



TAX LETTER

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IS YOUR RRSP OR RRIF SAFE? 10-YEAR LIMITATION PERIOD ON TAX COLLECTION CALCULATING AUTOMOBILE BENEFITS AND PARKING BENEFITS GST WRONGLY PAID ON INVESTMENT MANAGEMENT FEES? WERE YOU CHARGED U.S. WITHHOLDING TAX ON INTEREST IN 2008? ONTARIO AND BRITISH COLUMBIA HARMONIZE WITH THE GST AROUND THE COURTS

IS YOUR RRSP OR RRIF SAFE?

What happens if you owe money to creditors, including the Canada Revenue Agency? Can your Registered Retirement Savings Plan (RRSP) or Registered Retirement Income Fund (RRIF) be seized to pay your debts, including tax debts?

The answer *may* be yes. Other than on bankruptcy, a regular (non-life-insurance) RRSP or RRIF can be seized by creditors in most provinces, even though the *Income Tax Act* provides that an RRSP or RRIF cannot be used as security.

In British Columbia and Saskatchewan, however, provincial legislation generally prevents an RRSP or RRIF from being

seized, though there are some exceptions. (For B.C., this is in the *Court Order Enforcement Act*, section 71.3; for Saskatchewan, the *Registered Plan (Retirement Income) Exemption Act*.)

Note that you can still be **liable for tax on the income** when your RRSP is cashed in, even though you are not cashing it in voluntarily and you do not see any of the proceeds.

However, if the RRSP is set up as **life insurance**, it will likely be exempt from seizure under provincial insurance legislation. Note that putting an RRSP into life insurance may not defeat creditors if this is done shortly before going bankrupt.

On **bankruptcy**, an RRSP or RRIF does not form part of the property that the bankruptcy trustee divides up among the creditors, except for property contributed to the RRSP or RRIF in the 12 months before the date of bankruptcy (*Bankruptcy and Insolvency Act*, paragraph 67(1)(b.3)). A deferred profit sharing plan is also exempt on bankruptcy, under regulations passed in July 2008. So declaring bankruptcy can actually protect your RRSP or RRIF.

10-YEAR LIMITATION PERIOD ON TAX COLLECTION

In 2003, the Supreme Court of Canada ruled in the *Markevich* case that the Canada Revenue Agency could not take action on an old tax debt that it had written off internally and not proceeded with collection action for many years. The reason was that the *Crown Liability and Proceedings Act*, which permits legal actions by and against the federal government, provided a 6-year limitation period for legal actions by the government.

The government responded with new legislation, which came into effect on May 14, 2004. These changes are found in section 222 of the *Income Tax Act* (and, for the GST, section 313 of the *Excise Tax Act*).

Under these rules, the CRA has **10 years** to take collection action of any kind. Any collection action at all, including if the taxpayer acknowledges the tax debt or makes any payment, restarts the 10-year period. Collection action against another party for the taxpayer's debt (e.g. where the taxpayer has transferred property or money to a family member) also restarts the period. Furthermore, the period is extended if the taxpayer becomes non-resident, or if collection action is restricted for any reason (such as an

objection being filed or because of a proposal filed under the *Bankruptcy and Insolvency Act*).

Any "old" tax debts from the past had their 10-year period reset to begin on March 4, 2004. The limitation period for the CRA to take collection action on those old debts will not expire until **March 4, 2014**. This applies even if the taxpayer obtained a Court order suspending collection action based on the *Markevich* decision.

As a result, if you (or perhaps a corporation you own) have an old tax debt that has not been formally cancelled by bankruptcy, it can still be revived by the CRA taking collection action within the 10-year period, or before March 4, 2014.

CALCULATING AUTOMOBILE BENEFITS AND PARKING BENEFITS

The Canada Revenue Agency provides online tools for calculating employee benefits from the use of an employer-provided automobile, as well as for determining whether employer-provided parking is taxable.

