



Building a better
working world

2019-20

Managing Your Personal Taxes

A Canadian Perspective

This is an interactive document





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At EY, we're committed to doing our part in building a better working world. And we start with the world that matters most to you — your world. So we want to help make things a little easier for you when it comes to your personal taxes.



Foreword

How can you turn
tax complexity
into tax savings?

30 September 2019

It's no secret that tax can be pretty pervasive and complicated – personal taxes perhaps the most of all.

At EY, we're committed to doing our part in building a better working world. And we start with the world that matters most to you – your world. So we want to help make things a little easier for you when it comes to your personal taxes.

To build a better world, you need to ask better questions. How can I sort through the myriad tax credits to find the ones that are right for my situation? What tax deductions can I make for my kids? What do I need to know before buying a house or making any other major investment? Is an RRSP or a TFSA the better plan for retirement?

In the following pages, you'll find tips, strategies, suggestions and important updates that we hope will inspire you to ask yourself questions. Finding the answers can help you understand your tax situation, plan for the future, benefit from government incentives and – perhaps most important – save you time, money and, hopefully, stress.

For more tax-planning ideas and savings, visit us at ey.com/ca/tax, or contact us at the EY office nearest you, listed at the back of this book.



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1

Considering selling your business?



Without doubt, selling your business can be a challenging and emotional process for all involved.

Careful preparation is necessary throughout the process, from both an after-tax value perspective and a smooth process perspective. While the outcome of any sale process is ultimately impossible to foresee, you can significantly increase the likelihood of closing a deal on acceptable terms if you carefully plan ahead from both a business and a tax point of view.

Business and tax factors are equally important to helping shareholders achieve their objectives when they decide to exit their business, and both should be considered well before a sale takes place. Let's review some key considerations you should be aware of, preferably in advance of deciding to sell your business.

Business considerations

Management succession plan

If you're actively involved in the business's day-to-day operations, now is the time to think about who will run the business after you sell. Do you still want to be involved in the business? Is the next generation incorporated in the current structure? Is there a strong management team in place already?

If you've essentially made yourself redundant to the general day-to-day operations of the business, that feature will be an attractive selling point to potential buyers, assuming you've got a strong management team in place. If you're still involved with the operation of the business but have identified a leadership transition process, you should take action to ensure that you don't represent most of the business's goodwill. Not having a proper transition plan in place can eliminate certain

buyers, including private equity firms. It can also reduce the business's value, lead to contingent consideration (earnouts), or result in your longer continued employment with the business or your retention of a larger ownership interest after closing.

Putting a transition plan in place is also a form of insurance to allow for business continuity in the event of an unforeseen tragedy.

Strong financial reporting

When selling your business, it's critical to have solid financial information, since management reporting is one of the main tools the buyer will use to assess the company's value. The financial information needs to be accurate and consistent; it helps a buyer to understand what makes your business tick and where opportunities for improvement lie. When there's uncertainty, buyers may want to discount the price they're willing to pay for the business or adjust the terms of the deal structure in their favour.

Having the right internal and external financial resources is critical. Potential buyers will examine how you're managing the business's financial operations. They'll want to know whether you're using a part-time or full-time bookkeeper, controller, VP of finance or CFO. They're also going to assess who is carrying out external reporting on the financial statements and whether through a notice to reader, review or audit engagement.

In addition to looking at who is managing your finances, potential buyers will also consider *how* that financial information is being presented. Some of the critical questions buyers will ask include:

- ▶ How many adjustments are being made at year end (compared with month end)?
- ▶ Are the right systems in place to support the reporting function?

- ▶ What kind of monthly reports are available?
- ▶ What kind of financial information is being tracked? Customer, supplier, product line, revenues, margins, contribution?
- ▶ How accessible is the information?

When you present reliable and real-time financial information, and can demonstrate that this information is being used to manage the business, buyers will gain confidence in the picture you're presenting of the business and its earnings. This in turn makes the due diligence process easier to manage and reduces the potential for business valuation discounts due to uncertainty. Of course, if you have better-quality information available, you should also see tangible benefits in managing your business during your period of ownership.

Look through a buyer's eyes

How does an outside investor or buyer look at your business? What makes it attractive?

- ▶ Taking an objective "buyer's view" will improve your business, whether or not you sell
- ▶ Take an honest look at your business from a buyer's perspective
 - How credible is your story? Is it sustainable?
 - How might the buyer's business and yours fit together?
 - What might give buyers concern?
- ▶ Initiatives identified to improve your business need to be implemented and shown to be sustainable
 - Otherwise, you may not receive value for them

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Organization is key

When you're preparing to sell your business, it's important to ensure your records are organized and easily accessible. Potential buyers are interested in businesses that have processes in place for document retention, employee records, customer contracts, supplier contracts, leases, risk management and regulatory matters. When information is complete and presented in an organized manner, it provides confidence to the buyer, minimizing concerns around any "unknowns" and maintaining deal momentum. If you're in a position where formal contracts don't exist, now is the time to start getting those relationships properly documented. You'll want to have the information readily available on request when going through the due diligence process.

Some reports can be compiled quickly on an ad hoc basis, but having proper processes in place – years before a sale – can reduce the stress and time it takes to prepare for due diligence. It also provides the added benefit of helping the current business run more smoothly and with less risk while you're still the owner.

Building and retaining business value – being proactive

- ▶ Breadth and depth of management team
- ▶ Sustainable EBITDA
- ▶ Supportable forecasts
- ▶ Optimized working capital
- ▶ Cleaned-up balance sheet
- ▶ Solid financial reporting
- ▶ Tax attributes

Earnings before interest, taxes, depreciation and amortization

The value of a business is often looked at in relation to its enterprise value, which is typically calculated as sustainable EBITDA times a value multiplier. It's important to understand what your sustainable EBITDA is and evaluate how you can increase it. EBITDA that's calculated based on your financial statements will need to be adjusted for a range of factors. You should be aware of what these factors are, as they will be uncovered through the due diligence process.

Being prepared, having thought through the appropriate adjustments and being able to support adjustments are critical to maximizing your business's value. Adjusted, or normalized, EBITDA can be quite different from the number calculated from your financial statements. You don't want this to come as a surprise through the due diligence process and leave value on the table.

Supportable forecasts

You need to remember that a buyer is buying the future cash flows of your business, and they want to know what to expect. It's important for management to prepare detailed, supportable forecasts based on key business drivers.

Forecasts can provide an indication of future performance and show positively on management's understanding of the business and industry. This in turn will strengthen the management team's credibility. Forecasts with limited thought put into them, with no evidence to support them, will show negatively.

Optimizing working capital

Working capital is often overlooked and is an area that can cause many deals to fall through. Most business sale agreements have some form of purchase price adjustment that relates to working capital.

Typically the closing date working capital is compared to a previously negotiated target amount, and then a dollar-for-dollar price adjustment occurs. This can be in either party's favour, depending on how the process unfolds. Actual working capital is what is delivered to the buyer at closing. The target working capital is often based on a historical average. As a consequence, sellers want a low working capital target, since they have a better chance of having a price adjustment in their favour. There's a lot of hidden complexity in these calculations, and a lot of room for interpretation if you're not careful. Being aware of pitfalls early on can help prevent disputes that may arise at closing.

As you look at your business in advance of a sales process, you'll want to identify and implement ways to lower your working capital and demonstrate its sustainability. This is a proactive process that will deliver value to the business even if a transition or sale process is abandoned.

Clean up the balance sheet

To achieve the highest value possible for your business and facilitate a smooth transaction, you must assess your balance sheet. In many cases, private family-run businesses have many assets of a personal nature or redundant assets that are of little use in the actual business.

Personal assets can include items such as vehicles and non-business-related investments. Redundant assets can include things like older equipment that's not used in the business but is still included on the books. They can also include real estate owned by the business where there is the potential to increase liquidity now by selling the property and leasing it back; such a transaction may also be beneficial where the redundant asset (for example, real estate partially used in the business with the excess rented to arm's-length tenants) taints access to the various capital gains exemption asset value tests.

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It's advisable to remove such assets from the business before getting into a transaction process (see the discussion below on purifying a company to access the lifetime capital gains exemption (LCGE)). This will make it easier for the buyer when assessing the business's core enterprise value and will simplify the transaction's closing process. If the noise of personal and redundant assets is removed, the buyer can better assess the business's financial state. This can be a great way to boost the business's value. In the case of redundant assets, if unused equipment is sold off before a sale, it can add more value.

You should also consider any off-balance sheet liabilities in the business. Items like purchase commitments, operating leases, bonus and incentive plans, litigation

and environmental issues can all impact the business valuation. These items should be dealt with early on in the process and be properly managed to minimize the impact they may have.

Optimizing your tax outcomes

Get your tax structure right

On the tax side, achieving your goals takes advance planning. You'll want to have an optimal tax structure that provides the greatest after-tax proceeds for your selling shareholders. For example, you should consider whether a reorganization of the corporate group is needed to ensure that the greatest tax saving and deferral opportunities

are available to you on the exit. One example of such a structure involves having the future growth of the operating company shares accrue to a family trust so that you and your extended family can access the LCGE on the sale of the company's shares. To qualify for the LCGE, the shares must be qualified small business corporation (QSBC) shares. The QSBC share rules are quite complex, but generally require the shares to have been held for at least two years and for the company, directly or through a connected corporation, to be using 90% or more of the fair market value of its assets in a business primarily carried on in Canada.

The LCGE is almost \$870,000 per person, which may represent a significant portion of the value if multiple exemptions are available on the sale.¹ However, you can only pass future growth to the trust or to other family members. This means that waiting until just before the sale to put this structure in place will not be beneficial. There would be little time available for the company to grow sufficiently in value between the date of the reorganization and the closing of the sale. Generally, the trust must hold the shares for two years in order for the LCGE to be available on the sale of the shares by the trust.

If your business has too much of its current value represented by assets that aren't used in operating the business in Canada (such as passive assets or shares of foreign subsidiaries), the LCGE may not be available. There may be a need to "purify" the company so the shares qualify for the LCGE, and, depending on the proportion of these "bad" assets, it may be necessary to purify more than two years before a sale.



¹ Careful tax planning must be used to access the LCGE for capital gains splitting to avoid negative tax consequences, such as rules that treat capital gains realized by minors on the disposition of private company shares to non-arm's-length parties as non-eligible dividends taxed at top marginal rates. Refer to [Chapter 9: Families](#) and [Appendix E: The revised tax on split income rules](#).

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The LCGE is available only on the sale of shares. Some transactions are structured as “asset deals” where the corporation that carries on the business sells its tangible and intangible assets to the buyer. Some buyers may prefer this structure, since they would not inherit the tax history of the corporation that carried on the business and, because they are buying the assets directly, they can depreciate the actual fair market value of the purchased assets for tax purposes. This perceived tension on deal structure between buyers and sellers can often be overcome by prudent tax planning and negotiation.

Tax attributes

Tax attributes can often be an overlooked aspect of the business, and you’ll want to ensure you have sufficient time to put a proper plan in place. You’ll want to consider if there’s more than one shareholder and if there are shareholder agreements, and evaluate if these will detract from the value of your business and create any unexpected tax consequences if there’s a change of control.

In many situations, you may have purchased the business from another party a number of years ago. The cost basis of your shares and the impact of your past history will need to be tracked and understood.

Safe income is also a concept included in the *Income Tax Act*. It may allow you to defer significant tax on the sale of the business; it is based on tax retained earnings, not financial statement retained earnings, and requires detailed calculations based on historic tax and financial statement data. Try to ensure that the information required is available and up to date, because gaps in information can understate the accessible tax attributes of your business. Similarly, if you’re operating in jurisdictions outside of Canada, foreign surplus account calculations can be valuable to you in ways similar to the use of safe income, but only if you’ve accurately maintained the calculations.

Step back and evaluate the impact of your tax reserves, such as your work in progress or your deferred revenue. They can detract from or add to the value depending on what you do with them. Finally, most purchase price adjustments do not generally factor in the future tax impact of deferred deductions such as depreciable assets or tax losses. If these attributes are significant, consideration should be given to including the valuation of these future tax savings as part of the purchase price negotiation.

In addition, there are other key tax accounts in your business. Your refundable dividend tax on hand (RDTOH) can be an asset if you have the right type of income and property within your entity. Your capital dividend account can provide tax-free money out of the company, but this history will need to be tracked from day one. In recent years, the Canada Revenue Agency (CRA) has been maintaining more of this information, so it may be helpful to confirm balances with the CRA before a transaction takes place to avoid any unexpected tax issues.

The tax bridge

Taxes can be a bridge. Well-structured tax planning can help you bridge your needs with those of the buyer. The top-line price you’ll receive when you sell your business is far less important than what you keep in your pockets after taxes have been paid. If the structure that is used for the sale can also provide tax benefits for the buyer, such as in the case of an asset deal, the buyer may be willing to increase the purchase price to share some of this benefit with you. Even if the buyer does not wish to change the price, perhaps the buyer’s tax benefit will help with other deal negotiations and help bridge other gaps in the process.

Choose the right advisors

Bringing experienced M&A advisors on board as early in the process as possible can help you achieve your financial goals. Strategic and financial buyers often come to the table prepared with advisors who are looking out for their best interests. It’s important that you be equally prepared, so that you can achieve the financial and structural outcome you’re looking for.

For many, selling a business is a once-in-a-lifetime transaction. You’ll want to surround yourself with a trusted team of business and legal advisors who understand your intentions and will work with you to achieve your goals. Success can mean different things to different people. Whatever that means to you – whether it’s optimizing pre- and after-tax proceeds, preparing for retirement or continuing your interest in the business – having the right people behind you can help you sell your business on your terms.

To learn more about our Private Client Services practice, visit us at ey.com/ca/pcs.

Boosting the value of your business

- ▶ Make yourself redundant.
- ▶ Prepare early, have a plan in mind.
- ▶ Know your team, including their strengths and weaknesses.
- ▶ Have strong financial controls and processes.
- ▶ Have a realistic and supportable forecast.
- ▶ Separate family issues from business issues.
- ▶ Hire the right advisors. They add value.

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2 Worldwide Personal Tax and Immigration Guide 2019-20



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EY's Worldwide Personal Tax and Immigration Guide summarizes personal tax systems and immigration rules in more than 160 jurisdictions, including Australia, Brazil, Canada, France, Germany, Mexico, the Netherlands, Russian Federation, the UK and the US.

The guide provides at-a-glance information as well as details about a jurisdiction's personal taxes. It includes sections on the following:

- ▶ **Personal income tax:** Explains who's liable for tax, what types of income are considered taxable, and which rates, deductions and credits apply
- ▶ **Other taxes:** Varies by jurisdiction but often includes estate, inheritance, gift and real estate taxes
- ▶ **Social security taxes:** Covers payments for publicly provided health, pension and other social benefits
- ▶ **Tax filing and payment procedures**
- ▶ **Double tax relief and tax treaties**
- ▶ **Immigration information:** Includes temporary visas, work visas and permits, residence visas and permits
- ▶ **Family and personal considerations**

You can view the complete *Worldwide Personal Tax and Immigration Guide* at [ey.com/personaltaxguide](https://www.ey.com/personaltaxguide).

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Worldwide Estate and Inheritance Tax Guide 2019

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EY's 2019 Worldwide Estate and Inheritance Tax Guide summarizes the estate tax planning systems and describes wealth transfer planning considerations in 39 jurisdictions around the world, including Australia, Canada, China, France, Germany, Italy, the Netherlands, the UK and the US.

The guide is designed to enable internationally positioned individuals to quickly identify the estate and inheritance tax rules, practices and approaches in their country of residence. Knowing these various approaches can help you with your estate and inheritance tax planning, investment planning and tax compliance and reporting needs.

The guide provides at-a-glance information as well as details on the types of estate planning in each jurisdiction. It includes sections on the following:

- ▶ The types of tax and who is liable
- ▶ Tax rates
- ▶ Various exemptions and reliefs
- ▶ Payment dates and filing procedures
- ▶ Valuation issues
- ▶ Trusts and foundations
- ▶ Succession
- ▶ Matrimonial regimes
- ▶ Testamentary documents and intestacy rules
- ▶ Estate tax treaty partners

You can view the complete 2019 *Worldwide Estate and Inheritance Tax Guide* at [ey.com/estatetaxguide](https://www.ey.com/estatetaxguide).

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4 Check out our helpful online tax calculators and rates



Frequently referred to by financial planning columnists, our mobile-friendly 2019 **Personal tax calculator** is found at ey.com/ca/taxcalculator.

This tool lets you compare the combined federal and provincial 2019 personal income tax bill in each province and territory. A second calculator allows you to compare the 2018 combined federal and provincial personal income tax bill.

You'll also find our helpful 2019 and comparative 2018 personal income tax planning tools:

- ▶ An RRSP savings calculator showing the tax saving from your contribution
- ▶ Personal tax rates and credits, by province and territory, for all income levels

In addition, our site also offers you valuable 2019 and comparative 2018 corporate income tax planning tools:

- ▶ Combined federal-provincial corporate income tax rates for small-business rate income, manufacturing and processing income, and general rate income
- ▶ Provincial corporate income tax rates for small business rate income, manufacturing and processing income and general rate income
- ▶ Corporate income tax rates for investment income earned by Canadian-controlled private corporations and other corporations

You'll find these useful resources and several others – including our latest perspectives, thought leadership, Tax Alerts, up-to-date 2019 budget information, our monthly *Tax Matters@EY* and much more – at ey.com/ca/tax.

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When you're making investment decisions, consider the impact of income taxes and the expected rate of inflation on your investments. In other words, think about the after-tax real rate of return of investment alternatives in relation to their associated risk.

When inflation is low, investments offering a lower nominal rate of return can be as attractive as those with higher nominal returns in periods of higher inflation.

Investment income, also known as income from property, is the return on invested capital in passive situations (i.e., where little or no effort is required by you to produce the return). Interest, dividends and capital gains are subject to different rates of income tax, which vary depending on your province of residence (see [Appendix A](#)). In cases where a great deal of time and effort is directed at producing interest or rental income, these returns can be considered business income. For example, the rents earned by an individual who owns multiple shopping centres could be treated as business income. This can be an important distinction, since business income can qualify for additional deductions that are not available to be claimed against property income. However, while additional deductions may be available, gains realized on underlying assets that otherwise might be capital gains may be fully taxable as income gains.

Interest income

Interest earned in a year must be included in your taxable income. If you've earned interest on investments that is not paid to you on an annual basis, you must include the accrued interest in your income on each annual anniversary of the investment. Therefore, if interest is not paid annually, a portion of the interest income is deemed to be included in your income annually.

You must also report the bonus or premium received on maturity of certain investments – such as treasury bills, stripped coupon bonds or other discounted obligations, or linked notes (see below) – as interest income. The annual accrual rules generally apply to these investments.

Dividend income

Generally, if you receive a cash or stock dividend from a Canadian public corporation (eligible dividend) or an eligible dividend from a private Canadian company, you'll be required to gross up its amount by 38% when calculating your income. However, when computing your income taxes payable you'll be entitled to a non-refundable federal dividend tax credit (DTC) of 20.73% of the actual dividend. Combined with a provincial DTC, this will result in a top tax rate on public Canadian company dividends between 28% and 43%, depending on your province or territory (see [Appendix A](#) for rates).

Non-eligible dividends from private Canadian companies are subject to a 15% gross-up when you calculate your income and a 10.38% non-refundable federal DTC in 2019. Combined with a provincial DTC, this will result in a top tax rate on private Canadian company dividends between 37% and 48%, depending on your province or territory (see [Appendix A](#) for rates).

Dividends from foreign corporations are not eligible for dividend gross-up and DTC treatment and are taxed in the same manner as interest income. If foreign tax is withheld, you may be eligible for a foreign tax credit.

Tax tips

- ▶ Income tax can represent a substantial cost on your investments. Consider your after-tax returns when evaluating investment options.
- ▶ Accrued (but unpaid) interest income on investments you purchased after 1 January 2019 can be deferred for tax purposes until 2020.
- ▶ If your sole source of income is eligible dividends, you should consider diversifying your portfolio to reduce any alternative minimum tax obligation.
- ▶ You must report the bonus or premium received on maturity of certain investments – such as treasury bills, stripped coupon bonds or other discounted obligations – as interest income. The annual accrual rules generally apply to these investments.
- ▶ A reserve for doubtful debts may be available where it is unlikely that the accrued interest income reported on the return will be paid. Alternatively, consider whether the unpaid interest has become a bad debt in the year.

Capital gains and losses

When you sell your investments, the difference between the adjusted cost base (ACB) and net proceeds you receive is normally considered a capital gain or loss. Only 50% of the capital gain or loss is included in calculating your income. However, some securities transactions are considered on income account and are fully taxable or deductible.

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Sales of linked notes

A linked note is a debt obligation, the return on which is linked to the performance of reference assets or indices. Although the *Income Tax Act* contains rules that deem interest to accrue annually on prescribed debt obligations, investors have generally taken the position that due to the contingent nature of linked notes, there is no deemed accrual of interest before the maximum amount of interest becomes determinable. As a result, the full amount of the return on the note is included in income in the taxation year when it becomes determinable, generally at maturity.

Prior to 2017, investors who held their linked notes as capital property could sell them prior to maturity in order to convert the return on the notes from interest income to capital gains. As a result, only 50% of the amount of the gain was included in income for tax purposes. For sales of linked notes that occur after 2016, the rules were amended to ensure that any positive return on a linked note retains the character of interest income whether it is earned at maturity or upon a sale prior to maturity.

Capital gains election

You may elect to have your gains (or losses) realized on the disposition of Canadian securities always treated as capital gains (or capital losses). File Form T123, *Election on Disposition of Canadian Securities*,² with your personal tax return for the year. Once you've filed this election, it's irrevocable. As a result, all gains and losses on the disposition of Canadian securities are treated as capital gains and losses, rather than trading gains and losses.

Frequent traders may be taxed on income account and may not be eligible for the preferential capital gains treatment.

The election doesn't apply to dispositions made by a trader or dealer in securities or to dispositions of certain prescribed securities.

Capital gains reserve

If you sell capital property and take back a debt – other than a demand promissory note – from the purchaser, you may be able to claim a capital gains reserve for any proceeds not due until a later year. However, in most cases, you must include the entire taxable capital gain in income over a period of up to five years, at a minimum cumulative rate of 20% of the taxable capital gain reported per year.

This general reserve rule is extended to 10 years – with a minimum of 10% required to be reported each year for dispositions to children, grandchildren or great-grandchildren living in Canada – of qualified small business corporation (QSBC) shares, a family farm, fishing property, or shares in a family farm or fishing corporation.

Tax tips

- ▶ If you're selling capital property and a portion of the proceeds isn't due until a later year, plan to have enough cash on hand to pay the taxes due each year during the reserve period.
- ▶ If the proceeds are received as a demand promissory note, a reserve will not be available, since the note is considered to be due immediately rather than in a later year.

Loss carryovers

If your allowable capital losses for the year exceed your taxable capital gains, you can carry the excess losses back three years, but you can only apply them against your net taxable capital gains for those years. However, if you claimed the capital gains exemption for a portion of those gains, you should limit the amount carried back to an amount sufficient to offset those gains not sheltered by the capital gains exemption. Also, it is not prudent to carry losses back to a year in which you did not pay any tax (for example, because you had various credits offsetting tax payable). Any amount you don't carry back will be available indefinitely to shelter your future taxable capital gains.

Tax loss selling

By selling securities not held in your registered retirement savings plan (RRSP) or other registered plans with accrued losses before the end of the year, you can shelter tax that might otherwise be payable on capital gains realized earlier in the current tax year or recover tax paid on capital gains realized in the three preceding tax years. When reviewing your portfolio, determine which loss securities are not meeting your investment objectives and consider the timeframe over which a security may be expected to rebound, as you may have the opportunity to sell and later repurchase the security.

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² Once this election has been made with the CRA it automatically applies in Quebec. However, if you file in Quebec, you must inform Revenu Québec in writing and provide a copy of Form T123 and your federal income tax return within 30 days of making the election or by your income tax return due date or be subject to penalties.



However, be careful of the application of the superficial loss rules. If you dispose of a security and realize a loss, and the same or an identical security is acquired by you, your spouse or common-law partner, a company either of you controls or an affiliated partnership or trust (such as your RRSP, registered retirement income fund (RRIF), tax-free savings account (TFSA) or registered education savings plan (RESP)) – within the period beginning 30 days before and ending 30 days after the disposition (the 61-day period), and the security is still owned at the end of the period – the loss will be denied. This denied loss will, however, be added to the ACB of the same or identical security acquired in this period, which will result in you realizing the benefits of that loss when you later dispose of that security (subject to any further application of the superficial loss rules).

