, suppose you earn \$1,000 in dividends on a U.S. stock, and the U.S. company withholds \$150 as withholding tax. (We’ll ignore exchange rate issues for this example; assume all amounts are in Canadian dollars.) Assume you are in a 40% tax bracket, so you pay \$400 of Canadian tax on the same \$1,000 of dividend income.

In this example, Canada will grant you a foreign tax credit of \$150 on your Canadian tax return, so that you only pay \$250 of Canadian tax on the dividends. The total tax

burden (\$150 to the U.S. and \$250 to Canada) will thus equal the \$400 of Canadian tax you would have paid if there had not been any foreign tax. (Most developed countries have similar rules.)

The FTC has many complexities and traps. One trap you should be aware of is that the **foreign tax must be mandatory**. If you could have avoided paying the foreign tax, or recovered it from the foreign government, then you cannot claim it as a foreign tax credit.

Thus, for example, suppose your U.S.-source income is interest rather than dividends, and the interest is exempt from U.S. tax under the Canada-U.S. tax treaty. (Withholding tax on most interest payments from the U.S. is zero as of 2010; see our September 2009 Tax Letter.) If the U.S. payor withheld U.S. tax, and you can recover that tax from the U.S. government by claiming relief under the treaty, then the U.S. tax you paid is not eligible for the foreign tax credit, because **Canada will consider it to be a “voluntary” payment** to the U.S. rather than a foreign tax.

Finally, note that the foreign tax credit for “non-business-income tax” is based on the amount of foreign tax you actually paid, net of any refunds such as a U.S. child tax credit. This was confirmed by the Federal Court of Appeal in the *Zhang* case (2008).

### **AROUND THE COURTS**

#### *Old tax debts can come back to haunt you*

Old debts owing to the Canada Revenue Agency for income tax or GST may lie in limbo for years with no action, and come back to haunt you many years later, with massive amounts of accrued interest.

The recent case of *Leeado Enterprises Ltd.* is a good example. The CRA assessed a company for GST relating to the sale of land in 1992. The GST at stake was \$100,000. The company filed a Notice of Objection to the assessment, but when the CRA rejected the objection, the company did not pursue the matter further by appealing to the Tax Court of Canada. This was in 1997.

The CRA took no action on the debt for many years, either through inattention or because the CRA Collections officials could not find any assets to seize.

In 2008, the CRA discovered that the company had an interest in some land in British Columbia, and brought an application in the B.C. Supreme Court to determine what that interest was and to sell the land, with the proceeds paid over to the CRA. By this time the debt had mushroomed to \$400,000 with interest.

The company tried to dispute the Court action, but had no legal leg to stand on. There is no limitation period on CRA collection action at present, due to amendments to the *Income Tax Act* and the GST legislation that were enacted several years ago. Only if there has been no CRA collection action for 10 years after March 3, 2004 will there be a limitation period; thus, the first time a limitation period will arise is March 2014.

The company tried to appeal the Court's decision further to the B.C. Court of Appeal, but its request for leave to appeal was denied. The company's owner had various complaints about the CRA's actions in how it dealt with the assessment and collection process. However, since the company had not appealed the GST assessment to the Tax Court, it could no longer argue that the assessment was incorrect, even if the Court believed that it was.

This case is a good reminder of the importance of taking timely action to contest any CRA assessment or reassessment. If you leave matters until the CRA is pursuing collection action, you will likely be too late to raise any argument that the assessment is wrong.

\* \* \*

This letter summarizes recent tax developments and tax planning opportunities; however, we recommend that you consult with an expert before embarking on any of the suggestions contained in this letter, which are appropriate to your own specific requirements.