These tools are designed to be used by employers. If you are an employee, however, you may wish to use them as well, to determine the tax effects of benefits you are getting from a company car and/or parking. These benefits are reported by your employer on your T4 each February, and become part of the employment income on which you pay tax.

To calculate automobile benefits, including the "standby charge" and other benefits, use:

www.cra.gc.ca/autobenefits-calculator

To determine whether parking provided to an employee is a taxable benefit, use:

www.cra.gc.ca/payroll

Select “P”, and from the drop-down menu, “Parking”

GST WRONGLY PAID ON INVESTMENT MANAGEMENT FEES?

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.

If you have paid a significant amount of GST on this type of investment management service over the past two years, you may want to make a rebate claim. To claim the rebate, you must file a Form GST189 (available at cra.gc.ca/forms) with the Canada Revenue Agency within two years of when you paid the GST.

Note that if your investments are in a corporation, partnership or trust whose “principal activity is the investing of funds”, or in an “investment plan” such as an RRSP, then the rebate is less likely to be available (though there is uncertainty about this, due to the Tax Court’s earlier ruling in *CMPA* on the meaning of “management or administrative service”).

Even if you otherwise appear to qualify, your claim may well be denied. The CRA is

still considering its response to the *CMPA* case, and may reject all such claims on the basis that the facts are not exactly identical to *CMPA*. This means that you might have to file a Notice of Objection and possibly an appeal to the Tax Court of Canada. However, you definitely cannot recover any GST unless you file a claim within the two-year deadline. So if there is any chance that you may wish to pursue a claim, you should file the rebate application now.

WERE YOU CHARGED U.S. WITHHOLDING TAX ON INTEREST IN 2008?

Most countries apply a “withholding tax” on interest payments made by residents of the country to persons who are not resident in the country. (Canada used to apply such a withholding tax, but has eliminated it in most cases since January 2008.)

The United States is no exception. Although some types of interest are exempt from withholding, the United States does charge a 30% withholding tax on many payments to non-residents.

The Canada-U.S. tax treaty used to provide for a maximum withholding tax of 10% in each direction. The treaty was amended by the “Fifth Protocol” to phase out this interest, so that the interest withholding applies as follows:

Until 2007	10%
2008	7%
2009	4%
From 2010	0%

The Fifth Protocol was signed in September 2007, but was not ratified (passed into law by both countries) until December 2008.

If you have investments in U.S. bonds, bank accounts or other investments that pay interest, you may have been subject to U.S. withholding tax at a higher rate than should have applied.

First, if you did not complete the required form showing that you are a resident of Canada and entitled to benefit from the Canada-U.S. tax treaty, the payor may have withheld 30% withholding tax.

More likely, you did complete the form, but during 2008, until the Fifth Protocol was ratified, tax may have been withheld at 10% instead of the 7% that actually applies for 2008.

If you were subject to the 10% rate, you can apply to the IRS for a refund of the extra 3%. The deadline for applying is generally December 31, 2010. You may be able to use Form 1040NR or 1120F. However, if a significant amount is at stake, you should obtain advice from a tax professional familiar with the US rules to ensure that you meet the deadlines and follow the correct procedures.

Often, foreign withholding tax does not matter because you are paying Canadian tax on the income anyway and can claim a Foreign Tax Credit on your Canadian return to recover the foreign tax. Do not assume that this will be possible for the excess 3%! Because it is not legally payable, the CRA will likely take the position that it was not foreign tax paid, and so is not eligible for the Foreign Tax Credit.

ONTARIO AND BRITISH COLUMBIA HARMONIZE WITH THE GST

Ontario and British Columbia have announced that they will both harmonize their sales taxes with the GST, so that the Harmonized Sales Tax will apply in those provinces beginning July 2010 (at 13% in Ontario and 12% in B.C.).

What is the Harmonized Sales Tax?

To answer this question, a little history is helpful.

GST — A “Value Added Tax” (VAT)

The GST was originally introduced in 1991 as a 7% national sales tax. (It has been 5% since January 2008.)