Allowable business investment loss

A capital loss realized on the disposition of a debt owed by, or a share of, a bankrupt or insolvent small business corporation (SBC) may give rise to a business investment loss. An allowable business investment loss (ABIL) is one-half of the business investment loss and is reduced as a result of previous capital gains exemptions claimed. In certain cases, you may treat a loss suffered by honouring a guarantee as an ABIL, if you pay a reasonable guarantee fee on a debt that goes bad.³

You may use an ABIL to offset income from any source in the year you incur it. If you don't fully claim the ABIL in that year, you can claim it as a non-capital loss that you can carry back three years and forward 10 years to offset income from any source. When you don't use an ABIL in the carry-forward/carry-back period, it reverts to a net capital loss.

Disposition of foreign currency, securities held in a foreign currency

When you buy foreign currency or a security denominated in a foreign currency, you'll need to determine the ACB in Canadian dollars, using the foreign exchange rate on the settlement date.

Similarly, when you dispose of the foreign currency or the security, use the foreign exchange rate on the settlement date when determining the proceeds of disposition.

An individual's foreign exchange capital gains and losses on dispositions of foreign currency holdings (i.e., money) are subject to special rules. In general, the conversion of foreign currency holdings into Canadian dollars should result in a capital gain or loss.

Also, the repayment of a foreign-currency-denominated debt owing by an individual may result in a capital gain or loss where the foreign currency has fluctuated relative to the Canadian dollar. Special rules also apply to these foreign exchange gains and losses realized on the repayment of a foreign-currency-denominated debt (or similar obligation) owing by an individual.

Tax tips

If you carefully plan the timing of your investment dispositions, you may be able to reduce your taxes. Review your tax position and your investment portfolio annually to determine whether it would be advantageous to dispose of any investments with accrued capital gains or losses before the end of the year.

- ▶ **Dispositions in 2019:** If you plan to dispose of any securities on the open market before the year end, sell them on or before the stock exchange's last trading date for settlement in the year. For most North American stock exchanges, settlement occurs two business days after the trade date.⁴ As of the date of publication, 27 December would generally be the last trading date for settlement of a trade in 2019 on both Canadian and US exchanges.
- ▶ **Using capital losses:** Capital gains ineligible for your remaining capital gains exemption can be sheltered from tax if you dispose of investments with accrued capital losses before the end of the year. Remember to consider the superficial loss rules when planning to sell loss securities and consider if those rules may be used to your benefit. For example, if your spouse or partner owns investments that have decreased in value, but they cannot use the capital loss, consider taking advantage of the superficial loss rules by purchasing the investments from your spouse or partner at fair market value and electing out of the automatic rollover provisions. On the subsequent sale to an arm's-length party, you can claim the capital loss.
- ▶ **Prior years' losses:** If you did not report a capital loss in the year realized, speak to your EY advisor about the options available to you to ensure the CRA recognizes the loss. Capital losses, once realized, do not expire.
- ▶ **Using ABILs:** If you own shares or hold debt of an insolvent SBC, consider making a special election in the year the corporation becomes insolvent to realize an ABIL or capital loss without selling the shares or disposing of the debt. Note that if no interest is charged on a related party debt, and you are not a shareholder of the SBC, a capital loss will not be realized.
- ▶ **Determining cost:** If you're acquiring property identical to property you currently own, consider having your spouse or partner, your investment holding company (IHC), or other separate entity acquire the property. This will allow you to determine your gain or loss based on the sale of a specific property, rather than using the average cost.

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³ Certain conditions apply.

⁴ Settlement occurred three business days after the trade date prior to 5 September 2017.





New rules limit income splitting after 2017

Amendments enacted in June 2018 limit income-splitting arrangements that use private corporations to benefit from the lower personal tax rates of certain family members age 18 or over who are direct or indirect shareholders of the corporation or are related family members of direct or indirect shareholders.

Effective for 2018 and later years, the new rules limit the ability to share income within a family by expanding the base of individuals subject to the tax on split income (TOSI) (equal to tax at the highest marginal income tax rate (33% federal rate in 2019) and only applicable to certain types of income received by minors prior to 2018) to include children age 18 and over and other related adult individuals (including spouses or common-law partners, grandparents and grandchildren, but not aunts, uncles, nephews, nieces or cousins) who receive split income⁵ from a related (family) business either directly from a private corporation (such as by the receipt of dividends) or through a trust or partnership. A related business exists, for example, when a related person is active in the business on a regular basis or owns at least 10% of the fair market value of the shares in a corporation that carries on the business.

The types of income that are subject to the TOSI have also been expanded to include:

- ▶ Interest income earned on a debt obligation of a private corporation, partnership or trust (subject to some exceptions)
- ▶ Gains from the disposition of property if income from the property would otherwise be split income.

Under these rules, income received or gains realized from a related business by certain adult family members are excluded from the TOSI if any one of a number of exceptions is met. Adults who are 25 or older who receive split income are subject to a reasonableness test if they do not meet any of the exceptions. The test is based on the extent of their contribution of labour and capital to the business, risks taken and other payments already received from the business. The TOSI will apply to split income received to the extent it is unreasonable under this test.

For a detailed listing of the exceptions to the application of the TOSI and further details about these rules, see [Appendix E: The revised tax on split income rules](#), [TaxMatters@EY February 2018](#), [Revised draft legislation narrows application of income sprinkling proposals](#), and [EY Tax Alert 2017 Issue No. 52](#).

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⁵ Effectively, split income arises when a stream of income is connected, either directly or indirectly, to a related business.



Capital gains exemption

Canadian residents are entitled to a limited lifetime cumulative exemption from tax on net capital gains (actual gains less actual losses) realized on the disposition of certain property. The 2019 indexed maximum cumulative exemption in respect of qualified property, other than farm or fishing property, is \$866,912.

Qualified small business corporation shares

A SBC is generally defined as a Canadian-controlled private corporation (CCPC) that uses all or substantially all of the fair market value of its assets principally in an active business carried on primarily in Canada, or owns shares or debt of such companies (this allows shares of holding companies to qualify).

A capital gains exemption is available for capital gains arising on the disposition of QSBC shares that have only been held by you (or a person or partnership related to you) throughout the immediately preceding 24 months.

In addition, during those 24 months, more than 50% – and at the time of disposition, approximately 90% or more – of the fair market value of your corporation's assets must be attributable to assets used principally in an active business.

When you sell QSBC shares and claim the capital gains reserve, the capital gains reserve included in income in subsequent years is eligible for the capital gains exemption.

Tax tips

- ▶ If you own shares in a CCPC carrying on business in Canada:
 - Ensure the shares are and stay QSBC shares.
 - Consider crystallizing the capital gain now.
 - Consider planning to permit your family members to also use their capital gains exemptions⁶.
- ▶ A cumulative net investment loss (CNIL) will reduce your ability to use your remaining capital gains exemption. Consider converting salary from your corporation to dividend or interest income to reduce or eliminate the CNIL.
- ▶ Claiming an ABIL may reduce the capital gains exemption you may claim.
- ▶ If your net capital gain position does not result in the full use of your capital gains exemption, consider triggering capital gains.
- ▶ If you claim the capital gains exemption, it may give rise to an alternative minimum tax liability.
- ▶ If you're planning to sell an unincorporated business, consider incorporating beforehand to benefit from the capital gains exemption.
- ▶ The cumulative lifetime capital gains exemption as indexed for 2019 is \$866,912.
- ▶ If you have the option to either claim your remaining capital gains exemption or apply net capital loss carryforwards to eliminate or reduce realized net taxable capital gains, consider claiming the exemption. You can carry forward the net capital losses indefinitely.

Qualified farm or fishing property

If you dispose of qualified farm and/or fishing property after 20 April 2015, you may be able to claim the enhanced \$1 million capital gains exemption in respect of your disposition.

Qualified farm and/or fishing property includes real or immovable property or a fishing vessel used in a farming and/or fishing business, shares of a farm and/or fishing corporation, an interest in a family farm or fishing partnership and certain intangible assets used principally in a farming and/or fishing business (e.g., milk and egg quotas).

To qualify, various conditions must be met.

Tax tip

If you have farm and/or fishing property, you can transfer it to a child at any value between cost and fair market value. Consider transferring the property to your child at a value that will allow you to realize sufficient capital gains to use your exemption. Your child will then have a higher ACB for a future disposition.

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⁶ Consider the TOSI rules and consult with your EY Tax advisor. Capital gains realized by minors on the disposition of private company shares to a non-arm's-length party are treated as non-eligible dividends and taxed at top marginal rates. See [Appendix E: The revised tax on split income rules](#).



General rules

There are general rules that affect your ability to claim the capital gains exemption on QSBC shares and qualified farm and/or fishing property.

Eligibility: Corporations, partnerships or trusts cannot claim the capital gains exemption. However, eligible capital gains allocated or otherwise flowing out of partnerships or trusts do qualify for the exemption in the hands of the individual partners or beneficiaries.

Amount: Your available capital gains exemption is reduced by the amount of the exemption you claimed in previous years, including years before 1995, when the exemption was applicable to gains on most capital property.

Losses: Your net taxable capital gains eligible for the exemption are reduced by any claims made in the year for net capital losses of the current year, other years, and for ABILs.

Discretionary deduction: The capital gains exemption is a discretionary deduction. You may claim an amount less than the maximum, or no exemption, in a particular year. This allows you to maximize the use of other non-discretionary deductions and to preserve your remaining exemption for future years.

Cumulative net investment loss (CNIL): A CNIL balance will reduce your claim for a capital gains exemption.

A CNIL arises if you've deducted, in aggregate after 1987, investment expenses in excess of investment income. A CNIL is generally increased by investment expenses such as:

- ▶ Interest on money borrowed for investment purposes, including an investment in a partnership if you're not actively engaged in the business of the partnership
- ▶ Investment counsel fees

- ▶ One-half of most resource deductions claimed
- ▶ Property losses or rental losses from property owned by you or a partnership if you're not actively involved in the business of the partnership

A CNIL is generally reduced by investment income such as:

- ▶ Interest and dividend income, including the dividend gross-up for dividends from taxable Canadian corporations
- ▶ Property income or rental income from property owned by you, or by a partnership if you're not actively involved in the business of the partnership
- ▶ Net taxable capital gains that are ineligible for the capital gains exemption

For Quebec tax purposes, certain eligible deductions specific to Quebec are not taken into account in computing the CNIL.

Tax tip

If you've used your lifetime capital gains exemption, consider making the capital gains deferral election on the sale of SBC shares when you use the proceeds to acquire other small business investments.

Capital gains deferral for small business investments

In addition to the capital gains exemption, you can elect to defer the gain realized on the disposition of certain small business investments if you reinvest the proceeds in other small businesses. Eligible investments are generally common shares of a SBC issued from treasury.

In addition, there's a size limit on the corporation's assets and a minimum holding period for the shares that were sold. There's no limit on the amount of reinvestment you can make to defer a capital gain, but you must make the reinvestment in the year of disposition or within 120 days after the end of that year.

The deferred gain will be deducted from the ACB of the replacement investments acquired.

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Donations

Donation of publicly listed securities – To encourage gifts of appreciated property, capital gains realized on the donation of publicly listed securities to a registered charity are not included in income. Properties that qualify for this incentive include:

- ▶ Stocks (including shares of mutual fund corporations)
- ▶ Bonds
- ▶ Other rights listed on designated stock exchanges (both Canadian and foreign)
- ▶ Canadian mutual fund units
- ▶ Interests in segregated (insurance) trusts
- ▶ Prescribed debt obligations (such as certain government bonds)

A comparable savings applies to certain donations of securities by employees through stock option plans (see [Chapter 7: Employees](#) for details).

Exchangeable shares of a corporation or partnership interest – If you exchange unlisted shares of the capital stock of a corporation or a partnership interest for publicly listed securities, and you donate these securities to a registered charity or a public or private foundation, the income inclusion rate for capital gains realized on the exchange is nil, provided that certain conditions are met. To benefit from this treatment, the exchange feature would have to be included at the time of issuance and disposition of the shares, you may not receive any consideration on the exchange other than the publicly listed securities, and you must donate the securities within 30 days after the exchange.

With respect to unlisted partnership interests, the portion of the taxable capital gain attributable to a reduction in the ACB, generally resulting from operating losses, is not exempt from tax. This taxable capital gain is computed as the lesser of:

- ▶ The taxable capital gain otherwise determined; and
- ▶ One-half of the amount, if any, by which the cost to the donor (plus any contributions to partnership capital by the donor) exceeds the ACB to the donor. The ACB is determined without reference to any distributions of partnership profits or capital.

As a result, only the portion of capital gains attributable to economic appreciation of the partnership interest is exempt from tax.

Therefore, any portion of the gain arising from reductions in the ACB of the partnership interest (rather than the result of certain partnership distributions) will give rise to a taxable capital gain on the exchange. This result will generally occur when the ACB has been reduced by the donor's share of the operating losses of the partnership.

Publicly listed flow-through shares – In general, an investor's ACB of a flow-through share is zero. As a result, on disposition, the entire value of proceeds is a capital gain.

For flow-through shares acquired pursuant to an agreement entered into on or after 22 March 2011, the exempt portion of the capital gain on the donation of the flow-through shares is generally limited to the portion that represents the increase in value of the shares at the time they are donated over their original cost.

Gifts of cultural property – Donations of certified cultural property may be made to Canadian institutions and public authorities that have been designated by the minister of Canadian heritage (under the *Cultural Property Export and Import Act*). Capital gains realized on objects certified as Canadian cultural property by the Canadian Cultural Property Export Review Board (CCPERB) and gifted to a designated institution or public authority are not included in income.

The CCPERB website states that cultural property created anywhere in the world may be eligible for certification if the Review Board determines that it is of “outstanding significance”. An object or collection may be deemed to be of outstanding significance by reason of any one or more of the following criteria:

- ▶ Close association with Canadian history
- ▶ Close association with national life
- ▶ Aesthetic qualities
- ▶ Value in the study of the arts
- ▶ Value in the study of the sciences

2019 budget

Prior to 19 March 2019, there was an additional requirement that the cultural property had to also be of “national importance to Canada” to be eligible for certification. An object or collection could be deemed to be of national importance if its loss to Canada would significantly diminish the national heritage. The 2019 federal budget and enacting legislation has removed this requirement, effective 19 March 2019.

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In addition to the beneficial treatment of capital gains, you may claim a tax credit based on the eligible amount of your gift of certified cultural property (i.e., the amount by which the fair market value of the property exceeds the amount of any advantage you received in respect of the gift). The eligible amount of the gift is calculated on the basis of the fair market value of the property, as determined by the CCPERB. The net income limitation on donations (that generally limits the amount of charitable donations that an individual may claim in a taxation year to 75% of the individual's net income) does not apply to gifts of certified cultural property.

Gifts of ecologically sensitive land – Capital gains realized on gifts of ecologically sensitive land (including a covenant, an easement or, in the case of land in Quebec, a real or personal servitude) made to Canada, a province, territory or municipality, or a registered charity approved by the minister of the environment and climate change are not included in income. Eligibility requires the minister (or a person designated by the minister) to certify that the land is important to the preservation of Canada's environmental heritage.

You may also claim a tax credit on the basis of the eligible amount of a gift of ecologically sensitive land. Gifts of ecologically sensitive land made to a municipal or public body performing a function of government in Canada also qualify for a tax credit.

For purposes of determining the eligible amount of the gift, the minister will certify the fair market value of the gift. For a gift of a covenant or an easement, or a real or personal servitude (in Quebec), the fair market value of the gift is the greater of:

- ▶ The fair market value of the gift otherwise determined by the minister; and
- ▶ The amount by which the fair market value of the land is reduced as a result of the gift.

As with gifts of certified cultural property, the net income limitation on donations does not apply to gifts of ecologically sensitive land. For gifts of ecologically sensitive land made after 10 February 2014, the carryforward period (for the unclaimed portion of the donation) is extended from five years to 10 years.

Tax shelter gifting arrangements – You should only consider an investment in a tax shelter after obtaining professional advice. The CRA often challenges these structures. In particular, the CRA actively reviews tax shelter gifting arrangements, which most commonly involve schemes in which an individual receives a charitable donation receipt with a higher value than the actual donation.

The CRA has indicated that it audits all these tax shelter arrangements and, to date, has not found any that it believes comply with Canadian tax laws. It has generally succeeded in denying the benefits of tax shelter gifting arrangements before the courts.

The CRA will not assess your return until the tax shelter has been audited, with one exception: your return will be assessed before the completion of the audit only if you remove the donation tax credit claim for the gifting tax shelter in question. If you object to an assessment of tax, interest or penalties because a tax credit claimed for one of these arrangements has been denied, the CRA is allowed to collect 50% of the disputed amount while the objection is being processed.



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2019 budget

Donations to registered journalism organizations

The 2019 federal budget announced a number of measures supporting Canadian journalism, including a new refundable tax credit for qualifying journalism organizations producing original news, a new non-refundable tax credit for subscriptions to Canadian digital news, and the provision of qualified donee status to registered journalism organizations. These proposals were included in legislation enacted in June 2019. Qualified donees (e.g., registered charities) are tax-exempt entities that can issue official tax receipts for donations that they receive for purposes of the charitable donations tax credit applicable to individuals, and the charitable donation deduction applicable to corporations. Qualified donees can also receive gifts from Canadian registered charities. Effective 1 January 2020, if you make either a cash donation or a donation in kind (e.g., donating publicly listed securities) to a registered journalism organization, that organization will be required to issue a tax receipt to you for the amount donated (or for the fair market value of a donation in kind), which you may then claim as a charitable donation tax credit on your income tax return.

A registered journalism organization is a qualifying journalism organization that is registered with the Minister of National Revenue. This type of organization must be a qualified Canadian journalism organization (QCJO) that meets certain specified conditions. All of these terms are newly defined terms. A qualifying journalism organization will be required to be a Canadian corporation or trust constituted and operated for purposes exclusively related to journalism. Any business activities that it carries on must be related to those purposes. As a QCJO, the organization must be primarily engaged in the production of original news content primarily focused on matters of general interest and reports of current events (including coverage of democratic institutions and processes), but not primarily focused on a particular topic (e.g., industry-specific news, sports, recreation, arts, lifestyle or institutions). These organizations will not be permitted to distribute their profits, if any, or allow their income to be available for the personal benefit of certain individuals connected with the organization. A number of other conditions will apply to ensure that registered journalism organizations are not used to promote the views or objectives of any particular person or related group of persons. The names of all registered journalism organizations will be listed on the website of the Government of Canada.

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Interest expense

Generally, if you borrow money to buy an income-earning investment, any interest expense incurred is deductible. It's not necessary that you currently earn income from the investment, but it must be reasonable to expect that you will. Income for this purpose includes interest and dividends but not capital gains.

Interest expense on money you borrow to buy common shares is generally deductible because common shares have the potential for paying dividends, but whether the expectation of dividends is reasonable will depend on the specific facts.

Note that the CRA's positions on interest deductibility are included in its Income Tax Folio S3-F6-C1: *Interest Deductibility*.

In Quebec, the deduction of investment expenses (including interest expenses) is limited to the amount of investment income you earned in the year. Any investment expense that's not deductible in a year, as a result of this limitation, can be carried back to the three preceding years or carried forward to any subsequent year.

If you incur a loss on the disposition of an investment, interest on any remaining related borrowing continues to be deductible if you use the proceeds to pay down the related debt or to purchase another income-producing investment.

Interest on the money you borrow for contributions to a RRSP, registered pension plan (RPP) or deferred profit-sharing plan (DPSP), TFSA, RESP, registered disability savings plan (RDSP), or for the purchase of personal assets such as your home or cottage, is not deductible.

You can deduct interest expense on a paid or payable basis, provided you follow one basis consistently. Note, however, that compound interest must be paid in order to be deductible.

Tax tips

- ▶ If you're claiming a deduction for interest expense on a paid basis, make all necessary payments by 31 December.
- ▶ Consider converting non-deductible interest into deductible interest by using available cash to pay down personal loans and then borrowing for investment or business purposes.
- ▶ Use your excess funds to pay down personal debt, such as mortgages or credit card balances, before investment-related debt.
- ▶ To reduce the cost of non-deductible debt, pay off your most expensive personal debt first. Consider refinancing expensive debt like credit cards with a less expensive consumer loan.

Investment funds

Mutual funds

Usually structured as open-end trusts (and, in some instances, as corporations), mutual funds are a pooling of resources of many taxpayers with a common investment objective. Money managers buy and trade investments in the fund. Any interest, dividends, foreign income and capital gains from these investments, net of management fees and other fund expenses, are distributed to unitholders. The value of mutual fund units or shares, regularly quoted in newspapers and magazines, represents the value of the underlying investments divided by the number of units or shares outstanding.

You must include the income distributed to you annually from a mutual fund in your net income, even if you don't receive the distributions in cash, because you've chosen to have them automatically reinvested in the same or a different fund.

You can also realize capital gains or losses from mutual funds by the sale or redemption of fund units or shares. This gain or loss is the difference between your redemption proceeds and the ACB of the units or shares. The ACB of your mutual fund units is determined by dividing the total purchase cost – including commissions and other front-end fees – plus reinvested distributions, less returns of capital, by the number of units or shares you own just prior to redemption. Any deferred charges or redemption fees reduce the proceeds on redemption.

Many mutual fund corporations are organized as "switch funds." Such funds allow investors to exchange shares of one class of the mutual fund corporation for shares of another class. Prior to 2017, switches between classes were deemed not to be a disposition for income tax purposes. Instead, such exchanges occurred on a tax-deferred rollover basis. Effective 1 January 2017, and subject to certain exceptions, the exchange of shares of a mutual fund corporation for shares of another class of a mutual fund corporation is considered to be a disposition for tax purposes for proceeds equal to the fair market value of the exchanged shares.

Segregated funds

Segregated funds, or seg funds, are similar to mutual funds, but include an insurance element, which guarantees at least the return of all or a portion of your original principal on maturity or your death for individually owned contracts. You purchase a contract with the seg fund, which is supported by a pool of assets and treated in many ways similar to a mutual fund trust.

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Seg funds allocate to contract holders the income earned from the underlying fund assets, and capital gains or losses realized from the sale of underlying assets are considered to be the gains or losses of the contract holders. Unlike mutual funds, since capital losses of seg funds are considered to be losses of the contract holders, where the seg fund has net capital losses for a year these are effectively allocated to the contract holders.⁷

Any guarantee paid on maturity of the contract or on your death (the payment in excess of the investment's net asset value) is treated by insurers as a capital gain⁸. However, this capital gain may be offset by a capital loss on the disposition of the contract (cost in excess of net asset value).

Exchange-traded funds

An exchange-traded fund (ETF) is an investment fund that combines many of the attributes of mutual funds and individual stocks.

Typically, an ETF is a closed-end mutual fund that tracks an index, a commodity or a basket of assets. However, like stocks, ETFs experience price changes throughout the day as they are bought and sold, and they can be sold long or short.

Because an ETF trades like a stock, it does not have its net asset value calculated every day like a mutual fund does.

ETFs are normally structured as trusts, and the income from their investments, net of management fees and other fund expenses, is distributed to the unitholders either on a monthly, quarterly or annual basis. Generally, if the ETF is a Canadian-resident trust, its underlying assets dictate whether the income reported by unitholders is categorized as interest, dividends, foreign income or capital gains.

You can also realize capital gains or losses from ETFs by the sale or redemption of the units. This gain or loss is the difference between your redemption proceeds and the ACB of the units.

Labour-sponsored venture capital corporations tax credit

A labour-sponsored venture capital corporation (LSVCC) is a venture capital corporation established by either federal or provincial legislation and sponsored by a trade union or other specified employee organization. LSVCCs are intended to provide venture capital to qualifying businesses. In accordance with the 2013 federal budget, a 15% non-refundable tax credit on LSVCC investments of up to \$5,000 (maximum credit of \$750) began to be phased out in 2015 and was set to be eliminated by 2017. However, the 2016 federal budget reinstated this credit for investments in provincially registered LSVCCs, effective for 2016 and later years.

For 2019, you may claim a federal tax credit equal to 15% of the net cost of the original acquisition of the approved shares of a provincially registered LSVCC, with a maximum credit of \$750. For 2019, the credit may be claimed for shares acquired in 2019 or in the first 60 days of 2020 (but any shares acquired in 2019 and claimed on your 2018 income tax return cannot be claimed for 2019). The LSVCC tax credit for federally registered LSVCCs was eliminated for 2017 and later taxation years.

Income trusts and real estate investment trusts

Income trusts and publicly traded limited partnerships are classified as specified investment flow-through entities (SIFTs). SIFTs were originally designed to attract investors seeking stable and predictable cash flows.

Tax tips

- ▶ Keep records of the ACB of your mutual funds, ETFs, income trusts, limited partnerships and flow-through shares so you can report accurate capital gains and losses on the redemption.
- ▶ Evaluate whether the benefit of the seg fund's guarantees offsets the fund's higher fees.
- ▶ The ability to designate a named beneficiary of a seg fund provides the additional benefit of avoiding probate fees on death.
- ▶ Tax shelters are investments intended to offer a tax deferral. In determining the tax benefit available from a tax shelter, consider:
 - The at-risk rules, which may reduce deductions available to investors in limited partnerships by preventing tax write-offs in excess of amounts invested or earned
 - The requirement to recognize as a capital gain any negative ACB in a limited partnership interest
 - Minimum tax, which may result when you have significant tax shelter write-offs
 - Rules that require the cost of investments that finance another taxpayer's business expenses in exchange for a right to receive future income to be prorated over the life of that income stream
- ▶ The depreciation claim for computer software tax shelters is limited to the amount of the related income.

⁷ Segregated funds are able to allocate capital losses to contract holders pursuant to *Income Tax Act* (ITA) 138.1(3). Mutual fund trusts are not able to allocate capital losses to their unitholders (see paragraph 10 of CRA *Interpretation Bulletin* IT-381R3 - *Trusts - Capital Gains and Losses and the Flow-Through of Taxable Capital Gains to Beneficiaries*).

⁸ Interests in segregated funds are carved out of the usual exemption from capital gains treatment of insurance policies by ITA 39(1)(a)(iii).

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Since 2011, a distributions tax has applied to SIFTs, treating them more like corporations. This distribution tax effectively eliminates their tax advantage and in some cases may reduce the amount of cash available for distribution to investors.

As a result, many SIFTs have converted to corporations. Rules allow these conversions to take place on a tax-deferred basis without any immediate tax consequences to investors.

One important exception to the SIFT rules concerns qualified real estate investment trusts (REITs). REITs continue to be flow-through entities for tax purposes.

Real estate rental property

If you own property and rent it as a source of revenue, the net rental income or loss must be reported on your tax return. If a net rental loss results (an excess of rental expenses incurred over rental income earned in the year), it can generally be deducted against other sources of income for the year.

Reasonable expenses you incur to earn rental revenue can generally be deducted against this revenue. Current expenses (expenses that provide short-term benefits) are fully deductible in the year incurred. These expenses can include mortgage interest, property taxes, insurance premiums, maintenance and repairs, utilities, advertising and management fees.

Capital expenses (expenses that provide an enduring benefit), such as the cost of the building (but not land), and furniture and equipment rented with the property, may be deducted through capital cost allowance (CCA) (depreciation) over a period of several years. However, CCA may only be claimed to the extent of rental income before any claim for CCA. In other words, you cannot create or increase a rental loss through the deduction of CCA. For capital assets that are acquired and available for use after 20 November 2018 and before 2024, there is a temporary enhanced CCA deduction of up to three times the normal maximum first-year deduction amount (with a few exceptions). This enhancement is reduced to two times the normal maximum first-year CCA deduction amount in the 2024 to 2027 period.⁹ Certain types of capital expenses are subject to special rules allowing them to be deducted in the year incurred, including landscaping costs and eligible disability alteration costs that improve access to or mobility within a property for a person with a mobility impairment.

Tax tip

If you own more than one rental property, you may deduct automobile expenses incurred to collect rents, supervise repairs or provide general property management.



⁹ For further details, see EY [Tax Alert 2018 Issue No. 40](#).

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If you rent units in a building in which you live, you can deduct a reasonable portion of expenses relating to common areas.

If you sell your rental property for more than its original cost, you have to report a capital gain to the extent that the proceeds exceed that cost. You may also have to pay tax on income that represents previously claimed CCA. If proceeds from the sale exceed the undepreciated capital cost of the property, the excess, up to the original cost, is taxed as recaptured depreciation in the year of sale.

There are some pitfalls to avoid in property investments:

- ▶ You must have a source of income or potential to earn income against which to claim expenses. Caution should be exercised if there are recurring rental losses year over year. If there is no expectation of profit from the rental property, for example, due to the presence of a personal or hobby element to the rental of the property, the losses may be denied.
- ▶ If you rent property to a relative or close friend at less than market rates, any rental loss you incur will likely be denied.

RRSPs

Many Canadians use an RRSP to hold a significant portion of their investment assets. When the RRSP is self-administered, it can hold a wide range of eligible investments.

In determining the most appropriate mix of investments for your self-administered RRSP, you need to consider a number of factors, including the tax attributes of RRSPs. In particular, there is no tax on earnings within an RRSP and withdrawals are fully taxable as income. A general discussion of the tax attributes and the rules related to RRSP contributions, withdrawals and plan maturity is provided in [Chapter 11: Retirement planning](#).

Another factor to consider is how much growth you'll need in the RRSP to fund your retirement. In some circumstances, you may want to hold riskier growth-oriented investments in your RRSP to maximize its value. Generally, a lengthy holding period is necessary for this strategy to offset the risk associated with fluctuations in the value of the investments and the effects of the higher tax applicable to RRSP withdrawals than to capital gains or dividends.

Any beneficial treatment accorded to dividends and capital gains held personally is lost when securities are owned by an RRSP. However, this disadvantage may be outweighed by the tax deferral on income and gains accumulating within the RRSP. The value of the deferral will depend on your age and the expected timing of withdrawal.

Interest, on the other hand, receives no preferential tax treatment when held outside an RRSP. Therefore, you should consider holding your interest-bearing investments inside your RRSP.

Your RRSP can acquire investments in the marketplace or, alternatively, you may transfer qualified investments outside your plan to your RRSP. You can make this transfer in the form of a deductible contribution in kind for the year. For tax purposes, this may result in a capital gain, because the assets transferred to the plan are deemed to be disposed of at fair market value. Any capital losses will be denied.

It's important that your RRSP holds qualified investments only. If your RRSP acquired a non-qualified investment prior to 23 March 2011, the value of the investment was included in your income. However, once you disposed of the non-qualified investment in your plan, you were allowed to claim a deduction in your return equal to the lesser of the proceeds of disposition and the value of the investment previously included in your income. In addition, any income earned on the investment was taxable to the RRSP trust in the year it was earned, and a 1% per-month penalty tax was imposed on the RRSP trust for each month it held a non-qualified investment.

Anti-avoidance rules introduced for non-qualified investments acquired after 22 March 2011, and investments acquired before 23 March 2011 that became non-qualified after 22 March 2011, replace the income inclusion and deduction requirement for the annuitant and the 1% per-month penalty tax imposed on the RRSP trust (see **Anti-avoidance rules extended to RRSPs and RRIFs** for details). However, an RRSP trust remains taxable on any income earned on a non-qualified investment that is acquired by the RRSP after 22 March 2011.

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A non-qualified investment is defined as any property that is not a qualified investment. Qualified investments generally include:

- ▶ Cash
- ▶ Term deposits
- ▶ GICs
- ▶ T-bills
- ▶ Any security (other than a futures contract) listed on Canadian stock exchanges and most foreign stock exchanges
- ▶ Most government bonds
- ▶ Most Canadian mutual funds and segregated funds
- ▶ Options for the purchase of qualified investments
- ▶ Shares of certain private corporations in limited circumstances

Anti-avoidance rules extended to RRSPs and RRIFs

A series of anti-avoidance rules for RRSPs and registered retirement income funds (RRIFs) became law on 15 December 2011, with retroactive effect to 22 March 2011. These rules impose a 50% penalty tax on both prohibited investments and non-qualified investments held by an RRSP or RRIF, as well as a separate 100% penalty tax on certain “advantages” from transactions that exploit the tax attributes of an RRSP or RRIF. Similar rules already existed for TFSAs. These anti-avoidance rules were also extended to RESPs and RDSPs for transactions occurring and investments acquired after 22 March 2017, with a few exceptions. A plan holder could elect by 1 April 2018 to pay regular personal tax on the distribution of investment income instead of the advantage tax for an investment held on 22 March 2017.

Tax on prohibited and non-qualified investments

The penalty tax applies to prohibited investments acquired after 22 March 2011, and those acquired before 23 March 2011 that first became prohibited after 4 October 2011. A prohibited investment may generally be described as an investment to which the annuitant of an RRSP or RRIF is closely connected – including, for example, a debt obligation of the annuitant or a share of, an interest in or a debt of a corporation, trust or partnership in which the annuitant (or a non-arm’s-length person) has a significant interest (generally 10% or more).

In the case of non-qualified investments, the penalty tax applies to non-qualified investments acquired after 22 March 2011, and to those acquired before 23 March 2011 that first became non-qualified after 22 March 2011.

If the prohibited or non-qualified investment is removed before the end of the calendar year subsequent to the acquisition year, you may be entitled to a refund of the penalty tax.

Tax on advantages

The advantage tax generally applies to benefits obtained from transactions occurring, income earned, capital gains accruing and investments acquired after 22 March 2011, subject to certain transitional relief that was available by filing an election on or before 2 March 2013 (see below).

An advantage can be broadly defined as any benefit obtained from a transaction that is intended to exploit the tax attributes of an RRSP, RRIF or other registered plan.¹⁰ Examples include benefits attributable to prohibited investments, swap transactions, RRSP strips and deliberate overcontributions.

Transitional relief from the advantage tax may have been available if you filed an election on or before 2 March 2013.¹¹ The election was available if your plan held an investment on 22 March 2011 that became

a prohibited investment on 23 March 2011 and continued to hold it in the year. It allowed you to elect not to have the 100% advantage tax apply to income and gains accrued after 22 March 2011 and attributable to a prohibited investment held on 23 March 2011. To qualify for this relief, you must have filed the election form (Form RC341) by 2 March 2013 and you must withdraw the income or any realized gains attributable to the prohibited investment annually within 90 days after the end of the calendar year in which they are earned or realized. The amount withdrawn is taxed at your marginal tax rate, like any regular withdrawal from the plan. No provision allows for late filing of this election.

At the November 2016 Canadian Tax Foundation conference, the CRA announced that paying registered plan fees such as investment management fees from RRSP or other registered accounts will incur a tax penalty equal to the fee, as the CRA considers this to be an advantage subject to the 100% advantage tax penalty. The CRA originally announced that it would defer the application of this position until 1 January 2018. However, on 15 September 2017, the CRA announced a further deferral until 1 January 2019. Then on 1 October 2018, the CRA released IT Folio S3-F10-C3: *Advantages - RRSPs, RESPs, RRIFs, RDSPs, and TFSAs*, which was subsequently updated on 26 April 2019. Paragraph 3.35 of the Folio states that the CRA would provide “comments on the tax treatment of fees and expenses incurred in connection with a registered plan and its investments” in a future update. The CRA’s technical interpretation 2018-0779261E5, dated 28 September 2018, states that the implementation of its new position is deferred pending completion of a review of the issue by the Department of Finance Canada. The CRA also made this point at the November 2018 Canadian Tax Foundation conference (see CRA document 2018-0785021C6). On 30 September 2019, the Department of Finance issued a comfort letter, recommending relief. See additional comments in [Chapter 11: Retirement planning](#).

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¹⁰ The advantage rules were extended to RDSPs and RESPs effective after 22 March 2017, subject to certain transitional rules. Prior to this date, the rules already applied to TFSAs as well as RRSPs and RRIFs.

¹¹ Refer to the CRA Folio on Prohibited Investments (S3-F10-C2).



Filing obligations

If you owe tax under any of these rules, you must file Form RC339, *Individual Return for Certain Taxes for RRSPs, RRIFs, RESPs, or RDSPs*, and pay that tax no later than 30 June of the following year (e.g., 30 June 2020 for the 2019 taxation year).

Possible waiver of tax

The CRA may, at its discretion, waive all or a portion of the penalty taxes if it considers it just and equitable to do so, provided that the funds are withdrawn from the plan and are subject to personal tax.

Self-administered RRSPs investing in shares of private corporations

The anti-avoidance rules for post-22 March 2011 investments have made it more difficult for private corporation shares to be considered qualified investments for RRSPs. Shares in Canadian corporations carrying on active businesses not listed on a designated stock exchange may qualify for RRSP investment if the corporation is a small business corporation and you and related parties own less than 10% of the shares. Note that unless the corporation retains its small business corporation status at all times, its shares will be prohibited investments for RRSPs. Any pre-23 March 2011 RRSP investments in private corporations should be monitored to ensure they don't become prohibited, and you should consider the implications of removing any offside investments.

Tax tips

- ▶ In determining the mix of investments held by your self-administered RRSP, consider:
 - Your retirement cash-flow needs
 - The length of time before you expect to withdraw funds
 - The marginal tax rates applicable to interest, dividends and capital gains
 - Holding investments intended for capital growth outside your RRSP (to benefit from lower tax rates on capital gains and eligible dividends) and holding interest-generating investments inside your RRSP
 - Holding strip bonds inside your RRSP, since the interest earned would otherwise be annually subject to tax even though it's not received until maturity
 - Holding capital investments eligible for your remaining capital gains exemption outside your RRSP in order to use the capital gains exemption on the sale (these are qualified RRSP investments in limited circumstances)
- ▶ Certain employee stock options may be transferred to an RRSP – but this involves an element of double taxation.
- ▶ Before trying to rebalance the mix of investments held in your RRSP based on the above considerations, consider whether any transfers would fall into the punitive swap or advantage tax rules.
- ▶ If you believe your private company shares held in an RRSP have, or may become, prohibited, speak to your EY advisor about the rules for, and implications of, removing them from the plan.

Tax-free savings account

Every Canadian resident (other than US citizens and green card holders) aged 18 and older should consider including a TFSA as part of their investment strategy. The tax benefit of these registered accounts isn't in the form of tax-deductible contributions, but in the tax-free earning on invested funds.

For US citizens and green card holders, the decision is more complex, as income earned in the TFSA must be reported on the individual's US personal income tax return, so the tax savings may be limited and there will be additional US filing disclosures.

The mechanics of the TFSA are simple:

- ▶ You can contribute up to \$6,000 annually (\$6,000 in 2019; \$5,500 in 2016, 2017 and 2018; \$10,000 in 2015; \$5,500 in 2013 and 2014; \$5,000 prior to 2013). If you contribute less than the maximum amount in any year, you can use that unused contribution room in any subsequent year. The cumulative contribution limit for 2019 is \$63,500.
- ▶ Income and capital gains earned in the TFSA are not taxable, even when withdrawn.
- ▶ You can make withdrawals at any time and use them for any purpose without attracting any tax.
- ▶ Any funds you withdraw from the TFSA – both the income and capital portions – are added to your contribution room in the next year. This means you can recontribute all withdrawals in any subsequent year without affecting your allowable annual contributions. Recontribution in the same year may result in an overcontribution, which would be subject to a penalty tax.

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Permitted investments for TFSAs are the same as those for RRSPs and other registered plans. And, like RRSPs, contributions in kind are permitted. But be aware that any accrued gains on the property transferred to a TFSA will be realized (at the time of transfer) and taxable, while any accrued losses will be denied.

As with RRSPs and RRIFs, a special 50% tax applies to a prohibited or non-qualified investment held by a TFSA, and a special 100% tax applies to certain advantages received in connection with a TFSA.

The CRA tracks your contribution room and reports it to you annually as part of your income tax assessment. If you over-contribute, as with RRSPs, the over-contribution will be subject to a penalty tax of 1% per month while it remains outstanding. If you become a nonresident of Canada, a similar 1% penalty tax will apply to any contributions you make to your TFSA while you are a nonresident.

Be aware that if the activities of a TFSA constitute carrying on a business,¹² the related income earned within the TFSA would be subject to income tax. The trustee of the TFSA (e.g., a financial institution) and the TFSA trust are jointly liable for paying this tax. The 2019 federal budget and corresponding enacting legislation have extended this joint liability to include the TFSA holder, for 2019 and later taxation years.¹³

Tax tips

- ▶ Gift or loan funds to your spouse or partner so they can make their own contribution. You should not make the TFSA contribution directly on their behalf. The income earned on these contributions will not be attributed to you while the funds remain in the plan.
- ▶ You can also gift funds to an adult child for TFSA contributions. An individual cannot open a TFSA or contribute to one before the age of 18. However, when you turn 18, you will be permitted to contribute the full TFSA dollar limit for that year (currently \$6,000 for 2019).
- ▶ To pass your TFSA to your spouse or common-law partner, designate them as the successor holder so the plan continues to accrue tax free without affecting their contribution room.
- ▶ Your annual contribution limit is composed of three components:
 - The annual TFSA dollar limit of \$6,000 (\$6,000 for 2019; \$5,500 for 2016, 2017 and 2018; \$10,000 for 2015; \$5,500 in 2013 and 2014; \$5,000 prior to 2013)
 - Any unused contribution room from a previous year
 - The total amount of withdrawals from your TFSA in the previous year
- ▶ You can maintain more than one TFSA, as long as your total annual contributions do not exceed your contribution limit.
- ▶ You can view your TFSA transaction summary on the CRA's website. Go to *My Account*¹⁴ to see all of the contributions and withdrawals made from your TFSA.
- ▶ If you become a nonresident of Canada:
 - You will not be taxed in Canada on income earned in the TFSA (foreign tax may apply) or on withdrawals from your plan.
 - No contribution room will accrue for any year throughout which you are a nonresident. In the year of your emigration or immigration, the annual dollar limit without proration applies.
 - If you re-establish Canadian residence, any withdrawals while you were a nonresident will be added back to your TFSA contribution room in the following year.
- ▶ Consider holding your non-tax-preferred investments – those that give rise to interest and foreign dividends – in your TFSA.
- ▶ Neither income earned in the TFSA nor withdrawals from it affect your eligibility for federally income-tested benefits (i.e., Old Age Security, the Guaranteed Income Supplement) or credits (i.e., GST/HST credit, age credit and the Canada Child Benefit).

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¹² An example would be a business of trading investments in which the TFSA holder actively trades investments inside their TFSA like a dealer.

¹³ The liability of the TFSA trustee in respect of business income earned by a TFSA is limited to the property held in the TFSA at that time plus the amount of all distributions of property from the TFSA on or after the date that the notice of assessment is sent.

¹⁴ For more information about My Account, see [Chapter 17: Tax payments and refunds](#).



Investment holding companies

In the past, many individuals have incorporated their investments in an IHC to benefit from the tax deferral on income earned in a corporation that exists because earnings in a corporation do not attract personal tax until they are paid out to the shareholder.

This deferral advantage was largely eliminated with the imposition of an additional refundable tax on investment income of CCPCs, which is only refunded to the corporation when it pays a taxable dividend to an individual.

The combined corporate and personal tax represents the effective tax rate of earning income through a corporation. Since the gross-up and DTC mechanism is based on notional federal and provincial tax rates at the corporate and personal levels, to the extent that the actual rates differ, the effective tax rate on income earned through a corporation will be higher or lower than the rate an individual would pay on the same income earned directly. The difference is either an absolute cost or saving associated with earning income through a corporation.

In all provinces, there is a cost, on a fully distributed basis, to earning investment income in an IHC rather than directly as an individual. However, there may be deferral opportunities in some provinces (and in all provinces on non-eligible dividends) if funds are retained in the IHC due to the personal tax rates in those provinces, as well as other non-tax benefits to having an IHC.

Specifically, an IHC may still be useful in the following circumstances:

- ▶ Probate fee planning
- ▶ Sheltering assets from US estate tax
- ▶ Facilitating an estate freeze
- ▶ Deferring tax by selecting a non-calendar taxation year



- ▶ Reducing personal net income to preserve certain tax credits and social benefits
- ▶ Converting what might otherwise be non-deductible interest into tax-deductible interest
- ▶ Holding shares in operating companies that pay dividends¹⁵

Tax tips

- ▶ If you're thinking of winding up your IHC, consider the possible benefits of IHCs and be aware that there may be significant tax costs associated with the wind-up.
- ▶ If you're thinking of setting up an IHC, remember that transferring a personal portfolio to a corporation may make it difficult to utilize personal capital losses. Also, consider the tax cost relative to any deferral benefit in your province and remember the additional administrative costs of setting up and maintaining a corporation.

Investing offshore

Canadian residents are taxed on their worldwide income. As a result, you can't avoid Canadian tax by investing funds, directly or indirectly, outside Canada.

There are a variety of complex tax rules and reporting requirements aimed at offshore investments. These include:

- ▶ Rules that result in an annual income inclusion for Canadian tax purposes from a foreign investment entity, even though there may be no income distribution
- ▶ Rules that deem a foreign trust to be resident in Canada and therefore taxable in Canada
- ▶ Annual foreign investment reporting for individuals who own foreign investment property with an aggregate cost in excess of \$100,000 at any time in the year or shares in a foreign affiliate

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¹⁵ Options to income split using this method are now very limited. See [Chapter 9: Families](#).



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6 Professionals and business owners

If you're a professional or you own a business, there are many valuable tax-planning opportunities available to you.

Business expenses

In general terms, all reasonable expenses you incur to earn business income are deductible in computing business income for tax purposes. However, there are some specific restrictions:

- ▶ For business meals and entertainment, you can generally only claim a maximum of 50% of the expenses as a business expense.
- ▶ If you use your car for your business, you can claim business-related operating costs, including fuel, maintenance, repairs, licence and insurance. In addition, you can claim depreciation or lease costs subject to prescribed maximum amounts. Keep in mind that the business portion of these expenses will generally be computed by reference to business kilometres over total kilometres driven in a year. Driving between your home and your business premises is not considered business travel. To support your claim for automobile expenses, keep a record of your total kilometres and business kilometres driven in the year.
- ▶ If you operate your business principally from your home office (and you don't have an office elsewhere, or you use your home office space exclusively to operate your business and to meet clients, customers or patients on a regular basis), you can claim a reasonable portion of mortgage interest or rent, property taxes, utilities, and repairs and maintenance. A "reasonable portion" is generally based on the amount of office space to

total space in your house that is used as office space (special rules apply in Quebec). You can even claim depreciation on your house in relation to your business space, but this is generally not advised as it may limit your principal-residence claim when you sell the home. In any particular year, the deduction from home office expenses cannot exceed the income from the related office or employment. However, the excess can be carried forward and added to home office expenses in the subsequent year.

- ▶ You can claim the cost of attending conventions relating to your business or profession. However, you're limited to two conventions per year, and they must be held at locations within the scope of your business or professional organization. There will also likely be limitations on the deductibility of meals and entertainment costs, as discussed above, at the conventions.

2019 budget

The 2019 federal budget announced, and corresponding legislation implemented, amendments that significantly accelerate the rate of capital cost allowance (CCA) claims on a temporary basis, effective for eligible property acquired after 20 November 2018.¹⁶ These measures include:

- ▶ Full expensing of manufacturing and processing (M&P) machinery and equipment and specified clean energy equipment that become available for use in a business prior to 2024 (with accelerated CCA claims applicable to M&P equipment and specified clean energy equipment that become available for use between 2024 and the end of 2027)
- ▶ An accelerated investment incentive that provides for an enhanced CCA deduction, in the taxation year the property first becomes available for use in a business or profession, of up to three times the normal first-year CCA deduction for most classes of capital assets that become available for use prior to 2024 (and a first-year CCA deduction of up to double the normal claim for capital assets that become available for use between 2024 and the end of 2027)

The 2019 federal budget, and corresponding legislation, also announced and implemented amendments to provide for full expensing of eligible "zero-emission" vehicles for eligible vehicles that are purchased and become available for use in a business or profession on or after 19 March 2019 and before 2024, subject to a \$55,000 cap (plus sales taxes) per vehicle. Accelerated CCA deductions will be available for vehicles that become available for use between 2024 and the end of 2027. Eligible vehicles must be new and include electric battery, plug-in hybrid (with a battery capacity of at least 7 kWh) or hydrogen fuel cell vehicles, including light-, medium- and heavy-duty vehicles purchased by a business.

For full details of these measures, see EY [Tax Alert 2019 Issue No. 27](#) and [2018 Issue No. 40](#).

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¹⁶ These measures were first proposed in the government's 21 November 2018 fall economic statement.



- ▶ You can claim depreciation on tangible and intangible capital assets that are available for use in your business or profession in the course of earning income by claiming CCA. However, the amount of CCA that may be claimed each taxation year is subject to maximum limits, based on the classification of the capital asset for CCA purposes, such that the cost of capital assets is deducted over a number of years. Generally, these classes are based on the declining-balance system, and maximum rates apply to each class.

Private health-care premiums

Unincorporated business owners, including all self-employed individuals, may generally deduct premiums paid for private health and dental plans, subject to certain conditions and limits.

To be eligible for the claim, the private health-care costs must be paid to third parties who provide such plans and, to the extent that you claim these costs as a business expense, you cannot include them with your medical expense tax credit claim. However, costs in excess of deductible amounts are eligible for the medical expense tax credit.

This deduction is not available for Quebec tax purposes.

Billed-basis accounting for professionals

Legislative amendments enacted in December 2017 dealt with the perceived mismatching of revenue and costs that was primarily available to professional firms providing legal and accounting services, as well as to other designated professionals such as dentists, medical doctors, veterinarians and chiropractors. The former rules permitted a full deduction for expenses as incurred and the reporting of revenue only when amounts would be billed to clients.