The GST is a “value-added tax” (VAT), like the sales tax in almost every other country in the world other than the United States. The essence of the GST system is that business get back the GST they pay on their costs of doing business (by way of “input tax credits”), so that in effect they remit to the government only the tax on the value they have added.

The GST applies to a broad base of virtually all property and services, with specific exceptions such as basic groceries, certain medical devices, health care services, used housing and residential rent.

Retail Sales Tax (RST) systems

By contrast, in retail sales tax (RST) systems, businesses pay sales tax which becomes part of their cost.

With an RST, there is no tax on business purchases of inventory for resale, or, in many cases, goods to be manufactured into other goods for resale. But many other

purchases (e.g., computers to run the business) bear RST, and increase business costs. Most services are not subject to RST.

Before 1991, all provinces except Alberta had an RST system. (Alberta has never had a general provincial sales tax.)

Converting RSTs to VAT

The federal government has been trying for many years to get the provinces on-board with a national VAT system (the GST). The object is to reduce the complexity of having many different sales tax systems across Canada, and to provide businesses with the benefits of a VAT (i.e., input tax credits to recover tax they pay).

Quebec set up its own VAT (the Quebec Sales Tax) in 1992. It is very similar to the GST but not part of the GST system. Quebec administers the QST and the GST together.

In 1997, the three largest Atlantic provinces implemented the **Harmonized Sales Tax** (HST). Instead of a 7% GST, sales in those provinces became subject to a 15% HST.

The HST is part of the GST system. Business registered for GST are automatically registered for HST as well. If they are shipping goods to an HST province, they must collect HST regardless of where in Canada they are shipping from.

Since 1997, we have had a messy sales tax system across Canada. Nova Scotia, New Brunswick and Newfoundland & Labrador have the HST (now 13%). Alberta has only the GST (5%). Quebec has a 7.875% QST plus the 5% GST. Ontario, Manitoba, Saskatchewan, B.C. and Prince Edward

Island have their own RST systems plus the 5% GST.

Ontario and B.C. harmonize

Ontario announced in its March 26, 2009 Budget that it will join the HST starting July 1, 2010. Thus, the RST will stop applying, and the GST, instead of 5%, will become a 13% HST.

Virtually all goods and services now subject to 5% GST will be subject to 13% HST. There will be some exceptions. Books, children's clothing and footwear, children's car seats and car booster seats, diapers and feminine hygiene products will be subject to only 5% tax.

British Columbia announced on July 23, 2009 that it will also join the HST starting July 1, 2010. Instead of 5% GST, the HST rate will be 12%.

Again, virtually all goods and services not subject to 5% GST will be subject to 12% HST in British Columbia. The same exceptions will apply as in Ontario, plus fuel for motor vehicles will also be subject only to the 5% tax.

In both provinces, there will be special rebates for new housing, to reduce the impact of the new tax on the residential construction industry. There will also be special transitional rules to deal smoothly with the changeover from the RST to the HST system, especially with respect to new housing, so as not to provide a strong incentive to finish homes or sell them before or after the July 1, 2010 date.

What does this mean to you?

If you run a business that is in, or that does business with, either Ontario or B.C., then you will need to learn about the new HST rules and how they will apply to your business. There's still lots of time until next July, but don't delay too long, as systems and software changes can take time.

Large businesses with over \$10 million in sales will be subject to restrictions on input tax credits for the first 5 years (after which the restrictions are to be phased out over 3 years). During this period, they will not be able to claim an input tax credit to recover the 8% (Ontario) or 7% (B.C.) provincial portion of the HST on most purchases of energy, telecommunications, road vehicles, food and entertainment. These restrictions may be eliminated sooner if the province's fiscal situation improves.

AROUND THE COURTS

Unsuccessful class action lawsuits against couriers' brokerage charges

Have you ever ordered an item from the U.S., expecting to pay a few dollars of GST on the importation, and been charged an exorbitant "brokerage fee" by the courier company that delivers the goods to you? An enterprising law firm has tried to fight such fees, but failed.