The new rules include measures that phase out the deduction for unbilled work in progress (WIP) over a five-year period. For tax years that commence on or after 22 March 2017, a deduction for WIP is available for 80% of the lesser of cost and fair market value of unbilled WIP. In each of the four subsequent years, the amount of the deduction is reduced by an additional 20% of the lesser of the cost and fair market value of unbilled WIP. Consequently, as most practices have a calendar tax year, the 80% deduction was available for 2018, 60% is available for 2019, and by 2022 no WIP deduction will be permitted.

Canada training credit

2019 budget

The 2019 federal budget announced, and corresponding legislation implemented, amendments that introduce a new refundable tax credit, the Canada training credit. Effective for the 2020 and later taxation years, the credit will assist eligible individuals who have either employment or business income to cover the cost of up to one-half of eligible tuition and fees associated with training.

Eligible individuals will accumulate \$250 each year in a notional account that can be used to cover the training costs. To accumulate the \$250 each year, a Canadian-resident individual (who is at least 26 and less than 66 years of age at the end of the year) must file a tax return, have employment or business income in the preceding taxation year greater than or equal to \$10,000¹⁷ and have net income in the preceding taxation year that does not exceed the top of the third tax bracket (\$147,667 for 2019). The maximum accumulation over a lifetime will be \$5,000, which will expire at the end of the year in which the individual turns 65.

The amount of the refundable credit that can be claimed in a taxation year will be equal to the lesser of one-half of the eligible tuition and fees paid in respect of the year and the individual's notional account balance. For purposes of this credit, tuition and fees do not include tuition and fees levied by educational institutions outside of Canada. The refundable Canada training credit will reduce the amount that will qualify as an eligible expense for the tuition tax credit. The annual accumulation in the notional account will begin in 2019, and the first credit will be able to be claimed for the 2020 taxation year.

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¹⁷ Also includes maternity and parental employment insurance benefits; benefits paid under Quebec's *Act respecting parental insurance*; certain research grants, scholarships, fellowships or bursaries not exempt from taxation; and certain amounts normally exempt from income tax.



Change in use rules for multi-unit residential properties

2019 budget

When a taxpayer converts a property from an income-producing purpose (e.g., a rental property) to a personal use purpose (e.g., a residential property) or vice versa, there is a deemed disposition and re-acquisition of the property for tax purposes at fair market value. This means that to the extent there are accrued capital gains on the property, these gains would be realized and subject to tax upon the deemed disposition. When the use of an entire property is changed, there is an election available to not apply this deemed disposition. The election can provide a deferral of the realization of any accrued capital gain on the property until it is realized on a future disposition. Although the deemed disposition rule applies to changes in use of an entire property or just part of a property, the election does not currently apply to partial changes in use.

If, for example, you own a multi-unit residential property (e.g., a triplex) and rent the units out, but you decide to move into one of the units, the change-in-use rules would apply as there is a partial change in use of the property. However, under the current rules, you would not be able to elect to not apply the corresponding deemed disposition. The 2019 federal budget announced a proposal to allow a taxpayer to elect that the deemed disposition that normally applies on a change of use of part of a multi-unit residential property not apply, effective for changes in use occurring on or after 19 March 2019.

Partnerships

When two or more individuals combine their assets or business operations, or embark on a joint business without incorporating, they generally form a partnership. Although a partnership is not a taxable entity, income or loss is computed at the partnership level and flows through to the individual partners in the proportion agreed upon in their partnership agreement. Income from a partnership retains its character when allocated to and reported by a partner.

When a partnership has at least one individual partner, its year end must be 31 December, except when the alternative method election is available (discussed below).

Tax planning for partnerships

Prior to 22 March 2011, if all the partners were corporations, any year end could be selected, and many corporate partners were able to obtain a tax deferral on partnership income by selecting a partnership year end after a corporate partner's year end. For tax purposes, the corporation would report partnership income for the fiscal period that ends in the corporation's taxation year.

The 2011 federal budget eliminated this partnership income deferral for corporate partners, together with affiliated and related parties, that are entitled to more than 10% of either the partnership's income or net assets.

The 2016 federal budget introduced rules (enacted in December 2016) to limit access to the small-business deduction under certain corporate and partnership structures that multiply the number of small-business deduction limits within a group. Refer to EY's [Tax Alert 2016 Issue No. 15](#) for details. The rules are effective for taxation years beginning on or after 22 March 2016.¹⁸

Reporting business income

Sole proprietorships and partnerships are generally required to use a 31 December year end for income tax reporting purposes. However, because there are valid non-tax reasons for having off-calendar year ends, sole proprietorships (and partnerships of which all members are individuals) may elect to have non-calendar year ends for tax purposes and compute their business income for the year using a specified formula (the alternative method). Tiered partnerships and businesses investing primarily in tax shelters are not eligible for this election.

Tax tip

For individuals reporting business income, except when the only business income is from a tax shelter, income tax returns are due by 15 June, not 30 April. However, any tax liability must still be paid by 30 April.

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¹⁸ The 2018 federal budget included measures (enacted in December 2018) impacting the at-risk rules of limited partnerships vis-à-vis tiered partnership structures, to ensure that the at-risk rules apply at each level of a tiered partnership structure. For details, refer to EY's federal budget [Tax Alert 2018 Issue No. 7](#).



Incorporating your business

As a business owner, you're likely to face the decision of whether to incorporate once your business becomes successful. You'll need to base your decision on a number of factors, both commercial and tax related.

Incorporation can bring a number of commercial benefits, such as:

- ▶ The potential for liability is limited to assets owned by the corporation. However, corporate business owners often have to provide personal guarantees for business loans, thereby extending the risk beyond business assets.
- ▶ Because an incorporated business is a separate legal entity distinct from its owner, it can continue after the owner's death, facilitating business succession.

Offsetting the commercial benefits are the commercial costs, including the legal and accounting fees associated with setting up the corporation, and the ongoing maintenance and compliance fees, such as the costs of preparing minutes, financial statements and tax returns.¹⁹

The primary tax advantage of incorporation, compared to earning business income personally and paying tax at the top personal marginal tax rate, is income tax deferral. This deferral results because Canadian-controlled private corporations (CCPCs) pay a reduced tax rate, in general, on the first \$500,000²⁰ of active business earnings. The 2019 rate ranges from 9% to 15%, depending on the province or territory of operation. This amounts to a potential annual tax deferral of approximately \$185,000 to \$219,000 on the amount eligible for the reduced small-business rate, depending on the province or territory of operation and residence of the owner. The tax deferral advantage of incorporation may be reduced,



beginning in 2018, as a result of new rules that limit tax planning arrangements using private corporations (see below for further details).

In 2019, the federal small business rate is 9% (reduced from 10% in 2018).

As previously noted, Budget 2016 also introduced measures to prevent certain structures that multiply the number of small-business deductions within a group. Careful consideration should be given to these rules when planning to maximize the advantage of reduced small-business rates. These rules are complex: consult your EY Tax advisor.

Federally, this corporate rate reduction is eroded for larger corporations with taxable capital (and that of their associated companies in total) in excess of \$10 million. All provinces and territories have a similar "clawback" provision. The 2018 federal budget and corresponding legislation have introduced an additional clawback provision to the extent a CCPC's passive investment income (and that of its associated companies in total) is in excess of \$50,000 a year, effective for taxation years beginning after 2018. See **New rules impact private companies earning passive investment income** below for details.

The deferred tax will normally be eliminated when the corporate earnings are paid to the owner by way of dividends.²¹ However, the longer those earnings remain in the corporation, the greater the benefit associated with the tax deferral. The tax deferral may be reduced beginning in 2018 (as noted above). See **New rules limit income splitting after 2017** below.

Tax tips

- ▶ If you're operating a successful unincorporated business, consider whether incorporation would provide additional commercial and tax benefits.
- ▶ If your corporation is providing services that would normally be provided by an employee, consider the personal services business rules. In addition to the existing punitive rules restricting deductions and denying eligibility for the small-business deduction or general corporate rate reduction, the federal corporate tax rate applicable to personal services business income is very high, at 33%.

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¹⁹ The 2016 federal budget introduced rules permitting a full write-off in the year for the first \$3,000 of incorporation expenses (new par. 20(1)(b)) not otherwise deductible for tax purposes.

²⁰ Federally and all provinces and territories, except for \$600,000 in Saskatchewan.

²¹ In fact, there is a small overall tax cost in most provinces when corporate earnings are paid to the owner by way of dividends. In other words, the total combined corporate and personal income tax liability is slightly higher, compared to the overall tax liability that would result if the income was earned directly by an individual in respect of an unincorporated business.



Additional advantages

Other tax advantages to incorporating a proprietorship include:

- ▶ Availability of the capital gains exemption on the sale of qualified small business corporation shares.
- ▶ Flexibility in the character and timing of remuneration.
- ▶ Possibility of income splitting by having family members subscribe for shares of the corporation and receive dividends. Prior to 2018, income splitting of this kind was effective with respect to adult family members receiving income or capital gains from a private corporation, since only minor children receiving such income would be subject to the top marginal personal tax rate, the tax on split income (TOSI), on the amounts received. The revised TOSI rules, effective after 2017, extend the application of the TOSI to certain adult family members, thereby further restricting income splitting opportunities. See below.
- ▶ Managing the potential tax cost associated with the deemed disposition of assets on the owner's death by effecting an estate freeze. (Note that planning associated with estate freezes was also affected by the revised TOSI rules; see below.) For more on estate planning, refer to [Chapter 12: Estate planning](#).
- ▶ Reducing the potential probate fees payable on the owner's estate at death.

Disadvantages

There are some drawbacks to operating a business in a corporation, including:

- ▶ Trapped losses. If the business is operating at a loss, the owners cannot apply the loss against their other sources of income. Such losses can only be carried back three years or forward 20 years to be applied against other income of the corporation for those years. This is often why startup operations often start out as unincorporated businesses and are incorporated once they begin generating profits.
- ▶ The possibility of double taxation on the sale of the business or other disposition of assets. When assets are disposed of by a corporation, any gains realized on the disposition are subject to tax in the corporation. A second level of taxation occurs when the after-tax proceeds of the disposition are distributed to the shareholders in the form of dividends. However, you can achieve a more tax-efficient outcome with proper planning. See [Chapter 1: Considering selling your business?](#), for further information.

New rules limit income splitting after 2017

Amendments enacted in June 2018 limit income-splitting arrangements that use private corporations to benefit from the lower personal tax rates of certain family members age 18 or over who are direct or indirect shareholders of the corporation or are related family members of direct or indirect shareholders.

Effective for 2018 and later years, the new rules limit the ability to share income within a family by expanding the base of individuals subject to the TOSI to include children age 18 and over and other related adult individuals (including spouses or common-law partners, grandparents and grandchildren, but not aunts, uncles, nephews or nieces) who receive split income²² from a related (family) business either directly from a private corporation (such as by the receipt of dividends) or through a trust or partnership. TOSI is equal to the highest federal personal marginal rate of tax (33% in 2019). The types of income that are subject to TOSI have also been expanded to include interest income earned on a debt obligation of a private corporation, partnership or trust (subject to some exceptions), and gains from the disposition of property if income from the property would otherwise be split income.

Under these rules, income received or gains realized from a related business by certain adult family members are excluded from TOSI if any one of a number of exceptions is met. Adults who are 25 or older who receive split income are subject to a reasonableness test if they do not meet any of the exceptions. The test is based on the extent of their contribution of labour and capital to the business, risks taken and other payments already received from the business. TOSI will then apply to split income received to the extent it is unreasonable under this test.

For a detailed listing of the exceptions to TOSI and further details about these rules, see [TaxMatters@EY February 2018](#), *Revised draft legislation narrows application of income sprinkling proposals*, and EY's [Tax Alert 2017 Issue No. 52](#).

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²² Effectively, split income arises when a stream of income is connected, either directly or indirectly, to a related business.



New rules impact private companies earning passive investment income

Amendments enacted in June 2018 limit the tax advantage of investing undistributed earnings from an active business using a private corporation. The perceived advantage results from the fact that corporate income tax rates on active business income are generally lower than personal income tax rates, thereby allowing a greater amount of undistributed earnings to be invested in a passive portfolio. The new rules limit the tax advantage for CCPCs with passive investment income in excess of \$50,000 a year. Other new rules addressing this tax advantage limit a private corporation's ability to pay eligible dividends in order to obtain a dividend refund from its refundable dividend tax on hand account. Both measures are effective for taxation years beginning after 2018.

The new rules that target passive investment income exceeding \$50,000 per year introduce a second clawback provision that reduces a CCPC's access to the small business deduction (over and above the clawback for taxable capital in excess of \$10 million (see page 34)). The \$500,000 small business limit (eligible for the small business deduction) is reduced by \$5 for every dollar that a CCPC's passive investment income for the year (and that of its associated companies in total) exceeds \$50,000 in the preceding year. This means that the small business deduction is unavailable to the CCPC in a taxation year if income from passive investments of the CCPC together with an associated group of corporations exceeds \$150,000 for the preceding year. The amount of the applicable small business limit clawback for a CCPC for any given year is equal to the greater of the taxable capital and passive investment income clawbacks. As of June 2019, Ontario and New Brunswick are the only provinces that had tabled legislation confirming that they would not parallel these new rules with respect to passive investment income.

For further information about these measures impacting the small business deduction, see [TaxMatters@EY May 2018](#), *Federal budget simplifies passive investment income proposals*.

For further information about the measures impacting a private corporation's refundable dividend tax on hand account, see [TaxMatters@EY June 2018](#), *Federal budget proposes revised refundable tax regime for passive investment income*.

Private corporations, their shareholders and family members should consider reviewing dividend and other payments to family members in the context of the new rules and should consider the impact of these rules on existing arrangements or future planning.

For more information, contact your EY Tax advisor.

Factual control

The *Income Tax Act* contains two different definitions of control that apply for various purposes. Some provisions rely on de jure control while others rely on de facto control. De facto control generally applies for purposes of determining whether companies are associated and must share the benefit of the small-business deduction (which provides for the reduced small business rate) on the first \$500,000 of annual active business income and for the enhanced scientific research and experimental development tax credits available for CCPCs.

New legislation, effective for taxation years that begin on or after 22 March 2017, clarifies that in determining whether factual control exists, factors may be considered that are not limited to the constraints established by a recent Federal Court of Appeal case, but include all factors that are relevant in the circumstances. For further details on both of these items, see EY's [Tax Alert 2017 Issue No. 9](#).



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Remuneration planning for the corporate owner

Corporate business owners have great flexibility in making decisions about their remuneration from the company. It's important that decisions about remuneration be made before year end, as well as considered during the business's financial statement and tax return finalization processes.

Changing federal and provincial personal and corporate tax rates have made remuneration planning more important than ever; the plan should be re-evaluated each year based on the specific needs of the business owner and be part of a holistic financial plan.

Tax tips

- ▶ In determining the optimal salary-dividend mix, consider:
 - Before the amendments enacted in June 2018 (see above), in general, if the owner-manager did not need the money, it could be left in the corporation to grow subject to tax at corporate tax rates, which for active income are less than personal tax rates. However, under the new passive investment income rules (see above), this strategy will no longer be effective with respect to passive income that exceeds \$50,000 per year, effective for taxation years beginning after 2018. Consult with your EY Tax advisor.
 - Even if the owner-manager does not need the money, it may make sense to pay sufficient salary or bonus to create enough earned income to maximize their RRSP deduction next year.
 - Bonuses can be accrued and be deductible by the company in 2019, but don't have to be included in the business owner's personal income until paid in 2020 (provided they are paid within 180 days after the corporation's year end).
 - Pay sufficient salary or bonus to eliminate or reduce a personal minimum tax liability.
 - Payment of salary or bonus may increase provincial payroll tax.
 - If you anticipate that the cumulative net investment loss (CNIL) rules will affect your ability to claim your remaining capital gains exemption, pay yourself dividends rather than salary.
 - Paying dividends may occasionally be a tax-efficient way of getting funds out of the company. Capital dividends are completely tax free when received by Canadian-resident individual shareholders, eligible dividends are subject to a preferential tax rate and taxable dividends generate a dividend refund in a corporation with a refundable dividend tax account. A review of the company's tax attributes and relevant personal tax rates in the shareholder's province of residence will identify whether tax-efficient dividends can be paid.
 - Dividends do not represent earned income for the purpose of creating RRSP contribution room. Earned income is also required for other personal tax deductions such as child care and moving expenses.
 - Return paid-up capital, or pay down shareholder advances, as an alternative to paying taxable dividends or salary.
- ▶ Consider employing your spouse or partner and/or your children to take advantage of income-splitting opportunities. Their salaries must be reasonable for the work they perform. Consider whether your industry is subject to Workplace Safety and Insurance Board coverage in your province. Exemptions may exist for an executive officer, but details vary by province.

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Corporate loans

If you borrow funds from your corporation, either interest free or at a low rate of interest, you may have a taxable benefit for imputed interest on the loan, reduced by any interest payments you make by 30 January of the following year. The amount of imputed interest is computed at prescribed rates on the outstanding loan for the period. In 2019, the prescribed rate was 2% in Q1, Q2, Q3 and Q4. To avoid an income inclusion for the entire amount of the loan, you should repay the loan by the end of the corporation's taxation year following the year the loan was made. If the entire amount of the loan is included in income, the imputed interest benefit does not apply. If a shareholder repays a loan that was previously included in income under these rules, the shareholder is entitled to a deduction in the year of repayment to the extent of the amount repaid, provided the repayment is not made as part of a series of loans or other transactions and repayments.

Housing loans, car loans and funds borrowed to acquire newly issued shares of the company may not be subject to this income inclusion rule if received by virtue of employment.

Tax tip

If you take out a loan for the purpose of earning business or property income, the interest paid and the imputed interest benefit for low- or no-interest loans are deductible for tax purposes.

Asset ownership

As the shareholder/manager of a business, you may have the option of holding various assets and liabilities personally or in your corporation.

Tax tip

Consider holding investment assets personally so that the corporation maintains its SBC status. This will help ensure the shares are eligible for your remaining capital gains exemption by potentially reducing your personal CNIL account.

Shareholders' agreements

If your corporation has more than one shareholder, even if they're all family members, you should have a shareholders' agreement to protect your rights as a shareholder, minimize shareholder disputes and ensure a smooth transition on the death or withdrawal of any shareholder.

Review the agreement periodically in light of changes in the shareholders' personal circumstances, changes in tax law and other legislative developments.

Tax tips

- ▶ The shareholders' agreement should deal with many things, including the following:
 - The mechanism for buyout of a shareholder's interest on death, disability, bankruptcy or retirement, and how the buyout will be funded
 - Payment of dividends (eligible and capital)
 - Settlement of disputes between shareholders
 - Settlement of management issues
 - Valuation of the corporation's shares

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7 Employees

From benefits and company cars to stock options and sales tax rebates, employees of Canadian companies can take advantage of some helpful tax-saving opportunities.

Benefits

In addition to your salary, wages and bonuses, you're taxed on the value of the benefits you receive by virtue of your employment. However, certain benefits are tax free.

Common taxable and tax-free benefits

Tax-free benefits

- ▶ Contributions to a registered pension plan or deferred profit-sharing plan
- ▶ Private health-care premiums (except in Quebec)
- ▶ Supplementary unemployment benefit plan premiums
- ▶ Employee discounts offered to all employees on merchandise sold by your employer
- ▶ Subsidized meals, when a reasonable charge is paid
- ▶ Uniforms or special clothing
- ▶ Club memberships (athletic or social), when the benefit is primarily for your employer
- ▶ Tuition, if the course is required by your employer and is primarily for their benefit
- ▶ A reasonable per-kilometre car allowance
- ▶ Board, lodging and transportation to special work sites or remote work locations

- ▶ Transportation passes for rail, bus or airline employees, in certain situations
- ▶ Counselling services relating to re-employment, retirement or mental or physical health
- ▶ Use of the employer's recreational facilities (if available to all employees)
- ▶ Reimbursement for various job-related expenses (e.g., travel, entertainment, moving)
- ▶ Death benefit up to \$10,000
- ▶ Non-cash gifts received by arm's-length employees with an aggregate annual value of under \$500
- ▶ Personal use of frequent-flyer points when earned on your business travel, in most circumstances
- ▶ Business use of employer-provided cell phone or internet service

Taxable benefits

- ▶ Board, lodging, rent-free or low-rent housing (some exceptions for special work sites and remote work locations)
- ▶ Most gifts (other than non-cash gifts as noted), prizes and incentive awards
- ▶ Group sickness or accident insurance premiums
- ▶ Life insurance premiums
- ▶ Stock option benefits
- ▶ Adoption assistance
- ▶ Family travel costs, unless family members are required to accompany you and they're involved in business activities on your trip
- ▶ Interest-free and low-interest loans

- ▶ Employer-paid tuition for personal-interest courses or those primarily for your benefit
- ▶ Employer-provided car (monthly standby charge and operating benefit)
- ▶ Car allowance, when not computed with reference to distance travelled
- ▶ Parking privileges in certain circumstances
- ▶ Income tax return preparation fees and financial counselling fees
- ▶ Employer-paid financing for housing costs as a result of relocation, reimbursement for loss on sale of former home (only half of amount paid in excess of \$15,000 is taxable when the move is an eligible relocation)
- ▶ Employer-provided tickets to a game or event for personal use
- ▶ Use of company aircraft²³

We describe some of the most common benefits in more detail on the following pages.

Car allowance

If you're required to use your own car for business, the reasonable per-kilometre allowance you're paid is not taxable. But you must record the distance you travel. Otherwise, the allowance is not considered reasonable and must be included in your income.

If your employer doesn't provide a tax-free per-kilometre allowance, or if you include your allowance in income because it's not reasonable, you may be able to deduct certain car expenses when calculating your income.

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²³ The CRA has issued guidelines to its field auditors on how to calculate an employee's taxable benefit for the personal use of business aircraft owned or leased by a corporation. Depending on the type and nature of the personal use, the benefit is now based on the highest-priced ticket for an equivalent flight or the price of chartering an equivalent aircraft, or it will include an operating cost and available-for-use benefit.



Company car

If your employer gives you access to a company car for personal use, you'll have to pay tax on the benefit. This is referred to as a standby charge and is generally equal to 2% of the original cost of the car per month or, in the case of a leased vehicle, two-thirds of the lease cost, excluding insurance.

You may be able to reduce this standby charge if you use the car primarily (i.e., more than 50%) for business and if your annual personal driving does not exceed 20,004 km. In addition, any payment you make during the year to your employer in respect of the car, other than an operating expense reimbursement, reduces the taxable benefit.

If your employer pays any operating costs related to your personal use of the company car, a taxable benefit results.

However, if you use your company car at least 50% for business, you can have the operating benefit calculated as one-half of the standby charge less any personal operating costs repaid to your employer within 45 days after the year end. For this option, you must notify your employer in writing.

Harsh results may arise if you pay for your own gas and oil but your employer pays for incidental operating costs. For 2019, the full 28-cent per-kilometre operating benefit applies unless the alternate operating cost benefit (half of the standby charge) applies and results in a reduced income inclusion. If your employer pays your personal parking costs, a separate taxable benefit results. If you are employed principally in the business of selling or leasing automobiles, the operating cost benefit is 25 cents per kilometre for 2019.

If you work in Quebec, you must give your employer a copy of your travel log book so that the taxable benefit is appropriately calculated. A penalty of \$200 could be assessed if a log book is not provided within 10 days of the year end.

Tax tips

- ▶ Maintain car records of personal and business kilometres to substantiate a claim for a reduced standby charge.
- ▶ It may be advantageous to calculate the operating benefit as 50% of the standby charge if the car is used at least 50% for business, particularly if the reduced standby charge applies. If so:
 - Notify your employer in writing by 31 December.
 - Record personal and business kilometres.
- ▶ If you use your employer-provided car less than 50% for business, consider paying for the personal portion of your operating costs.

Low-interest or interest-free loans

A taxable benefit results from most low-interest or interest-free loans from your employer.

It's calculated using the interest rates prescribed quarterly by the CRA (in 2019, 2% for Q1, Q2, Q3 and Q4), but is reduced by interest you pay to your employer by 30 January of the following year.

Home-purchase loan

If you used the loan proceeds to buy or refinance a home, this may result in a reduced benefit. The benefit is calculated using the lesser of the current prescribed rate and the rate in effect at the time you received the loan. For this purpose, the loan is considered to be new every five years.

Income-producing property loan

If you used the loan proceeds for an income-producing purpose, you may generally deduct the amount of the taxable benefit as interest expense. This deduction is included in your cumulative net investment loss (CNIL) and may restrict your ability to use your remaining capital gains exemption.

Tax tip

Consider renegotiating your home-purchase loan when prescribed rates are low, in order to minimize your taxable benefit on the loan in subsequent years.

Security option benefits

If you've acquired shares or units of a mutual fund trust under an employee stock or unit option plan, the excess of the value of the shares or units on the date you acquired them over the price you paid for them is included in your income from employment as a security option benefit.

When the corporation is not a Canadian-controlled private corporation (CCPC), the benefit is generally included in your income in the year you acquire the shares/units.

Half of the security option benefit included in income generally qualifies as a deduction, provided the price you paid for the securities was not less than the value of the securities on the date you were granted the options and the securities meet the prescribed share tests. The 2019 federal budget has proposed to limit the availability of this deduction where security options are granted to employees of "large, long-established, mature firms" (see 2019 budget below).

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Any increase in the value of the securities after you acquire them is generally taxed as a capital gain in the year you sell them. Any decrease in value is a capital loss that, generally, you cannot use to reduce any tax you pay on your security option benefit.

If you've acquired CCPC shares under an employee stock option or stock purchase plan since 22 May 1985, the benefit (as calculated above) is always taxed in the year you dispose of the shares, rather than in the year you acquired them.

If you held the CCPC shares for at least two years, 50% of the benefit qualifies as a deduction, even if the price you paid for them was less than their value on the date you were granted the option. You have a capital gain to the extent the net proceeds exceed the value of the shares on the date they were acquired. This capital gain may be eligible for your remaining capital gains exemption.

For Quebec income tax purposes only, the rate of the deduction is generally 25% for options exercised after 30 March 2004.

The difference in treatment of option benefits for CCPC and non-CCPC shares is based on the status of the corporation at the time the options are granted. Therefore, if you have an option to acquire, or have acquired, shares of a CCPC, and the company goes public or ceases to be a CCPC, the special tax treatment for CCPC options continues to apply to the options previously granted and shares previously acquired, and to shares or options of the public company you may receive in exchange.

2019 budget

The 2019 federal budget announced proposals to limit the availability of the security option deduction to an annual maximum of \$200,000 of stock option grants, based on the fair market value of the underlying shares on the date of grant. These proposals will apply to security options granted to employees of "large, long-established, mature firms", but will not apply to security options granted to employees of "startups and rapidly growing Canadian businesses". These terms were not defined in the budget papers.

On 17 June 2019, a Notice of Ways and Means Motion (NWMM) was tabled that includes these proposals with accompanying comments by the Department of Finance (Finance). The NWMM did not define the terms noted in the 2019 budget announcement. Instead, Finance stated that the proposed rules would not apply to security options granted to employees of "start-up, emerging, or scale-up companies". The government launched a consultation process in which stakeholders were invited to provide their input on what these terms should mean. The consultation process ended on 16 September 2019. The prescribed definition of these terms should follow.

The following example illustrates the impact of these proposed measures:

- ▶ Your employer, a large, long-established, mature company, grants you 10,000 options to purchase shares of the company for \$100 per share at a time when the fair market value of the shares is also \$100 per share. Therefore, the value of the shares represented by the options at the time of grant is \$1,000,000. If you exercise the 10,000 options in a particular year, the stock option deduction will only apply to 2,000 (\$200,000/\$100) of the options granted.

An employer will be able to claim a tax deduction on the portion of the stock option benefit that does not qualify for the employee stock option deduction as a result of these proposed rules. An employer will also have the ability to designate options as "non-qualifying securities" that are not eligible for the 50% stock option deduction on any portion of the grant, provided the employer notifies the employee at the time of the grant. This designation will be able to be made on a grant-by-grant basis.

All of these proposed measures will not apply to the deduction applicable to options on CCPC shares (see above). These proposals will only apply to stock options granted on or after 1 January 2020. All options granted prior to 1 January 2020 will be subject to the existing rules.

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Employer remittance of employee taxes arising from stock option exercise

- For non-CCPC shares acquired by an employee under an employee stock option agreement, an employer is required to remit tax in respect of the stock option benefit, net of the stock option deduction, at the time of exercise of the option. In addition, an employer will not be able to reduce withholding on the stock option benefit by claiming hardship in these particular circumstances.

For most employees exercising options, this will have the effect of making it a requirement for the employee to sell sufficient shares or units on the market at the time of exercise of the options to cover the tax on the employment benefit that arises upon exercise.

Cash settlement of stock options - A number of companies have put in place plans whereby employees have the choice to receive cash instead of shares at the time of exercising the stock option. Prior to 2010, the employer corporation could claim a deduction for the cash paid, and the employees were entitled to the 50% stock option deduction (25% in Quebec) where certain conditions were met.

Under the current rules, in order for an employee to claim the stock option deduction in a cash-out transaction, the employer must file an election with the CRA stating that the employer will not deduct any amount paid to the employee in respect of the employee's disposition of their rights under the stock option agreement. The employer must provide the employee with a statement that this election has been made, and the employee, in turn, must file the statement from the employer with the employee's tax return for the year in which the stock option benefit was received.

If this documentation is not provided, the employee cannot claim the stock option deduction, and the stock option benefit would be taxed in the same manner as any other employment income (i.e., 100%, as opposed to 50%, of the benefit would be included in taxable income).

Charitable donation of employee option securities

- When a security acquired as a result of the exercise of an employee security option is disposed of by way of gift to a qualified donee within 30 days, an additional deduction is available to eliminate the tax on the security option benefit, provided certain conditions are met.

When an employee directs a broker to immediately dispose of securities acquired by a security option and pay all or a portion of the proceeds of disposition to a qualified donee, the employee is deemed to have made a gift of the securities to the qualified donee at the time the payment is made. The employee may claim the additional deduction on the same basis as if the securities had been donated directly. However, the CRA has taken the position that this additional deduction is not available when an employee directs the broker to dispose of such securities and pay the proceeds of disposition directly to the employee who, in turn, donates all or a portion of the proceeds to a qualified donee.

Tax tips

- ▶ Develop an "exercise and sell" strategy for stock options. Ensure it considers cash-flow needs, tax consequences and investment risk – including the risk that you can't use a loss you suffer on selling the shares to reduce any tax you pay on your net stock option benefit.
- ▶ If you own shares of a CCPC under a stock option or stock purchase plan and the company is going public, you may be able to make a special election for a deemed disposition of the shares so that you may benefit from your available lifetime capital gains exemption (if applicable).



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Employee deductions

As an employee, you can claim some expenses against your employment income, but not very many. Unless you earn commissions, your deductions are generally restricted to employment-related office rent, salary to an assistant, supplies, professional membership or union dues and, if certain conditions are met, car expenses.

If at least part of your income is commissions, and certain conditions are met, you can claim a broader range of expenses, including promotion costs that you've incurred to earn commission income. The deductible amount is limited to your commission income. When the promotion costs include the cost of meals and entertainment, you may only deduct 50%.

Home office

If you work from your home, you may be able to claim limited home office expenses. This is possible if you perform most of your employment duties from your home workspace, or you use the home workspace exclusively for job-related purposes and regularly for meetings with customers, clients or others.

The only expenses you may deduct are a proportionate share of rent relating to your home office and, if you own the home, a proportionate share of maintenance costs, such as utilities, cleaning supplies and minor repairs. As a homeowner, you cannot deduct notional rent, mortgage interest, insurance or property tax, unless you're a commission salesperson, in which case you may be able to deduct part of your insurance and property tax.

The amount of the deduction from home office expenses in any particular year is limited to the amount of income from the office or employment in that year. However, the excess of expense over the income from the office or employment in a particular year can be carried forward and added to home office expenses in a subsequent year.

Automobile

You may claim the costs of operating a car, including capital cost allowance (CCA), if you've driven it for business purposes and/or it's available for business use, and you are required to travel and pay these costs in the performance of your employment duties.

The total cost of a car on which you can claim CCA is generally restricted to \$30,000 plus goods and services tax/harmonized sales tax (GST/HST) and provincial sales tax (PST). Related interest expense is limited to \$300 per month. If you lease your car, you can generally deduct lease costs of up to \$800 per month, plus GST/HST and PST.

You cannot deduct car expenses if you're in receipt of a tax-free per-kilometre allowance, which is excluded from your income. If you received the allowance but your reasonable business-related car expenses exceed this amount, consider including the allowance in income and deducting the expenses.

Claiming costs

To claim these employment-related costs, complete Form T2200, *Declaration of Employment Conditions*, (and Form TP-64.3-V, *General Employment Conditions*, for Quebec tax purposes). On this form, your employer must certify that you were required to pay these expenses and you were not reimbursed for the related costs or the amount reimbursed was not reasonable.

Legal fees

You're able to deduct legal fees incurred to collect unpaid salary and to substantiate entitlement to a retiring allowance. Legal fees incurred to negotiate your employment contract or severance package are not deductible.

Employee credits

Canada training credit

2019 budget

The 2019 federal budget announced, and corresponding legislation implemented, amendments that introduce a new refundable tax credit, the Canada training credit. Effective for the 2020 and later taxation years, the credit will assist eligible individuals who have either employment or business income to cover the cost of up to one-half of eligible tuition and fees associated with training.

Eligible individuals will accumulate \$250 each year in a notional account that can be used to cover the training costs. To accumulate the \$250 each year, a Canadian resident individual (who is at least 26 and less than 66 years of age at the end of the year) must file a tax return, have employment or business income in the preceding taxation year greater than or equal to \$10,000²⁴ and have net income in the preceding taxation year that does not exceed the top of the third tax bracket (\$147,667 for 2019). The maximum accumulation over a lifetime will be \$5,000, which will expire at the end of the year in which the individual turns 65.

The amount of the refundable credit that can be claimed in a taxation year will be equal to the lesser of one-half of the eligible tuition and fees paid in respect of the year and the individual's notional account balance. For purposes of this credit, tuition and fees do not include tuition and fees levied by educational institutions outside of Canada. The refundable Canada training credit will reduce the amount that will qualify as an eligible expense for the tuition tax credit. The annual accumulation in the notional account will begin in 2019 and the first credit will be able to be claimed for the 2020 taxation year.

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²⁴ Also includes maternity and parental employment insurance benefits; benefits paid under Quebec's *Act respecting parental insurance*; certain research grants, scholarships, fellowships, or bursaries not exempt from taxation; and certain amounts normally exempt from income tax.



Incorporated employee: personal services business

When an individual offers services to an organization through a corporation owned by the individual or a related party, there is a risk the corporation will be considered to be carrying on a “personal services business.” A personal services business exists where the corporation employs five or fewer employees, and the individual providing services to an organization would, if not for the existence of the corporation, be considered an employee of the organization to which the services are provided.

Tax tips

- ▶ If you're required to use your own car and your employer doesn't provide you with an allowance or reimbursement of expenses, you should:
 - Keep a record of expenses and retain receipts
 - Keep a record of distance travelled for business
 - Complete Form T2200, *Declaration of Conditions of Employment* (and TP-64.3-V, *General Employment Conditions*, in Quebec)
- ▶ If you're thinking of buying a car for your employment duties, consider buying it before the end of the year rather than at the beginning of the next year. This will accelerate the CCA claim by one year.
- ▶ If you intend to claim a GST/HST or Quebec sales tax (QST) rebate, save the supporting receipts and GST/HST and QST registration numbers.
- ▶ If you operate a personal services business, you may wish to reconsider your decision to do so. The tax deferral opportunity from incorporation is significantly reduced and there is a substantial reduction in the after-personal tax funds available to the shareholders.

A personal services business does not qualify for the small business deduction or the general corporate rate reduction, and is therefore subject to tax at full corporate rates. There is also an additional 5% corporate tax levied on income from a personal services business, resulting in a total federal corporate income tax rate of 33%.

When the provincial corporate income tax is added, the combined corporate tax rate on this income is punitive. In addition, the only deductions allowed are the salary and benefits provided to the incorporated employee and certain employee expenses.

GST/HST and QST rebates

You may generally claim a GST rebate in respect of your employment expenses (including GST and PST) deducted for income tax purposes (provided the expenses are considered to be taxable for GST purposes). The amount of the GST rebate is included in taxable income in the year it is received. Or, in the case of GST rebates arising from CCA claims, it will reduce the undepreciated capital cost of the asset.

Rebates available to employees under the GST also apply for HST and QST purposes.

Employee versus independent contractor

Determining your employment status is fundamental to determining the proper tax treatment of income you earn and expenses you incur in the course of your work.

In general, self-employed individuals are subject to fewer restrictions and are allowed to deduct a larger amount than employees for expenses such as travel costs, meals and entertainment, and supplies and tools. As a result, many people may believe that arranging their work as independent contractors is in their best interest. However, it's important to realize that the legal relationship between an employer and an employee is very different from that of a purchaser and a vendor of services (e.g., a self-employed individual). A self-employed individual often assumes additional legal obligations, costs and risks and has fewer legal protections than an employee.

Over the years, the courts have developed various tests to determine whether an individual is an employee or an independent contractor. The need for these tests arose not just in applying income tax legislation, but also in applying employment legislation (including the Canada Pension Plan and the *Employment Insurance Act*) and in actions concerning vicarious liability and wrongful dismissal. Some of the more recent court decisions seem to emphasize the legal relationship and intention of the parties involved.

Given the many court decisions concerning the differences between employees and independent contractors, the CRA has developed some administrative guidelines, which are outlined in Guide RC4110, *Employee or Self Employed?* In general for common law situations, the CRA has been using a two-step approach (similar to the approach the courts have been using recently), first determining the parties' intent when they entered into the working arrangement and then considering various factors to get a better understanding of the actual working relationship and verify whether it reflects the parties' intent.

A similar approach is also outlined in Guide RC4110, where Quebec's Civil Code applies.

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The principal residence exemption



General comments

The principal residence exemption is a very attractive feature of the Canadian tax system, as it allows a capital gain realized on the sale of a principal residence to be earned free from tax, provided the residence was designated as the taxpayer's principal residence for every year of ownership.

The following types of property may qualify as your principal residence:

- ▶ Housing unit, which may be a:
 - House
 - Apartment or unit in a duplex, apartment building or condominium
 - Cottage
 - Trailer or mobile home
 - Houseboat
- ▶ Leasehold interest in a housing unit
- ▶ Share of the capital stock of a cooperative housing corporation acquired for the sole purpose of obtaining the right to inhabit a housing unit owned by that corporation

Generally, a property qualifies as your principal residence for any year if the following conditions are met:

- ▶ The property is one of the properties described above
- ▶ You own the property alone or jointly with another person
- ▶ The property is ordinarily inhabited by you or certain family members such as your current or former spouse or common-law partner, or any of your children
- ▶ You designate the property as a principal residence

In general, a housing unit must be ordinarily inhabited in the year, not *throughout* the year. This means that a housing unit you inhabit for only a short period during a year may still qualify as a principal residence. This may occur, for example, if you dispose of your residence early in the year or acquire it late in the year. However, a 24-hour stay would likely not be enough to meet the ordinarily inhabited requirement. A cottage or vacation home may also meet the ordinarily inhabited requirement (even if you reside there only when on vacation), as long as the residence is not owned primarily to gain or earn income.

For years before 1982, an individual could designate only one home as his or her principal residence, but a separate property could be designated by another member of the individual's family unit for those years. A *family unit* generally includes you, your spouse or common-law partner, and any of your unmarried children under the age of 18. Therefore, prior to 1982, two individuals who are married could each designate different principal residences in the same year (provided each property met all of the required conditions to qualify). For 1982 and later years, a family unit may designate only one home as the family's principal residence for each year. Properties purchased before 1982 continue to be governed by the old rules for pre-1982 ownership years.

The principal residence exemption will not completely eliminate a taxable capital gain realized on the disposition of a property unless the property is designated as the owner's principal residence for a minimum of all but one of the years of ownership (or all of the years of ownership if the owner was a nonresident throughout the year in which the property was acquired).

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The *Income Tax Act* provides a formula to calculate the portion of the gain that is sheltered by the principal residence exemption. Generally, this is calculated by multiplying the gain by a fraction, the numerator of which is one plus the number of taxation years that the property was designated as your principal residence and the denominator of which is the number of taxation years during which you owned the property. The extra year in the numerator of the formula, the so-called “one plus” rule, effectively allows a taxpayer one extra year of exemption room.²⁵ This rule is useful because it means that if you sell your principal residence and then purchase another residence in the same year, you will, effectively, not be denied the principal residence exemption on either of those properties for that year, even though you can only designate one residence as a principal residence in the year.

If only part of a home is used as a principal residence (for example, where there is a secondary suite in the basement that is rented out), only the part occupied by the owner would qualify for the principal residence exemption. When the property is sold, the capital gain on the rented portion must be reported on the owner’s personal income tax return.

Beginning with the 2016 taxation year, you are now required to report every disposition of a principal residence on your personal tax return, whether the gain is fully sheltered or not by the principal residence exemption. In the past, the CRA did not require you to report the sale of a principal residence if the gain was fully sheltered by the exemption. If you don’t report the sale on your return, the property disposition will be subject to an open-ended reassessment period.²⁶ If the principal residence designation is filed late, penalties will be payable.

The change-in-use rules

The change-in-use rules apply where the use of a property changes from an income-earning purpose to a non-income-earning purpose (or vice versa). A change in use of only part of a property also causes the rules to apply to the relevant area.

When there is a change in use, the owner is treated as having sold and repurchased the property at its fair market value. This causes any capital gain that has arisen since the property was originally bought to be realized. However, the principal residence exemption may be used to shelter the gain if the relevant conditions are met.

Although an election that effectively ignores the change in use for up to four years is available in the case of a change in use of an entire property, this election is not available in the case of a partial change in use, such as the conversion of a basement in a home to a self-contained rental suite.

If an entire property has a change in use from being a residential property to a rental property, the taxpayer may be able to make an election to continue to treat the property as a principal residence for up to four years. If, however, an entire property has a change in use from being a rental property to a residential property, then the taxpayer can elect for the property not to be treated as having been sold and re-acquired at that time. This essentially allows the capital gain to be deferred and taxed only when the property is eventually sold. In addition, this election allows the taxpayer to treat the property as his or her principal residence for up to four years before it is actually occupied as his or her principal residence.

Budget 2019 update

The 2019 federal budget announced that, effective for changes in use of property that occur on or after 19 March 2019, an individual will be able to elect that the deemed disposition that would normally apply on a change in use of part of a property not apply. This will in turn allow the relevant part of the property to be treated as a principal residence for an additional four years.

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²⁵ Effective for dispositions of property that occur after 2 October 2016, a taxpayer who was a nonresident throughout the year that includes the acquisition of the property can no longer have an extra year of exemption room when computing the reduction in the taxable capital gain on the disposition of the taxpayer’s principal residence.

²⁶ The normal reassessment period for an individual taxpayer is generally three years from the date of the initial notice of assessment. The “open-ended” assessment period means that an extended assessment period has been added outside of the normal reassessment period for any tax year where the taxpayer does not report the disposition of property in the year in their tax return or does not file a tax return for the year in which the property was disposed. If income tax is subsequently assessed in respect of the property disposition, the three-year limit does not apply.



Making the most of your home and cottage

Owning a home or a cottage can be expensive, and you may be counting on the principal residence exemption to reduce the tax on any capital gains you would have to pay on a sale. The exemption is not available in all cases - make sure you understand how it applies in your situation.

Renting out part of your home

Home buyers in the Canadian housing market face high prices in many key urban centres. One way homeowners can offset the rising cost of housing is by renting out part of the property, whether as a self-contained suite or a unit in a duplex. Alternatively, several generations of the same family may move in to one property to consolidate their assets and keep housing costs low.

But if you're considering these options, you need to keep in mind the principal residence and change-in-use rules. Depending on the facts of the situation, adding a secondary rental suite could, for example, limit your ability to claim the principal residence exemption on the eventual sale of the property. Three CRA technical interpretations provide useful information on how the CRA treats various situations with respect to secondary suites and duplexes.

Implications of having a secondary suite in a home

In a technical interpretation,²⁷ the CRA was asked several questions in relation to a secondary suite. The CRA's policy on changes in use is set out in Income Tax Folio S1-F3-C2: *Principal Residence*. The policy states that a change in use will generally be considered to have occurred when a taxpayer converts part of his or her property to an income-producing purpose.

A change in use is treated as not having occurred, however, if all three of the following conditions are met:

- ▶ The income-producing use is secondary to the main use of the property
- ▶ No structural changes are made to the property to improve its suitability for rental
- ▶ No capital cost allowance is claimed on the property

The CRA considers that there is no bright-line percentage test that can be applied to determine whether use of the property is a secondary use. Each case depends on its own facts.

Structural changes to the property that are of a permanent nature will be taken into account. In particular, the CRA considers the addition of a kitchen or separate entry, or the reconfiguration of space by adding or removing walls, to be significant. The CRA commented that it will generally apply the change-in-use rules if a taxpayer converts a portion of his or her principal residence into a separate housing unit to be used to earn rental income. This scenario can be contrasted with the situation where a taxpayer rents a bedroom in their home to a student without making any structural changes to the building, which would generally not constitute a change in use.

Duplex units and the principal residence exemption

In a different situation considered in a CRA technical interpretation,²⁸ an individual bought a duplex, intending to live in one unit while the individual's mother lived in the other. The individual's mother needed help with daily living and so, although the building had two separate street addresses, modifications were made to facilitate communications between the property owner and the parent, including the installation of an interior connecting door. Most meals were prepared and consumed in the owner's unit.

The CRA was asked whether the two units could be considered to be a single principal residence. In its reply, the CRA identified the integration between the units as an important factor. If it would not be possible to live normally in the living areas of one unit without access to the other unit, then the two units would be considered to be a single housing unit. This could be the case where one unit contained the kitchen and bathroom while the other contained all the bedrooms. The CRA also pointed to other important factors, such as whether the two units had separate titles, street addresses and entrances.

In the particular situation outlined, the CRA suggested the units were not sufficiently integrated to constitute one housing unit for purposes of the principal residence exemption. This would mean that, on a sale of the whole property, the owner could not claim the exemption on the unit occupied by the parent. In addition, the parent would not own the property, so in this situation the entire benefit of the principal residence exemption on this part of the property would be lost.

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²⁷ CRA document 2016-0673231E5.

²⁸ CRA document 2016-0625141C6.



Duplex units and the change-in-use rules

An owner of a duplex may live in one unit and rent out the second unit to earn income. In a technical interpretation,²⁹ the CRA was asked whether it would consider a change in use to have taken place when the owner moved from one unit in a duplex to the other. The unit the owner had formerly occupied was then rented out, while the unit formerly rented became the owner's residence.

The CRA's view was that there would be no change in use where the relative sizes of the units were unchanged and the proportions of personal and rental use remained the same. In the situation outlined, the units were identical in size, meaning that both before and after the change of use, half the property was used for rental purposes and half was used for personal purposes. Furthermore, renovations to the owner's portion of the property should not result in a change in use, provided the relative size of each unit remained the same after the renovations.

Tax tips

- ▶ If you live in only part of a property and rent out the other part as a self-contained secondary suite, the principal residence exemption may only be claimed in respect of the first part. In the case of a duplex, the two units would need to be interdependent in order to form one housing unit for purposes of the principal residence exemption; simply installing a connecting door between them would not be sufficient.
- ▶ If you own a residence that has no secondary suite and decide to rent out part of the property, it will depend on the facts of the situation whether the CRA will consider a change in use to have occurred (and hence a deemed disposition and reacquisition of the property).
- ▶ Rental of one or two bedrooms in the home may not result in a change of use, whereas renovating the home to install an extra kitchen and separate entrance would likely trigger the change-in-use rules.
- ▶ If a partial change in use does take place, it must be reported on the homeowner's personal tax return, even if the principal residence exemption may be claimed to offset the capital gain that would otherwise result.³⁰
- ▶ Installing rooftop solar panels on a residence and selling the electricity generated by them back to the grid would not generally be considered a change in use; leasing the rooftop to a third party for electricity generation using solar panels may be considered a change of use unless certain conditions are met.



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²⁹ CRA document 2015-0589821E5.

³⁰ If the principal residence exemption is claimed, the designation is considered to have been made on the entire property, not just the portion subject to the deemed disposition. See Income Tax Folio S1-F3-C2: *Principal Residence*, at paragraph 2.36.



Family cottages and the principal residence exemption

If you and your spouse or common-law partner each own a home and a cottage, you'll have to decide how best to use the principal residence exemption when you dispose of either property. This is because you can designate only one of your properties as a principal residence in any given year of ownership, as noted above. For example, it may be beneficial to designate the property with the greater average annual accrued gain. In order to properly calculate the gain on the disposition of each property, you should maintain records (including receipts and invoices) for the cost of all capital improvements you make to each property. These costs can be added to the adjusted cost bases of the properties and reduce the gains that may not be sheltered by the exemption.

The situation becomes more complex if your cottage is used by several family members. Tax issues aside, some children may feel a stronger connection to the cottage than others, and it can be challenging to be fair to everyone when transitioning ownership to the next generation. Say you bought the original cottage and over time have made significant improvements to it, such as winterizing the property so the family could gather there for the holidays. You may no longer want the responsibility of owning and maintaining the cottage but want it to stay in the family for your children and grandchildren to enjoy. When you decide to pass it on to younger family members, you need to think about whether a capital gain will result and, if so, whether you will be able to claim a principal residence exemption to offset part or all of that gain.