Blackman v. Federal Trade Networks and *MacFarlane v. United Parcel Service Canada Ltd.* were class action lawsuits launched by the same Vancouver law firm.

In each case, a representative plaintiff had ordered a small item to be shipped from the United States. The item was shipped by Fedex in one case and UPS in the other. When the item was delivered to the

purchaser in Canada, the courier insisted on collecting a "brokerage fee" in the \$30-\$40 range, for clearing the item through Customs, in addition to any GST or Customs duties payable.

The *Blackman* case was decided first. Blackman claimed that he received unsolicited services, because he did not ask Fedex's courier to clear the goods for him; that Fedex engaged in deceptive practices by not disclosing its brokerage fees ahead of time; that the charges were unconscionable.

The British Columbia Supreme Court dismissed Blackman's claim. Fedex's Service Guide did state that brokerage charges may apply to international shipping.

The problem for Blackman was that goods shipped by a vendor to a purchaser are legally considered to be shipped *as the purchaser's agent*. (This rule is well-established in the law of the sale of goods, both at common law and by legislation.) The vendor, acting as Blackman's agent, contracted with Fedex, and so Blackman was bound by the conditions of the vendor's contract with Fedex. That contract included the Service Guide, which stated that brokerage charges may apply.

Furthermore, Fedex's services were clearly not unsolicited. The Court also found that Fedex's failure to disclose the specific brokerage charge to Blackman was not a "deceptive practice". As well, there was no inequality of bargaining power, and no undue pressure exerted by Fedex, so the charge was not unconscionable. Fedex's brokerage fee did not grossly exceed what other couriers charge, other than Canada Post, which charges only \$5. (This \$5 fee is set by federal regulations.)

As a result, Blackman's claim was dismissed. Due to the *Blackman* case, Macfarlane's claim against UPS met the same fate. (Macfarlane's claim is being appealed to the B.C. Court of Appeal.)

These cases are a reminder that Canadian purchasers do have a choice. When ordering goods from the U.S., you can ask the vendor to ship the goods by U.S. Mail (and thus Canada Post), including Express Mail, so that the brokerage charge will be limited to \$5. (The GST legislation specifies that no GST applies to the \$5 charge.)

Taxpayer liable to penalty and interest for not paying RRSP overcontribution tax

You are allowed a certain amount of RRSP contribution each year. Your contribution limit depends on your previous year's "earned income", your "pension adjustment", and a dollar limit that applies to each year (e.g. for 2009 the maximum is \$21,000). If you contribute less than the maximum in any year, you can carry the excess "room" forward, and contribute it in a later year.

If you overcontribute to your RRSP, a special tax applies. While it is often called a "penalty tax", it is a tax imposed by Part X.1 of the Income Tax Act, not a penalty.

You are allowed \$2,000 of overcontribution leeway (useful if you have miscalculated your contribution limit). Beyond that level, any overcontributions are subject to Part X.1 tax of **1% per month**.

Most people think that if the Part X.1 tax applies, then the Canada Revenue Agency will apply it, and that is that. Well, not quite. The Income Tax Act actually requires you to file a return (the "T1-OVP") to report the overcontribution and pay the Part X.1 tax. This is rarely done, of course; if you have overcontributed, you will normally want to fix the problem by withdrawing the excess amount.

In the recent case of *Pereira-Jennings*, a taxpayer was assessed a **penalty** on her Part X.1 tax, and **interest** as well, on top of the overcontribution tax. She appealed to the Tax Court of Canada.

The Court dismissed her appeal. The penalty and interest were correctly applied, based on the wording of the Income Tax Act.

This is a surprising case, because, as noted above, few people ever think of filing the T1-OVP return. Most people who realize that they have overcontributed, aside from withdrawing the excess, simply hope that the CRA won't find the overcontribution. *Pereira-Jennings* shows that there is a risk in not filing this return. If you do not file it for one year from when it is due, then the penalty is 17% of the Part X.1 tax owing, in addition to the interest.

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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.