Cottage trusts

One way for families to manage cottage ownership is to transfer it to a trust that has family members as beneficiaries. A trust can allow for some flexibility in administering the property, letting the original owners (who may now be grandparents) hand over some responsibility to their children and grandchildren without giving up all rights to use the cottage or to earn income from it. Transferring a property to a trust can also keep it outside of the grandparents' estate on death, thus reducing probate fees and deferring capital gains tax. When a trust owns a cottage (or other real property), title is registered in the name of the trustee(s), not the trust. If one or more of the trustees is a nonresident, there could be certain tax consequences.

Because there are both tax and non-tax considerations to bear in mind, cottage owners should seek advice when they're considering the right option for their family's situation.

Capital gains tax on a cottage³¹ held in trust

Capital gains tax could become payable on a cottage held in a trust at the time when the property is transferred into the trust, and at the time when the property is distributed from the trust to a beneficiary, with certain exceptions. In some situations the trust will also be treated for tax purposes as if it had sold and immediately repurchased the cottage, which can give rise to a capital gain.

For example, if a certain type of trust still owns the cottage on the 21st anniversary of the formation of the trust, then there is a deemed disposition of the cottage, meaning that for tax purposes the cottage is treated as if it has been sold at fair market value and then immediately reacquired. The deemed sale can produce a capital gain that is taxable in the trust. Depending on the circumstances, it may be possible for a trust to claim a principal residence exemption to shelter part or all of the gain from taxation.

Cottage trust - an example

There are several different types of trust that can be used to hold a cottage, and different rules apply depending on which type is used. A capital gain generally arises when an individual gifts a cottage to a trust, but if certain special types of trust are used, then the gain can be deferred until a later time.

For example, say the grandparents in a particular family jointly own a cottage and are both aged 70. They want to continue to use the cottage themselves, but they also want to eventually hand over responsibility to their children, as well as reduce any capital gains tax and probate tax liability where possible. If the grandparents gifted the cottage to a regular *inter vivos* trust, this would be a taxable event and capital gains tax would be payable by the grandparents on half the difference between the proceeds of disposition and the adjusted cost base of the property (including any improvements made to the cottage over the years). However, the principal residence exemption may be available to them, depending on whether they have already used it or plan to use it to shelter gains on other properties they own at the same time as the cottage.

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³¹ The tax implications of having a cottage held in a trust apply also to other types of homes held in a trust.



Because they are over 64 years of age, the grandparents could instead gift the cottage to a special type of trust known as a joint partner trust. The grandparents would still be entitled to use the cottage and to receive any income from it during their lifetimes. This type of trust allows the grandparents to “roll over” the cottage to the trust without having to pay capital gains tax at that time. The capital gains tax is instead deferred until the death of the second grandparent, at which time capital

gains tax would become payable by the trust on half the difference between the fair market value of the cottage and its original cost to the grandparents (including any improvements made to the property). The trust deed could name the grandparents’ children as contingent beneficiaries of the trust and, once both grandparents are deceased, the trust would distribute the cottage to the children.³²

Trusts and the principal residence exemption

A trust may be able to claim the principal residence exemption, but the rules are complex and essentially require that none of the trust beneficiaries (or members of their family unit) has already claimed the exemption in respect of another property for the relevant years. In addition, the property must generally be inhabited by a specified beneficiary,³³ by a current or former spouse or common-law partner of such a beneficiary, or by any of the beneficiary’s children.

Corporations (except for a registered charity) and partnerships cannot be beneficiaries of the trust. If the trust uses the principal residence exemption for the cottage, the trust beneficiaries are not allowed to claim the exemption for other properties they may own during the same time period.

The rules allowing trusts to claim the principal residence exemption were tightened further for properties disposed of after 2016, and fewer types of trusts are eligible to claim the principal residence exemption for 2017 and later years. Transitional rules ensure that a trust that no longer qualifies to designate a property as a principal residence because of the new limitations can still benefit from the principal residence exemption on the gain accrued to the end of 2016. As a result, cottage trusts should review their eligibility for the principal residence exemption under the new rules in consultation with an EY advisor.



³² Note that there is a requirement that no one other than the grandparents (in this case) may receive, or make use of, the income or capital of the trust before the later of their deaths. Failure to meet this requirement would adversely affect the tax-free rollover of the cottage to the trust. If the grandparents intend to allow the children or grandchildren to use the cottage while the grandparents are living, they should consult an EY Tax advisor.

³³ A specified beneficiary is an individual who has any right (current, future, absolute or contingent) to the income or capital of the trust.

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Changes to the principal residence exemption for trusts

For properties disposed of after 2016, there are two main conditions for trusts to meet in order to be able to claim the principal residence exemption:

- ▶ At least one of the trust's beneficiaries must be resident in Canada during the year and be a specified beneficiary of the trust for the year.
- ▶ The trust must qualify as an eligible trust,³⁴ meaning that it must fall under at least one of the following three categories:
 - Alter ego trust, spousal or common-law partner trust, joint spousal or common-law partner trust, or certain trusts for the exclusive benefit of the settlor during the settlor's lifetime (life interest trusts)
 - Testamentary trust that is a qualified disability trust for the taxation year
 - Inter vivos or testamentary trust where the settlor died before the start of the year

If the trust owns a property at the end of 2016 and cannot designate the property as a principal residence under the new rules, the trust's gain on disposition of a property is effectively separated into two distinct periods:

- ▶ The first gain is calculated as if the trust sold the property on 31 December 2016 for its fair market value on that date and is computed under the rules that apply for taxation years that begin before 2017.
- ▶ The second gain is calculated as if the trust re-acquired the property at the start of 2017 at a cost equal to the proceeds used in determining the first gain, with no principal residence exemption claim being available on gains accrued from the beginning of 2017 to the date of disposition.

In circumstances where a trust is no longer eligible to claim the principal residence exemption on a cottage, special rules may allow the trust to distribute the property to a Canadian-resident beneficiary on a tax-deferred basis. The beneficiary would be treated as if he or she had owned the cottage throughout the period when the trust owned it, and would pay tax on the gain only when the cottage was later sold or otherwise transferred to a third party. Alternatively, a taxable distribution may be triggered to crystallize a gain, and the trust could then use the principal residence exemption to offset the gain for the period up until the end of 2016.

Summary

Given the substantial increases in property values in recent years, homes or cottages may have a high fair market value and a low cost, meaning that a substantial capital gain could result if the property were to be sold or gifted.

Holding a property in a trust can help achieve several objectives, including passing the property to the next generation of a family and minimizing probate fees.

There are many possible ways to structure a trust that holds a home or cottage, and, in view of the recent changes to the rules reducing the ability of trusts to claim the principal residence exemption, property owners should consult an EY Tax advisor to review existing or help set up future trusts.

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³⁴ The criteria to qualify as an eligible trust in Quebec are slightly different. Please refer to the French version of Managing Your Personal Taxes for details.



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There's virtually no area of family life in Canada that's not affected in some way by tax. But there are many tax credits and planning strategies that you need to be aware of that could potentially save you and your family a significant amount.

Spouses and common-law partners

Common-law partners (including same-sex couples) are treated as spouses for income tax purposes.

Income and capital gains splitting

Individuals are taxed at graduated income tax rates. The more you earn, the higher your marginal tax rate will be.

The top marginal combined federal-provincial income tax rate varies from approximately 44% to 54%, depending on your province or territory of residence (see [Appendix A](#)). To the extent that your income can be spread among other family members with lower marginal tax rates, you can reduce your family's overall tax burden. And this can result in increased wealth for the family as a whole.

Income splitting is a well-established tax planning technique. With the enactment of the revised income tax rules for income splitting, however, the tax landscape has changed dramatically. Generally, income splitting is still permitted in ways that are discussed later in this chapter, such as prescribed interest rate loans, spousal RRSPs, pension income splitting, splitting the Canada Pension Plan (CPP) and gifts to adult children. But there are fewer opportunities to income split and it may be more difficult to do so. As well as considering the income tax attribution rules that have been in the *Income Tax Act* since 1986, you need to consider the new income splitting rules. If income is derived from a business and is received, directly or indirectly, from a private corporation, the ability to reduce your family's overall tax burden in this manner is significantly limited for 2018 and later taxation years due to the revised tax on split income (TOSI) rules (see **Tax on split income** below and [Appendix E: The revised tax on split income rules](#)).

Income splitting, to the extent that it is still possible, is beneficial when you are taxed at the top marginal rate and your spouse or partner or your children are subject to tax at a lower rate. Also, a family earning all its income through one family member will generally have a higher income tax burden than it would if the same amount of income were earned by two or more individuals in the family.

Some simple examples: a family earning \$500,000 in 2019 through a single person in Ontario could potentially reduce its annual income tax burden by approximately \$37,100 by having \$200,000 of that income taxed in the hands of another family member who has no other income, provided that the revised TOSI rules do not apply. A family with one member earning \$200,000 can achieve an annual tax savings of more than \$21,500 by splitting that income equally between two low-income family members.

Even greater tax benefits may be achieved when income can be shared among multiple family members and unused tax credits are available or the nature of the income attracts a preferred tax treatment. Again, the revised TOSI rules may limit the ability to achieve this.

Income splitting can maximize the amount of Old Age Security (OAS) you can retain and perhaps the age credit, as well. However, the *Income Tax Act* contains several rules aimed at discouraging income splitting. These include the attribution rules and the TOSI. You need to take care to ensure that income-splitting techniques are not offside with those rules (see **Attribution rules** and **Tax on split income** for more information, as well as [Appendix E: The revised tax on split income rules](#)).

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Tax tips

There are a variety of income-splitting techniques you should consider:

- ▶ Arrange your financial affairs so that the spouse or partner who earns the higher income is paying as much of the family's living expenses as possible, allowing the other one to save and invest.
- ▶ Contribute to a spousal RRSP if your spouse or partner is in a lower marginal tax bracket, or will be when withdrawing the funds.
- ▶ Apply to share your CPP/Quebec Pension Plan (QPP) retirement pension payments with your spouse or partner.
- ▶ Split pension income where appropriate.
- ▶ Lend funds for investment purposes to the lower-income spouse or partner, or use a formal trust to lend funds to minor children at the prescribed rate (See **Putting a prescribed rate loan in place** below). The attribution rules won't apply to the net investment income earned, and, provided the income is not split income for purposes of the TOSI rules, you will thus reduce your overall family tax burden (see below for more information on the attribution rules).³⁵
- ▶ Transfer property to a spouse or partner or your children so they'll be taxed on the eventual income earned on income previously attributed (as there is no attribution on this income).³⁶
- ▶ Transfer property or lend funds to your children so they can earn capital gains that aren't subject to attribution, provided that the capital gains are also not subject to the revised TOSI rules.³⁷
- ▶ Contribute to a registered education savings plan (RESP) as a means of saving for your children's or grandchildren's post-secondary education. If you contribute \$2,500 per child per year, the plan will receive the maximum annual government grant of \$500 per child.
- ▶ Gift or loan funds to your spouse or partner so they can make a tax-free savings account (TFSA) contribution. The income earned on these contributions will not be attributed to you while the funds remain in the plan.
- ▶ Make gifts to your children aged 18 and over to enable them to earn sufficient income to absorb their deductions and credits,³⁸ and to pay for certain expenses that you would ordinarily pay out of after-tax dollars.
- ▶ Make gifts to your children aged 18 and over to enable them to make the maximum deductible RRSP contributions, and/or contribute to a TFSA.

(Note that gifts to adult relatives other than a spouse or partner are generally not subject to the attribution rules.)

³⁵ This planning can still be effective, provided the income is not split income for purposes of the TOSI (see **Tax on split income**) rules. In general, the attribution rules will not apply if the income is already subject to the TOSI. However, if the income is subject to the TOSI, income tax splitting will not be achieved. Before entering into this type of planning, consult your EY Tax advisor.

³⁶ Income on previously split income is not subject to the TOSI under the revised TOSI rules. See **Tax on split income**.

³⁷ Certain types of property are impacted by the revised TOSI rules (see **Tax on split income**). Gains from dispositions of property after 2017 where the income from the property would otherwise be split income are taxed at the highest marginal tax rate, subject to certain exceptions. Capital gains realized by minors on dispositions of private company shares to a non-arm's-length party are treated as non-eligible dividends and taxed at top marginal rates, which are higher than the top rates applicable to capital gains. Consult your EY Tax advisor.

³⁸ Provided gifts do not consist of property, or funds used to acquire property, that produces income subject to the revised TOSI rules. See **Tax on split income**.

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Attribution rules

Attribution rules are intended to restrict or prevent income splitting in certain situations.

Income attribution: If you lend or transfer property – directly, indirectly or through a trust – to your spouse or partner or any relative under the age of 18, any income or loss from the property is attributed to you and taxed in your hands.

The same rules apply to low-interest or interest-free loans made to relatives if the loan is intended to reduce income tax. A loan is generally considered a low-interest loan when the interest rate charged is less than the federal prescribed rate used to calculate taxable benefits (2% at the time of writing); prescribed-rate loans are generally not subject to attribution, as long as the interest is paid within the prescribed period.

There's generally no attribution to earnings on income that has been previously attributed. And gifts to adult relatives other than your spouse are generally not subject to the attribution rules.

The attribution rules do not apply to business income, but they do apply to income from a limited partnership.

Attribution will also apply to certain transfers and loans to a corporation (other than a SBC). Estate-planning arrangements, when the objectives are other than income-splitting among family members, can generally be structured to avoid the corporate attribution rules.

There's no attribution of income from property sold, money lent or property substituted for that property or money if the property is sold at fair market value, or the loan is made at commercial terms and rates equal to or greater than the prescribed rate (2% at the time of writing), and other conditions are met. If you sell property to your spouse or partner, you must file a special election for the transfer to occur at fair market value.

Attribution will also not apply if you elect to have your spouse or partner receive a portion of your CPP/QPP payments. In addition, "split-pension income" should not be subject to attribution.

Tax on split income

Even when attribution doesn't apply, a special income-splitting tax on split income, which was often called the "kiddie tax" prior to 2018, may apply. The TOSI is calculated at the top marginal personal rate (33% federal rate in 2019), and applies to certain types of income.

Prior to 2018, the TOSI was limited to the following types of income received by minor children:

- ▶ Taxable dividends and interest from private corporations
- ▶ Shareholder benefits from private corporations
- ▶ Income from a partnership or trust if it is derived from a business or rental property, and a person related to the minor is actively engaged on a regular basis in the activities
- ▶ Income from a partnership or trust that provides property or services to or in support of a parent's or grandparent's business
- ▶ Capital gains from the disposition of shares to a person who does not deal at arm's length

However, new legislation effective 1 January 2018 expanded the base of the TOSI to include certain related individuals aged 18 and over, and the types of income subject to the TOSI were expanded.

Effective for 2018 and later years, the new rules limit the ability to share income within a family by expanding the base of individuals subject to the TOSI to include children age 18 and over and other related adult individuals (including spouses or common-law partners, grandparents

and grandchildren) who receive split income³⁹ from a related (family) business either directly from a private corporation (such as by the receipt of dividends) or through a trust or partnership. A related business exists, for example, when a related person is active in the business on a regular basis or owns at least 10% of the fair market value of the shares in a corporation that carries on the business.

The types of income that are subject to the TOSI have also been expanded to include:

- ▶ Interest income earned on a debt obligation of a private corporation, partnership or trust (subject to some exceptions)
- ▶ Gains from the disposition of property if income from the property would otherwise be split income.

Under these rules, income received or gains realized from a related business by certain adult family members are excluded from the TOSI if any one of a number of exceptions is met. Adults who are 25 or older who receive split income are subject to a reasonableness test if they do not meet any of the exceptions. The test is based on the extent of their contribution of labour and capital to the business, risks taken and other payments already received from the business. The TOSI will apply to split income received to the extent it is unreasonable under this test.

For a detailed listing of the exceptions to the application of the TOSI and further details about these rules, see [Appendix E: The revised tax on split income rules](#), [TaxMatters@EY February 2018](#), [Revised draft legislation narrows application of income sprinkling proposals](#), and [EY Tax Alert 2017 Issue No. 52](#).

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³⁹ Effectively, split income arises when a stream of income is connected, either directly or indirectly, to a related business. According to the CRA, salary is not included in split income.



Use of trusts and corporations

Effective for 2018 and later years, income splitting through trusts and corporations has been significantly limited due to the revised TOSI rules – see **Tax on split income** above and [Appendix E: The revised tax on split income rules](#). Other than considering the application of the TOSI rules, the attribution rules must be respected when considering the use of a trust or corporation.

Capital gains splitting among family members is still possible in certain situations, and can produce the greatest benefits in cases where the gain is on property eligible for the capital gains exemption and is taxed in the hands of more than one family member. Trusts can be used in a similar manner to access the capital gains exemption of multiple family members when selling a family business. The exemption amount for 2019 is \$866,912. Thus, the potential tax savings are significant. However, the planning can be complex and there are potential traps to be avoided.⁴⁰

If this type of planning is done, it is important that the allocated proceeds of the business are, in fact, received by the trust beneficiaries. In a recent Federal Court of Appeal case⁴¹ where this type of planning was undertaken, the beneficiaries were obligated to immediately remit the proceeds to the taxpayer who set up the trusts and founded the business. The CRA denied the beneficiaries' claim to their respective capital gains exemptions. The court concurred with the CRA's decision, noting that the transactions amounted to a sham. Consult your EY Tax advisor.

Although less flexible than a trust, an investment holding company could also be used prior to 2018 to split income among family members who had attained the age of 17 at the beginning of the taxation year. However, after 2017, unless one of the exceptions to the revised TOSI rules applies, the dividends would be subject to tax at the



highest marginal rate, rendering the strategy ineffective. The exceptions are discussed in [Appendix E: The revised tax on split income rules](#). Consult your EY Tax advisor.

Putting a prescribed rate loan in place: Generally, with prescribed rate loan planning, the higher-income spouse or partner loans cash at the prescribed interest rate to his or her partner, or to a trust for the benefit of the spouse or partner and/or children or grandchildren. The loan proceeds are invested to earn a higher rate of return than the prescribed rate (in 2019 2% for Q1, Q2, Q3 and Q4). The net income from the invested funds (i.e., net of interest expense paid on the prescribed rate loan) is taxable in the hands of the lower-income family members at lower tax rates than would apply to the lender.

It should be noted that once a prescribed rate loan has been entered into, the interest rate on the loan does not need to fluctuate, even if the published prescribed rate changes.

To ensure that the income attribution rules do not apply, interest charged on the loan must be paid within 30 days of the end of each calendar year. The lender reports

this interest received as income, while the loan recipient deducts the interest in the year it is paid.

For purposes of this planning, the loan is generally payable on demand and should have sufficient flexibility such that any portion of it is payable 30 days after demand and the borrower has the right to repay it at any time without notice or penalty. Legal counsel should be consulted to draft the terms of the promissory note. A separate bank or broker account should be set up to preserve the identity and source of the investments and the resulting income.

If cash is not readily available but you have a portfolio of securities, you could sell these investments to your family members, or to a trust for their benefit, in exchange for a prescribed-rate loan equal to the value of the investments at that time. You would be required to report the disposition of the investments on your personal income tax return. Although any resulting capital gains are taxable, capital losses realized could be denied under the superficial loss rules.

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⁴⁰ For example, capital gains realized by minors on the disposition (either directly or through a trust) of private company shares to a non-arm's-length party are treated as non-eligible dividends and taxed at top marginal rates as described in footnote 37 above.

⁴¹ *Laplante v the Queen*, 2018 FCA 193.



If you sell shares of your private corporation to your family members in exchange for a prescribed rate loan equal to the value of the shares, the revised TOSI rules (see **Tax on split income** above) may result in adverse income tax consequences if the shares are sold after 2017. Any gains realized from the subsequent disposition, if income from the shares would otherwise be split income, are taxed at the highest marginal tax rate, subject to certain exceptions. Also, capital gains realized by minors on dispositions of private company shares to a non-arm's-length party are treated as non-eligible dividends, and taxed at top marginal rates (which are higher than the top rates applicable to capital gains). Consult with your EY Tax advisor.

Refinancing a prescribed rate loan: If you have an existing prescribed rate loan that was established when interest rates were higher, consider whether to repay the old loan and advance funds for a new loan at a lower interest rate.⁴² As an example, the prescribed interest rate was 5% throughout 2007 and ranged from 5% to 6% during 2001 (from 2009 Q2 to 2013 Q3, the prescribed rate was 1%; in 2013 Q4, the prescribed rate was 2%; in 2014 Q1 the prescribed rate returned to 1%, where it remained until 2018 Q2, when it increased to 2%).

Be aware that simply changing the interest rate on an existing loan to the new lower prescribed rate – or repaying the loan with a new prescribed rate loan – would cause the new loan to be offside, and attribution would apply so that any income earned on the loaned funds would be reported by the lender.

The safest way to repay the existing loan without attracting attribution would be to liquidate the investments held by the debtor family member or trust, and use the proceeds to repay the loan. However, this may be costly from an investment or tax perspective if there are accrued capital gains or losses on the investments. As well, in difficult market conditions, the liquidation of the investments may not provide sufficient funds to repay the original loan.

If you liquidate the investment portfolio, the existing loan should be repaid before a new prescribed rate loan is made. Funds must be transferred and appropriate documentation should be available to substantiate the repayment of the existing loan and the establishment of the new loan arrangement. It would also be prudent to make the value of the new loan and/or its terms sufficiently different than the repaid loan, so it could not be viewed as the same loan.

If it is not feasible to liquidate the investments, consider borrowing from an arm's-length party, such as a bank (using the existing investments as collateral), to fund the repayment of the original loan. It is important to ensure that the original lender does not guarantee the bank loan and that appropriate documentation is prepared as proof of the loan repayment. Once the original loan has been repaid, the attribution rules would no longer apply to income or gains earned on the property.

You could then enter into a new, lower prescribed rate loan arrangement, and the debtor family member could use the loan proceeds to repay the bank and invest any excess funds. It would be best if the new loan comes from funds other than the proceeds from the repayment of the original loan, and the amount of the new loan exceeds the bank borrowing to distinguish the two loans and provide evidence that they are not the same.

Capital gains attribution: If your spouse or partner realizes capital gains on transferred or loaned property, these gains are attributed to you. A portion of any income realized on the reinvestment of the proceeds will also be attributed. However, there's no attribution of capital gains realized on property you loan or transfer to your children (including those under the age of 18 as well as other relatives who are minors) or other relatives. As a result, providing funds to a child to invest in properties that will generate a capital gain should result in the gain being taxed in the child's hands.⁴³

Income splitting through a spousal RRSP: A spousal RRSP is a plan to which you contribute, but your spouse or partner receives the annuities. A contribution you make to a spousal RRSP does not affect your spouse's or partner's RRSP deduction limit for the year. But your total deductible contributions to your and a spousal RRSP may not exceed your own deduction limit.

Contributions to a spousal plan become the property of your spouse or partner. In most cases, the withdrawn funds are taxable in the hands of the beneficiary, presumably the lower-income spouse or partner, if planned properly. However, caution should be exercised, as funds withdrawn within three taxation years of any contribution to the plan may be attributable to you and taxed in your hands, instead of your spouse's or partner's.

The attribution rules are very complex. Your EY advisor can assist you with implementing your planning.

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⁴² Consider the possible exposure to TOSI outlined above.

⁴³ Although attribution will not apply, consider the impact of the revised TOSI rules (see **Tax on split income**). Under these rules, gains from the disposition of property after 2017, if income from the property would otherwise be split income, are taxed at the highest marginal rate, subject to certain exceptions. Consult with your EY Tax advisor.



Pension income splitting

If you receive pension income that qualifies for the pension income tax credit, you can transfer up to half of it to your spouse or partner. There is no maximum dollar amount.

Income eligible for splitting

Different types of pension income may be eligible for splitting, depending on your age:

- ▶ **If you're under 65:** Annuity payments from a registered pension plan (RPP), certain other payments received as a result of the death of your spouse or partner (e.g., a survivor pension annuity), amounts received out of a retirement income security benefit (RISB) with respect to Canadian Forces veterans, subject to certain conditions and, effective 1 April 2019, amounts received as an income replacement benefit in respect of a Canadian Forces veteran, for the months following the month in which the veteran attained or would have attained age 65, subject to certain conditions.
- ▶ **If you're 65 or older:** The payments described above and annuity payments from a RRSP or a deferred profit-sharing plan (DPSP), registered retirement income fund (RRIF) payments and certain qualifying amounts distributed from a retirement compensation arrangement. Pension income for this purpose does not include OAS, CPP or QPP benefits, death benefits, retiring allowances, RRSP withdrawals (other than annuity payments), or payments out of a salary deferral arrangement or employee benefit plan.

A foreign pension annuity may qualify for income splitting. However, neither the portion that's tax exempt due to a tax treaty with the foreign country nor income from a US individual retirement account qualifies.

How to split eligible pension income

To split pension income, you and your spouse or partner must make a joint election by completing Form T1032, *Joint Election to Split Pension Income*, and file the election with the income tax returns for the year the pension income is being split. Where the returns are efiled, a signed copy should be retained in your file. When you make the election, the pension income allocated to the spouse or partner is a deduction from net income on the transferor's return and an addition to net income in the transferee's return. The transferred income will retain its character as either pension income or qualifying pension income (for those under 65) in the transferee's return.

When income tax has been withheld from pension income that's being split, allocate the tax withheld in the same proportion as you report the related income.

You have to make the pension income-splitting election on an annual basis. Each year, you and your spouse or partner decide if you want to split eligible pension income and how much you want to split (up to a maximum of 50% of eligible pension income). Each annual election is independent and is based on the eligible pension income received in that taxation year.

Splitting CPP

Although CPP is not pension income for the purposes of the pension income-splitting rules, couples have been able to split or share CPP benefits for many years.

CPP sharing is available, by application, to spouses or partners who are both at least 60 years of age and living together, where one or both are either receiving or applying for CPP benefits. You do not, however, get to choose how to split the income. Instead, you share the benefits equally. Under CPP sharing, cash payments are actually "split."

If you're not currently splitting your CPP income and would like to do so, visit the Service Canada website.

Benefits of pension income splitting

Pension income splitting can produce significant tax savings for couples. The extent will depend on a number of factors, including:

- ▶ The ability to double up on the basic and pension income tax credits
- ▶ Increases in OAS retention and age credit because of reduced income to the transferor
- ▶ Use of lower marginal tax rates on the split income diverted to the transferee spouse or partner
- ▶ A potential reduction in tax instalments

Tax tips

- ▶ If instalments are calculated based on current-year income amounts, don't forget to factor in the pension split amount for both spouses, as the tax deducted at source on the pension income will also be transferred to the spouse.
- ▶ Be aware that the amount of instalments payable by each spouse may be affected due to an increase in income tax payable for the transferee and a decrease in income tax payable for the transferor as a result of the pension income split.

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The case for spousal RRSPs

Since the advent of pension income splitting in 2007, many think spousal RRSPs aren't necessary and don't provide additional benefits. That's simply not the case. For many families, spousal RRSPs can continue to provide benefits.

Spousal RRSPs can allow more flexibility than pension income splitting, and the two options can actually work well together. Pension income splitting is limited to one-half the recipient's eligible pension income. By using a spousal RRSP, a person can effectively direct any amount of RRSP or RRIF income to a spouse. This strategy can be beneficial when the higher-income spouse continues to work or has other significant income in his or her retirement years.

Those with earned income (including director fees, business income, royalties and rental profits) beyond age 71 and who have younger spouses or partners can continue to make spousal RRSP contributions. This strategy allows for a prolonged deferral of tax in relation to amounts contributed.

Another important distinction between spousal RRSPs and pension income splitting is that spousal RRSPs can be used as an income-splitting tool well before retirement. Under the pension income-splitting rules, only eligible pension income can be split. In the case of RRSP or RRIF income, this means the transferor must be at least 65.

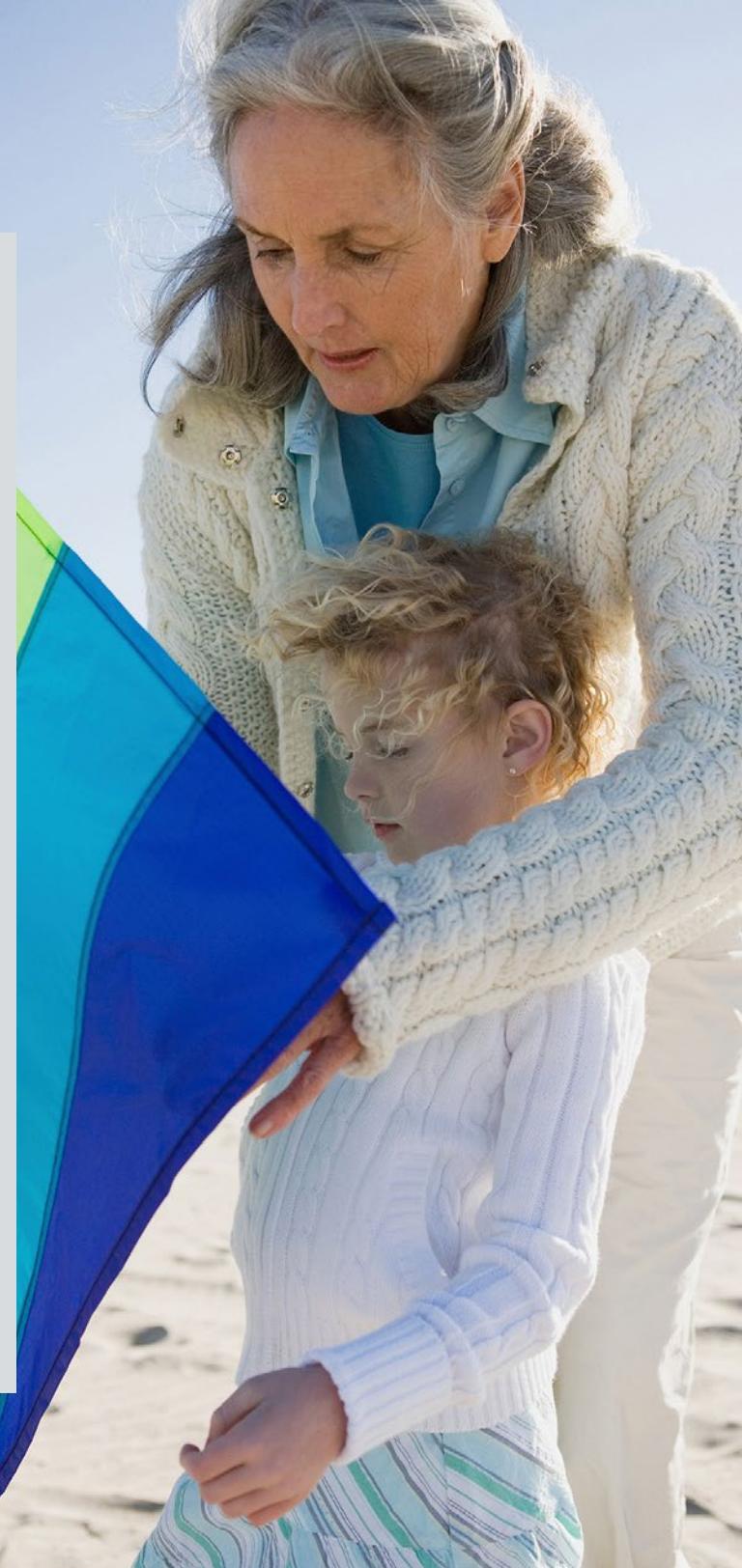
But with a spousal RRSP, the annuitant spouse can withdraw the funds after a period of time beyond the date of the spouse's contribution, with the withdrawal being taxed in the annuitant spouse's hands. There is a special attribution rule requiring a taxpayer to include in income any RRSP benefit received by his or her spouse or partner – to the extent the taxpayer has made a deductible contribution to a spousal plan in the year or the two preceding years.

This means a high-income spouse or partner can get the tax benefit of making contributions to a spousal plan at a high tax rate. After a three-year non-contribution period, the low- or no-income spouse can withdraw funds and pay little or no tax. This planning may be particularly advantageous in providing additional family funding when a lower-income spouse takes time off work, perhaps to raise children or start a business that isn't expected to earn profits for a number of years.

However, unlike with TFSA's, the funds withdrawn from the RRSP cannot be recontributed to the plan at a later date without drawing down on future contribution room.

Another important point is that pension income splitting is not a physical split of money; it's only an allocation of pension income for purposes of taxation. That means the lower-income spouse is not accumulating capital. By using spousal RRSPs, the RRSP income becomes capital to the recipient and can be invested to earn additional income (not necessarily pension income).

This doesn't mean spousal RRSPs should be used instead of pension income splitting. Depending on your personal situation, the strategies can be combined in a manner to produce the most effective financial and tax results.



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Marital breakdown

The breakdown of a marriage or common-law relationship may include financial settlements, custodial decisions and various accompanying tax consequences.

Attribution rules: Attribution of income ceases to apply when a couple is separated. However, capital gains attribution does not cease until divorce (for married couples), unless the parties jointly elect to have it cease on separation.⁴⁴

Support payments: If you make alimony payments, you may deduct them for tax purposes, provided certain conditions are met. Generally, the payments must be payable on a periodic basis to your current or former spouse or partner, and in accordance with a signed separation agreement or a court order. In addition, certain payments to third parties under the terms of a separation agreement may also be deductible. You can also claim a deduction for payments made prior to signing an agreement or obtaining a court order, provided that the agreement is signed or the order is obtained before the end of the following year and the agreement or order specifically deals with these payments.

Deductible alimony payments must be included in the recipient's income in the year received.

Child support is treated differently than spousal support in that the paying parent cannot deduct the payments, and the recipient parent would not include them in their income.

Professional fees: Legal fees paid to obtain a separation or divorce are not deductible for tax purposes. However, the individual receiving support may deduct legal fees paid to establish or increase the amount of support.

Tax credits and deductions: After separation, a parent may claim an eligible dependant credit in respect of a child under the age of 18 living with that parent. The credit is not available to the parent who is paying support. In cases where there is more than one child, and both parents support and house the children, each parent can claim the credit in respect of one child. Both eligible parents must

agree on who is entitled to claim the personal tax credits for a particular child, or else neither will be allowed to make the claim. Child-care expenses may only be claimed by the parent living with the child, provided the conditions for deductibility are met. If the children live with both parents, each parent may claim a share of the expenses in relation to the period that the children live with them. The transfer of tuition credits can be claimed by either parent, but the total claim cannot exceed the maximum per child.

Tax tips

- ▶ If you're negotiating a separation agreement, review the terms to ensure that you'll be entitled to the maximum deduction or the minimum income inclusion possible.
- ▶ If you have more than one property eligible for the principal residence exemption, be sure that you agree on who will claim it for the years in question, as it may represent a significant benefit.
- ▶ Ensure that all tax-deductible alimony or maintenance payments for the year will be made by 31 December.
- ▶ If you're negotiating a separation agreement, ensure that you segregate the child support component from alimony. Otherwise, the entire amount will be considered child support and will not be deductible.
- ▶ While income tax is calculated and returns are filed on an individual basis, entitlement to many benefits and credits is computed on a family basis. If your marital status changes during the year, be sure to report it to the CRA and consult your EY advisor to help you navigate the tax implications.

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⁴⁴ Although not an attribution matter, capital property may be transferred to a spouse or common-law partner on a tax-deferred basis as long as both individuals are Canadian residents at the time of the transfer. In other words, if the property has an accrued capital gain, there will be no tax applicable until the transferee spouse or common-law partner disposes of the property. If a couple is separated, however, this tax-deferred rollover only continues to apply in respect of assets specifically noted in the separation agreement.



Children

Child-care expenses

Only the lower-income spouse or partner can deduct child-care expenses, unless they were infirm, confined to an institution, living separately because of a marital breakdown, or in full-time attendance at a designated educational institution in the year.

The deduction limit is \$8,000 for each child under the age of seven at the end of the year, and \$5,000 for those aged seven to 16, inclusive. And if the child is eligible for the disability tax credit (DTC), the limit is \$11,000. The total deduction cannot exceed two-thirds of the claimant's earned income.

For Quebec tax purposes, there's a refundable tax credit system for child-care expenses. The tax credit rate varies depending on the amount of family income.

Tax tips

- ▶ Ensure that all child-care payments for the year will be made by 31 December.
- ▶ Retain receipts supporting child-care expenses indicating the recipient's name and, where applicable, social insurance number.
- ▶ If you're a single parent attending school, you may still be entitled to claim a child-care expense deduction if you have net income, subject to certain limitations.

Adoption expenses

A non-refundable tax credit is available for eligible adoption expenses, up to a maximum of \$16,255 per child (as indexed for 2019), for the completed adoption of a child under the age of 18.

The adoption expenses credit may be claimed in respect of a child only in the taxation year in which the adoption of the child is completed (i.e., the taxation year in which the adoption period ends). For example, eligible adoption expenses incurred in 2018 during an adoption period that began in 2018 and will end in 2019 are claimable only in the 2019 taxation year.

The adoption period begins on the earlier of the following:

- ▶ The moment an application is made for registration with a provincial or territorial ministry responsible for adoption (or with an adoption agency licensed by a provincial or territorial government)
- ▶ The moment an application related to the adoption is made to a Canadian court

The adoption period ends on the later of the following:

- ▶ The moment an adoption order for the child is issued or recognized by a government in Canada
- ▶ The moment the child first begins to reside permanently with the individual

The total of all eligible adoption expenses for an eligible child must be reduced by any reimbursement or other form of assistance the adoptive parent is or was entitled to receive for these expenses. However, this reduction does not apply where the reimbursement or assistance is included in the individual's income and is not deductible in calculating the individual's taxable income.

Canada Child Benefit

The Canada Child Benefit (CCB) program provides a tax-free monthly payment to help eligible families with the cost of raising children under 18 years of age. The program provides a maximum benefit of \$6,639 (\$553 per month) per child under the age of six and \$5,602 (\$467 per month) per child aged six through 17.

The benefit is tied to household income. It begins to be phased out for adjusted family net income over \$31,120 and is generally completely phased out for adjusted family income over \$200,000 (actual amount varies depending on the number of children and their ages). Indexation of CCB amounts began 1 July 2018.

The child disability benefit (CDB) is an additional monthly benefit included in the CCB to provide financial assistance to qualified families caring for children who have a severe and prolonged impairment in physical or mental functions. Families with children under 18 years of age who are eligible for the DTC may receive the CDB. The CDB provides up to \$2,832 per year (\$236 per month) for each child eligible for the DTC. It begins to be phased out when adjusted family net income is more than \$67,426. Indexation of CDB amounts also began on 1 July 2018.

The CRA uses information from your income tax return to calculate how much your CCB payments will be. In order to obtain the CCB, you have to file your tax return every year, even if you did not have income in the year. If you have a spouse or common-law partner, they also have to file a tax return every year. Benefits are paid over a 12-month period from July of one year to June of the next year. Your benefit payments are recalculated every July based on information from your income tax return from the previous year.

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There are a number of eligibility requirements that must be met in order to receive the CCB. Full details about this program, and related provincial and territorial child benefit and credit programs, can be obtained from CRA guide T4114, *Canada Child Benefit and Related Provincial and Territorial Programs*.

The CCB replaced the previous non-taxable Canada Child Tax Benefit program and its National Child Benefit Supplement (which provided assistance to lower-income families with children) and the taxable Universal Child Care Benefit, effective 1 July 2016.

Education

Registered education savings plans

You can use an RESP to fund your child's, grandchild's, spouse's or partner's, or even your own education.

An RESP is an arrangement between you and a promoter under which you agree to make payments to the plan and, in turn, the promoter agrees to make educational assistance payments to the beneficiary when that person attends a post-secondary institution.

There are two basic types of RESP:

- ▶ Group plans, in which you enrol with many other contributors.
- ▶ Individual plans (including family and non-family plans), to which you're the only contributor, your named beneficiaries are the only beneficiaries, and you have some control over the investments. Individual plans generally offer much more flexibility than group plans.

Transfers between individual RESPs for siblings are permitted without triggering penalties and repayments of Canada Education Savings Grants (CESGs), so that these plans enjoy the same flexibility available under family plans.

You can contribute a lifetime maximum of \$50,000 for each beneficiary, and there's no annual contribution limit.

Contributions to an RESP are not tax deductible, but do earn income free of tax while in the plan. Income earned in the plan is taxed as ordinary income in the beneficiary's hands when it is paid out to fund post-secondary education. Contributions withdrawn are not taxable.

The advantage of an RESP is that tax is deferred on any accumulated income and, when this income is paid out, it will likely be taxed at a lower marginal tax rate and the beneficiary can benefit from personal tax credits that may otherwise go unused.⁴⁵

When you make RESP contributions on behalf of beneficiaries under age 18, a CESG may be paid to the plan. The basic CESG is 20% of annual contributions you make to all eligible RESPs for a qualifying beneficiary, to a maximum CESG of \$500 in respect of each beneficiary (\$1,000 in CESG if there is unused grant room from a previous year), and a lifetime limit of \$7,200. For families of modest income, an enhanced CESG may be available.

If an RESP has not received the maximum CESG cumulative entitlement, you can receive the unclaimed entitlement in a later year if your contributions in that year exceed \$2,500. However, the maximum CESG you can receive in a year is \$1,000 (20% of a \$5,000 RESP contribution).

No CESG is paid for a child who is over age 17 in the year.

If the child is between 15 and 17, there are special CESG eligibility rules. RESPs for beneficiaries 16 and 17 years of age can only receive CESGs if at least one of the following two conditions is met:

- ▶ A minimum of \$2,000 of contributions has been made to, and not withdrawn from, RESPs in respect of the beneficiary before the year in which the beneficiary turns 16; or

- ▶ A minimum annual contribution of at least \$100 has been made to, and not withdrawn from, RESPs in respect of the beneficiary in any four years before the year in which the beneficiary turns 16.

You can contribute to an RESP for up to 31 years. The deadline for termination of the plan is the end of its 35th anniversary year. In the case of a disabled beneficiary, you can contribute to an RESP for 35 years, and the termination deadline is the end of its 40th anniversary year.

If none of the RESP beneficiaries pursues higher education, you can withdraw the income from the plan in addition to your contributed capital. But you must repay the CESG receipts. Up to \$50,000 of the income withdrawal will be eligible for transfer to your RRSP, to the extent that you have contribution room, and the remainder will be subject to a penalty tax as well as the regular tax on the income inclusion.

Anti-avoidance rules

There are anti-avoidance rules applicable to RRSPs, RRIFs, TFSAAs, RESPs and registered disability savings plans (RDSPs). These rules impose a 50% penalty tax on both prohibited investments and non-qualified investments held within these plans, as well as a separate 100% penalty tax on certain "advantages" from transactions that exploit tax attributes of these plans. Further information about these rules can be found in [Chapter 5: Investors](#).

If you're concerned about the potential application of these rules, consult with your EY Tax advisor.

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⁴⁵ However, this could impair the transfer of tuition credits to a parent, depending on the amount of RESP taxable income that is paid out to the RESP beneficiary.



Canada Learning Bond

In addition to the CESG, a \$500 Canada Learning Bond (CLB) is paid to an RESP of a child born since 2004, provided eligibility requirements are met. In each subsequent year to age 15, the RESP receives a further payment of \$100, provided the family continues to qualify. Effective for the 2019-20 benefit year beginning on 1 July 2019, families with up to three children may be eligible for the CLB if their adjusted net family income is less than or equal to \$47,630. The adjusted net family income threshold increases for families with more than three children (e.g., for four children, the threshold is \$53,740). Prior to the 2017-18 benefit year, the CLB was paid provided the child's family was entitled to the National Child Benefit Supplement (which was part of the Canada Child Tax Benefit program that was replaced on 1 July 2016 by the CCB).

Lifelong Learning Plan

You may withdraw up to \$20,000 from your RRSP, tax free, to finance full-time education or training for yourself or your spouse or partner. To qualify, you must be enrolled in a qualifying educational program at a designated educational institution as a full-time student in the year of withdrawal or by the end of February of the following year. If certain disability conditions are met, you can be enrolled on a part-time basis.

You can withdraw amounts annually until January of the fourth year following the year of the first withdrawal under the plan. The maximum amount you can withdraw annually is \$10,000.

RRSP withdrawals under this plan are generally repayable in equal instalments over a 10-year period, with the first repayment due no later than 60 days after the fifth year following the first withdrawal. If you fail to make the minimum repayment, the shortfall must be included in your income for that year. A repayment of RRSP *withdrawals under the Home Buyers' Plan* (see **Home Buyers' Plan** below) does not also qualify as a designated repayment of an RRSP withdrawal under the Lifelong Learning Plan. Both must be done separately.

Tax tips

- ▶ Provide for a child's or grandchild's post-secondary education by establishing an RESP on their behalf.
- ▶ Obtain the maximum CESG by making an RESP contribution of \$2,500 each year until the lifetime limit of \$7,200 CESG is received/receivable.
- ▶ If less than the maximum CESG has been received, make an RESP contribution of up to \$5,000 each year until the maximum amount is received.
- ▶ With no maximum annual RESP contribution limit, consider whether the tax-free compounding benefit of early lump-sum contributions outweighs the CESG benefits available with regular contributions.
- ▶ Confirm that the RESP plan documents allow for a successor subscriber and ensure a successor is designated in your estate plan or will. In the event of death of the individual who created the RESP (not the beneficiary of the RESP), failure to provide for a successor subscriber may result in termination of the RESP and the inclusion of certain RESP funds in the deceased's estate.



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Registered disability savings plans

People with disabilities, and family members who support them, can establish registered disability savings plans (RDSPs), which are tax-deferred savings plans designed to provide long-term financial security for severely disabled individuals.

RDSPs are very similar to RESPs. Contributions are not tax deductible, investment income accrues on a tax-deferred basis, and withdrawals of income from the plan will be taxable to the beneficiary. In addition, like RESPs, government assistance is available for some families in the form of the Canada Disability Savings Grant (grant) and the Canada Disability Savings Bond (bond).

Eligibility

An RDSP can be established by a person who's eligible for the DTC, their parent (if the eligible person is a minor) or a legal representative (if the eligible person is not contractually competent). The beneficiary must be under 60 years old, have a valid social insurance number and be a Canadian resident eligible for the DTC in the year the plan is established and when each contribution is made to the plan. The beneficiary need not remain a resident of Canada; however, contributions may not be made while the beneficiary is a nonresident.

Unlike RESPs, multiple RDSPs are not permitted for the same beneficiary.

If the eligible person is not contractually competent, a temporary measure permits certain family members, such as the eligible person's parent or spouse or common-law partner, to establish and manage the RDSP (to be the RDSP "plan holder") if there is no legal representative, provided the RDSP is set up before the end of 2023. An individual who becomes an RDSP plan holder under these rules will generally be able to remain the holder of the RDSP after 2023.

Contributions

Like RESPs, there is no annual contribution limit for RDSPs. However, the lifetime maximum contribution limit to any one plan is \$200,000. Contributions are not tax deductible and can be made in any year up to and including the year in which the beneficiary turns 59. With written permission from the RDSP holder, anyone can contribute to an RDSP. Contributions cannot be made after a beneficiary has died, ceases to be eligible for the DTC or ceases to be a resident of Canada.

Annual contributions will attract matching grants of 100% to 300%, depending on the amount contributed and family income. The maximum grant is \$3,500 per year subject to a lifetime maximum of \$70,000.

For lower-income families, bonds will add up to an additional \$1,000 per year to the RDSP, to a maximum lifetime limit of \$20,000. This supplement does not depend on amounts contributed.

For minor beneficiaries, the parents' (or guardians') net income is considered in determining net family income for purposes of the threshold amounts. Otherwise, the beneficiary's family income is used. The income threshold amounts will be indexed annually to inflation.

Both the grant and the bond are only payable to a plan up until the year the beneficiary turns 49.

A 10-year carryforward of unused grant and bond entitlements (from 2008 onwards) is available. This allows contributions that are made after 2010 to an RDSP to be used to catch up on prior-year unused entitlements (subject to an annual maximum of \$10,500 for grants and \$11,000 for bonds).

In order to encourage long-term savings, the grants and bonds are subject to repayment if withdrawn within 10 years of their contribution (starting with the oldest contributions first). Whenever money is withdrawn from an RDSP, the beneficiary must repay \$3 of any grants

or bonds paid into the plan in the preceding 10 years for every \$1 that is taken out, up to the total amount of grants and bonds paid into the RDSP in the last 10 years.

When an RDSP is terminated, a beneficiary is generally required to repay any grants and bonds received by the RDSP in the preceding 10 years.

Withdrawals

Disability assistance payments can be made from an RDSP at any time and used for any purpose for the benefit of the disabled beneficiary.

Lifetime disability assistance payments are disability assistance payments that must be paid at least annually beginning by the end of the year in which the beneficiary turns 60. Once started, annual payments must continue until the plan is terminated or the beneficiary dies.

Unlike RESPs, contributors cannot receive a refund of their contributions. Only beneficiaries or the beneficiary's estate may receive payments from an RDSP.

There are limits to the amount that can be paid out of an RDSP:

- ▶ A payment cannot be made if it causes the fair market value of plan assets to fall below the "assistance holdback amount" (generally the amount of grants and bonds paid into the plan in the 10-year period preceding the payment).
- ▶ Once lifetime disability payments commence, they must be made annually, and the annual payments are limited by a formula generally dividing the value of the assets of the plan at the beginning of the year by the number of years until the beneficiary reaches age 80 plus three. This limitation is intended to ensure that the plan will continue to provide for the disabled beneficiary evenly over their remaining life.

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Taxation

Only the income that has been earned in the plan, plus the grants and bonds deposited to the plan, or rollover amounts are taxable when payments are made from an RDSP. The contributions are not taxable.

Therefore, each disability assistance payment comprises both a non-taxable and a taxable portion. The non-taxable portion is calculated by applying the ratio of total contributions to the total value of plan assets, reduced by the assistance holdback amount. The remaining taxable portion is included in the beneficiary's income for the year in which the payment is made.

Amounts paid out of an RDSP are excluded from income for the purposes of calculating various income-tested benefits, such as the GST/HST credit and CCB. In addition, RDSP payments will not reduce OAS or Employment Insurance benefits.

Anti-avoidance rules

There are anti-avoidance rules applicable to RRSPs, RRIFs, TFSAs, RESPs and RDSPs. These rules impose a 50% penalty tax on both prohibited investments and non-qualified investments held within these plans, as well as a separate 100% penalty tax on certain "advantages" from transactions that exploit tax attributes of these plans. Further information about these rules can be found in [Chapter 5: Investors](#).

If you're concerned about the potential application of these rules, consult with your EY Tax advisor.

RDSP election for beneficiaries with a shortened life expectancy

A specified disability savings plan (SDSP) allows a beneficiary with a life expectancy of five years or less to withdraw up to \$10,000 in taxable amounts annually from their RDSP without triggering the repayment of CDSGs and CDSBs.

To qualify as an SDSP, the holder of the RDSP must make an election in prescribed form, and a medical doctor or, alternatively, a nurse practitioner after 7 September 2017, must certify that the beneficiary of the RDSP is unlikely to survive more than five years.

Once the election has been made, no more contributions can be made to the plan and the plan will not be entitled to any grants or bonds.

RDSP election to continue plan on loss of DTC eligible status

An RDSP holder may elect, by the end of the year following the first full calendar year for which the beneficiary is DTC ineligible, to extend the life of the RDSP for four additional years if a medical practitioner or, alternatively, a nurse practitioner after 7 September 2017, has certified in writing that the beneficiary will become DTC eligible in the foreseeable future.

During the period of the election, no contributions may be made and no new grants or bonds will be paid, but withdrawals are permitted subject to the regular limitations.

2019 budget

The 2019 federal budget proposed to remove the time limitation on the period that an RDSP may remain open after a beneficiary ceases to be DTC eligible, and to remove the requirement for medical certification that the beneficiary is likely to become DTC eligible in the foreseeable future. This proposed measure would be effective for the 2021 and later taxation years.

Existing rules that apply when an election is filed to extend the life of an RDSP will continue to apply subject to a number of modifications. For example, withdrawals from the RDSP will continue to be permitted subject to the regular limitations, but the assistance holdback amount (see **Withdrawals** above) will be modified, depending on the beneficiary's age. If a beneficiary regains eligibility for the DTC in a year, the regular RDSP rules will once again apply to the RDSP commencing in that year. Should the beneficiary become ineligible for the DTC at some later time, the proposed amendments in respect of DTC ineligibility will resume.

As a transitional measure, an RDSP issuer will not be required to close an RDSP after 18 March 2019 and before 2021 solely because an RDSP beneficiary ceases to be eligible for the DTC.

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Permitted rollovers

A deceased individual's RRSP and RRIF proceeds (and certain RPP and pooled registered pension plan proceeds) may be rolled over to an RDSP of the deceased's impaired and financially dependent child or grandchild. The accumulated investment income earned in an RESP may be rolled over to an RDSP of the same beneficiary under certain circumstances, where the beneficiary is unable to pursue post-secondary education.

Amounts rolled over to an RDSP will reduce the \$200,000 contribution room. Grants will not be paid on amounts rolled over into an RDSP.

2019 budget

Legislative amendments enacted in December 2017 and applicable to 2014 and subsequent taxation years permit a rollover of proceeds from a deceased individual's RRSP or RRIF to the RDSP of the deceased's DTC-ineligible impaired and financially dependent child or grandchild, provided that a valid election to continue the RDSP on the loss of DTC-eligible status is in effect at the time of the transfer. The 2019 federal budget has proposed an amendment that would permit such a rollover only if it occurs by the end of the fourth calendar year following the first full year throughout which the beneficiary is ineligible for the DTC. This amendment would be effective for the 2021 and later taxation years.



Principal residences

A principal residence is generally any accommodation you own and that you, your spouse or partner, or your child ordinarily inhabits, provided you designate it as your principal residence.

A special exemption applies in the case of a gain on the sale of a principal residence. As a general rule, no tax liability will arise from the sale of a principal residence, as long as the property does not exceed one-half hectare.

If you own more than one property that can qualify as a principal residence (e.g., a home and a cottage), you do not have to decide which one is your principal residence until you sell one of them. However, to properly calculate the gain on disposition of each property, you should maintain records (including receipts and invoices) for the cost of all capital improvements you make to your residence. These costs can be added to the adjusted cost base of the property and reduce the gain that may not be sheltered by the exemption.

If you and/or your spouse or partner own two properties, there are opportunities for tax planning if at least one of the properties was purchased before 1982. Prior to 1982, one spouse could own and designate one property as their principal residence, and the other spouse could own and

designate another property, provided each property met the "ordinarily inhabited" test. A cottage would have met this test in most cases. Properties owned before 1982 continue to be governed by the old rules for pre-1982 ownership years. For years after 1981, however, a family can only designate one property as a principal residence.

Amendments effective for the 2016 and later taxation years impact the special exemption that may apply to shelter a gain on the sale of a principal residence. While some of these amendments are targeted at nonresidents who purchase a residence in Canada, others apply more broadly to all Canadian homeowners. In particular, as of the 2016 taxation year, you are required to report every disposition of a principal residence on your tax return, whether the gain is fully sheltered or not by the principal residence exemption. In the past, the CRA did not require you to report the sale of a principal residence if the gain was fully sheltered by the exemption.

Additional amendments include introducing an extended assessment period for taxpayers who do not report the sale of a principal residence on their tax return, and permitting the late filing of a principal residence designation (subject to a late-filing penalty).

For more information, refer to [Chapter 8: The principal residence exemption](#), or contact your EY Tax advisor.

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Home Buyers' Plan

If you're a first-time home buyer, the Home Buyers' Plan (HBP) allows you to withdraw up to \$35,000⁴⁶ from an RRSP to finance the purchase of a home. You're considered a first-time home buyer if neither you nor your spouse or partner owned a home and lived in it as your principal residence in any of the five calendar years beginning before the time of withdrawal.

If you're buying a new home that's more suitable or accessible for a disabled individual, you can take advantage of the HBP without having to meet the above prerequisites.

If you withdraw funds from your RRSP under the HBP, you must acquire a home by 1 October of the year following the year of withdrawal. No tax is withheld on RRSP withdrawals made under this plan.

You must repay the withdrawn funds to your RRSP over a period of up to 15 years, starting in the second calendar year after withdrawal. The CRA will provide you with an annual statement informing you of your minimum repayment requirement. If you fail to make the minimum repayment, the shortfall must be included in your income for that year. Annual repayments may be made within the first 60 days of the following year. A contribution made to an RRSP fewer than 90 days before it is withdrawn is generally not deductible.

2019 budget

The 2019 federal budget announced, and corresponding legislation implemented, amendments that will permit an individual to re-qualify, under certain circumstances, for the HBP following the breakdown of a marriage or common-law partnership, even if they would not otherwise meet the first-time home buyer requirement. The amended rules are effective for withdrawals made after 2019.

A number of conditions must be met. For example, at the time an individual makes an HBP withdrawal from an RRSP, they must be living separate and apart from their spouse or common-law partner for a continuous period of at least 90 days because of a breakdown of the marriage or common-law partnership. In addition, the individual must have begun to live separate and apart in the year the withdrawal was made or in one of the four preceding years. If the withdrawn amount does not otherwise meet the eligibility requirements under the HBP, the amount will not be included in the individual's income as long as it is repaid to an RRSP before the end of the second year after the year in which the withdrawal is made.

Other conditions and rules will apply depending upon the circumstances.

Tax tips

- ▶ For each principal residence acquired before 1982, consider:
 - The need to establish the value of the residence at 31 December 1981
 - The need for separate rather than joint ownership of the residence
- ▶ If your family owns more than one residence, the principal-residence designation should generally be used for the property with the largest gain per year. However, the timing of the tax liability must also be considered.
- ▶ Property with an area in excess of one-half hectare may, in certain circumstances, qualify as a principal residence.
- ▶ By withdrawing funds from your RRSP under the HBP, you forgo the income that would have been earned on those funds, as well as the related tax-deferred compounding.

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⁴⁶ The HBP withdrawal limit was increased from \$25,000 to \$35,000, effective for 2019 and later years in respect of withdrawals made after 19 March 2019. The increase to this limit was proposed by the 2019 federal budget, with corresponding legislative amendments enacted in June 2019.



First-time home buyers' tax credit

First-time home buyers who acquire a qualifying home are entitled to a one-time non-refundable federal tax credit of up to \$750. Any unused portion of the non-refundable credit may be claimed by the individual's spouse or partner. If the property is acquired jointly, the total credit claimed by the individual and their spouse or partner may not exceed \$750.

The same eligibility provisions as for the HBP apply. You're considered a first-time home buyer if neither you nor your spouse or partner owned a home and lived in it as your principal residence in the calendar year of purchase or in the preceding four calendar years. In addition, the property must be occupied as your principal residence within one year of its acquisition.

Home accessibility tax credit

The home accessibility tax credit (HATC) is a non-refundable tax credit of up to \$1,500 designed to help seniors and persons with disabilities live more independently in their own homes by encouraging home renovations that improve accessibility, safety and functionality. See [Chapter 10: Tax assistance for long-term elder care](#) for further discussion.

Non-refundable tax credits

Most federal personal tax credits are fully indexed to inflation (measured by changes in the consumer price index). Most provinces also provide for full or partial indexing of their non-refundable tax credits (the indexation rate varies by province).

For a summary of the maximum combined federal and provincial value of the most common non-refundable tax credits see [Appendix B](#).

Tax tips

- ▶ If you're not making full use of your pension income credit, consider purchasing an annuity or RRIF, which provides annual pension income. One way of doing so is by withdrawing \$2,000 per year (enough to use up the maximum pension credit) from your RRSP and converting it to an RRIF or annuity.
- ▶ Consider combining the claim for medical expenses incurred by you, your spouse or partner, and your eligible dependants for any 12-month period ending in the year, to optimize the tax savings. Also, by having the lower-income spouse or partner make the claim, the credit may be increased because of the 3%-of-net-income threshold (in Quebec, the threshold is 3% of net family income).
- ▶ If you support a dependent relative who is physically infirm, you may be entitled to claim a special tax credit. For more information, see [Chapter 10: Tax assistance for long-term elder care](#).
- ▶ If your children attend private school, check with the school to determine if a portion of the tuition fees is eligible for the child-care expense deduction or qualifies as a charitable donation.
- ▶ If your spouse or partner or your child has tuition fees in excess of approximately \$5,000, consider income splitting. This may enable you to create sufficient income to use any non-transferable tuition credit. (The maximum federal tax credit available for transfer of tuition credits is \$750.)
- ▶ If one spouse or partner has no income tax payable and at the same time has not fully used their non-refundable credits (e.g., age credit, pension, tuition and disability tax credits), the unclaimed balance of these credits can be transferred to the other spouse or partner. (In Quebec, it is also possible to transfer credits to a spouse or partner. To benefit from this transfer, the spouse or partner has to file a Quebec return, even if no tax is payable.)



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Charitable donation tax credit

You're entitled to a federal non-refundable tax credit of 15% on the first \$200 of charitable donations. For donations in excess of \$200, an individual can obtain a 33% federal credit to the extent the donations relate to an individual's taxable income in excess of the highest income bracket threshold (\$210,371 for 2019); otherwise, a 29% rate applies. For example, if you have taxable income of \$214,000 in 2019 and make \$5,000 of donations in the year, \$3,629 of the donations will qualify for the 33% credit (\$214,000 - \$210,371). Of the remaining \$1,371, \$1,171 will qualify for the 29% credit, and \$200 for the 15% credit.

The maximum annual claim for charitable donations is 75% of your net income for the year. Any donations beyond that may be carried forward for five years.

If you make a "gift in kind" (e.g., capital property rather than cash), special rules may apply. Unless you elect otherwise, the property is deemed to be disposed of at fair market value for capital gains purposes and you're considered to have made a donation for the same amount. See [Chapter 5: Investors](#) for further discussion of the capital gains implications of certain gifts in kind.

In the case of a donation of capital property, the donation limit can be as much as 100% of the resulting taxable capital gain (or recapture, in the case of depreciable property) included in income.

In the year of your death and in the immediately preceding year, the donation limit rises to 100% of your net income.

Claims for charitable donations must be supported with official tax receipts from the charitable organization.

You may claim donations made by either yourself or your spouse or partner. However, as of 2016, the previous administrative practice of allowing a gift made by an individual's will to be claimed by a deceased individual's spouse or partner no longer applies (as per CRA document 2014-0555511E5).

Donating recently purchased property - There are a number of complex tax rules to combat "buy low, donate high" tax shelter schemes. These rules apply to any gift of appreciated property that was acquired within three years of the time of the gift (10 years if one of the main reasons for acquiring the property was to make the gift). In these situations, the gift amount will be the lesser of the cost of the property to the donor and its fair market value at the time of the gift.

If the property was acquired by any person with whom the donor did not deal at arm's length within the applicable time period (i.e., three or 10 years), the cost of the property to the donor will be the lesser of the cost to (i) the donor and (ii) the non-arm's-length person. Gifts of publicly traded securities, certified cultural property (other than property acquired as part of a tax shelter gifting arrangement), ecological gifts, inventory, real property situated in Canada, certain shares of closely held corporations and gifts made on death are excepted from these rules.

Tax shelter gifting arrangements - The CRA has been auditing all gifting tax shelter schemes and will not assess tax returns of individuals who claim a donation tax credit as a result of such a scheme until the audit of the particular scheme is complete. An individual whose return is on hold will be able to have the return assessed before the completion of the audit only if the individual removes the donation tax credit claim for the gifting tax shelter in question. In addition, the CRA may collect 50% of any assessed tax, interest or penalties that result from the disallowance of a tax credit claimed in respect of a tax shelter involving a charitable donation.

The CRA has indicated that, to date, it has not found any tax shelter gifting arrangements that it believes comply with Canadian tax laws. It has generally succeeded in denying the benefits of tax shelter gifting arrangements before the courts.

Foreign gifts - In general, gifts to foreign charities are not eligible for the charitable donation tax credit. Exceptions include gifts to qualified universities outside Canada (the CRA maintains and posts a list of qualified foreign universities for this purpose), gifts to certain foreign charities that have qualified and applied for registration in Canada (the CRA maintains and posts a list of qualified foreign charities) and gifts made to US charities where the US charity would qualify as a charity in Canada (as provided in the Canada-US tax treaty). Note that a tax credit for gifts to US charities is available to the extent that the individual making the gift has sufficient US-source income and the claim is limited to 75% of that US-source income.

Gifts of cultural property - Objects certified as Canadian cultural property by the Canadian Cultural Property Export Review Board (CCPERB) and gifted to a Canadian designated institution or public authority (designated by the minister of Canadian heritage under the *Cultural Property Export and Import Act*) are eligible for a non-refundable tax credit. The credit is based on the fair market value of the property as determined by the CCPERB, not by the museum or institution that receives the property. The tax credit is calculated at the same rate as for charitable donations. (In Quebec, the Conseil du patrimoine culturel provides certification for cultural property.)

There are two benefits of certification:

- ▶ Any appreciation in value is not recognized as a capital gain.
- ▶ The 75% net income limitation on donations does not apply.

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If the credit exceeds your federal taxes payable for the year, the excess can be carried forward for five taxation years. The same rule applies in Quebec.

Gifts of ecologically sensitive land - Eligibility for the non-refundable tax credit is determined by the minister of the environment and climate change, who must certify that the land is important to the preservation of Canada's environmental heritage. The minister will also certify the fair market value of the gift for purposes of determining its eligible amount.

Gifts of ecologically sensitive land (including a covenant, an easement or, in the case of land in Quebec, a real servitude or certain personal servitudes) made to Canada, a province, territory or municipality or a registered charity approved by the minister of the environment and climate change are eligible. Eligible gifts may also be made to a municipal or public body performing a function of government in Canada.

There are two benefits of certification:

- ▶ Any appreciation in value is not recognized as a capital gain.
- ▶ The 75% net income limitation on donations does not apply.

If the credit exceeds your federal taxes payable for the year, the excess can be carried forward for 10 taxation years.

Gifts of publicly listed flow-through shares –

In general, an investor's adjusted cost base (ACB) of a flow-through share is zero. As a result, on disposition, the entire value of proceeds is a capital gain.

For flow-through shares acquired pursuant to an agreement entered into on or after 22 March 2011, the exempt portion of the capital gain on the donation of the flow-through shares is generally limited to the portion that represents the increase in value of the shares at the time they are donated over their original cost.

Tax tips

- ▶ All charitable donation claims must be supported by official tax receipts.
- ▶ If you typically make large charitable gifts and also plan to sell securities and realize capital gains, consider gifting the securities instead to reduce your taxes.
- ▶ Consider whether any property you own may qualify as Canadian cultural property, which could be gifted over a number of years to a designated institution in order to reduce your taxes payable.
- ▶ Maximize the donation tax credit by claiming your and your spouse or partner's donations on one return. Donations made to US charities should be claimed by the spouse or partner who has US-source income. (Tax credits for donations to US charities are limited to 75% of US-source income.)

Tax credits for students

If you're a student, you can take advantage of federal and provincial personal tax credits for tuition and various other fees paid to an educational institution such as a university, college or private school for post-secondary courses.

To be eligible for the tuition tax credit, the tuition must generally be paid to an educational institution in Canada or a university outside Canada and the total course fee must be higher than \$100.

A student enrolled at a university outside Canada may claim the tuition tax credit for full-time attendance in a program leading to a degree, where the course has a minimum duration of three consecutive weeks, provided the student is enrolled in a full-time course.

Various examination fees paid to obtain a professional status or to be licensed or certified to practice a profession or trade in Canada are also eligible for the tuition tax credit. Fees for admission examinations to begin study in a professional field do not qualify.

The tuition tax credit may also be claimed for tuition fees paid to a university, college or other post-secondary institution in Canada for occupational skills courses taken after 2016 that are not at the post-secondary level. The tax credit is available in these circumstances only if the course is taken for the purpose of providing a student with skills (or improving a student's skills) in an occupation and the student has attained the age of 16 before the end of the year.

2019 budget

The 2019 federal budget announced, and corresponding legislation implemented, amendments that introduce a new refundable tax credit, the Canada training credit. Effective for the 2020 and later taxation years, the credit will assist eligible individuals who have either employment or business income to cover the cost of up to one-half of eligible tuition and fees associated with training. The portion of eligible tuition fees refunded through the Canada training credit will reduce the amount that would otherwise qualify as an eligible expense for the tuition tax credit. See [Chapter 7: Employees](#) for further details about the Canada training credit.

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Prior to 2017, federal education and textbook tax credits were available, in addition to the tuition tax credit. The maximum amounts that could be claimed varied depending on the number of months the student was in school and whether the student was full time or part time. These tax credits were eliminated effective 1 January 2017. However, any unused education and textbook tax credit amounts carried forward from years prior to 2017 remain available to be claimed in 2017 and subsequent years.

If the student doesn't have sufficient tax payable in the year to use these tax credits, up to \$5,000 of unused tuition amounts can be transferred to a parent or grandparent for use in their tax return (provincial amounts may vary). Any amounts not used by the student (including education and textbook tax credit amounts from years prior to 2017) and not transferred can be carried forward and used by the student in a subsequent year.

Other costs, such as supplies, equipment and student fees, are not deductible or creditable.

Tax tips

- ▶ Students should file an income tax return even where no amount is owing. Doing so establishes future RRSP contribution room and may result in provincial tax credits.
- ▶ Most scholarship, fellowship or bursary payments may be received tax free.
- ▶ Research grants must be included in income, but related expenses may be deducted.
- ▶ Moving expenses may be deductible against certain taxable scholarship or grant income where the student moves to attend a university that is at least 40 km away from home on a full-time basis.

2019 budget

The 2019 federal budget announced, and corresponding legislation implemented, amendments introducing a temporary 15% non-refundable tax credit for eligible digital news subscriptions, for a maximum annual amount of \$500 (a maximum annual tax credit of \$75). The credit will apply to eligible amounts paid after 2019 and before 2025.

Eligible digital news subscriptions will be those that entitle an individual to access content provided in digital form by a qualified Canadian journalism organization (QCJO)⁴⁷ that is primarily engaged in the production of original written news content, and not engaged in a broadcasting undertaking.

The credit will be limited to the cost of a comparable standalone digital subscription where the subscription is a combined digital and newsprint subscription. If there is no such comparable subscription, individuals will be limited to claiming one half of the amount actually paid.

Medical expense tax credits

There are federal and provincial tax credits available for medical costs for yourself, your spouse or partner, and your dependent children. Only medical expenses in excess of the lesser of a fixed threshold amount (see [Appendix B](#)) and 3% of your net income are eligible for credit.

If you claim medical expenses for a dependent relative other than a spouse or dependent children, the annual amount you may claim for each person is limited to the eligible amounts paid in excess of the lesser of 3% of the dependant's net income and the threshold amount.

In determining eligible expenses, you may consider expenses paid in the year or in any 12-month period that ends in the year (as long as you have not claimed the expenses previously). Either spouse or partner can claim the credit for the family. It may also be possible to claim a medical expense tax credit for medical costs you pay for other dependent relatives, such as elderly parents, grandparents, aunts or uncles.

Receipts must be kept in case the CRA asks to see them and must include the name of the person to whom the expense was paid.

Most people are not aware of the range of medical costs that qualify for the medical expense tax credit. In order to be eligible for the medical expense tax credit, a particular expenditure must meet certain specified conditions over and above being incurred for medical reasons. For example, medical or dental expenses incurred for purely cosmetic procedures are allowable only if they were necessary for medical or reconstructive purposes. Eligible expenses may include those incurred outside Canada. For a comprehensive list, see the guide [RC4065, Medical Expenses](#), on the CRA's website.

Attendant care expenses and the disability tax credit

For details on claims for the cost of attendant or nursing home care, and a discussion of the disability tax credit, see [Chapter 10: Tax assistance for long-term elder care](#).

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⁴⁷ A QCJO, a newly defined term, is a Canadian corporation, trust or partnership that is primarily engaged in the production of original news content, primarily focused on matters of general interest and reports of current events (including coverage of democratic institutions and processes), but not primarily focused on a particular topic (e.g., industry-specific news, sports, recreation, arts, lifestyle or institutions). Other conditions apply.



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Tax assistance for long-term elder care



Populations across the industrialized world are aging more rapidly than ever. In recent years, the proportion of persons aged 65 years and older has grown in every G7 country.

Relative to other G7 countries, the US and Canada have the lowest proportion of people age 65, but established trends are significant and will impact Canadians planning elder care for parents and other elderly relatives, or for their own retirement.

The federal and provincial governments have put programs in place to address aging. In general, provincial governments provide health care and social assistance programs, while the federal government provides funding for many of these programs and offers financial assistance through the Canadian tax system.

In general, tax assistance for long-term care is provided in three broad categories:

- ▶ Non-refundable tax credits for individuals who meet certain eligibility criteria
- ▶ Tax relief for the cost of attendant care or institutional care
- ▶ Tax relief for other itemized medical expenditures

Disability tax credit

A person who requires long-term care will likely be eligible for the non-refundable disability tax credit (DTC). However, as explained below, the DTC is not available if you claim full-time attendant care or nursing home care as a medical expense for the disabled person.

In general terms, the DTC is available when an individual is certified by an appropriate medical practitioner⁴⁸ as having a severe and prolonged mental or physical impairment – or a number of ailments – that markedly restricts his or her ability to perform a basic activity of daily living. Basic activities recognized by Canadian tax authorities include walking, feeding or dressing oneself, seeing, speaking, hearing and eliminating bodily waste. A marked restriction is one that inhibits the individual from performing the activity almost all the time, or results in the individual having to take an inordinate amount of time to perform the activity.

An impairment is prolonged if it has lasted, or can reasonably be expected to last, for a continuous period of at least 12 months.

To claim the credit, prescribed Form T2201, *Disability Tax Credit Certificate*, must be completed and signed by a specified medical practitioner. Once the CRA approves the claim, eligibility continues unless recertification is required (i.e., the previous period of approval has expired).

The federal DTC base amount for 2019 is \$8,416, resulting in a non-refundable tax credit of \$1,262. The provinces and territories provide a comparable credit: for 2019, the total tax benefit of the DTC ranges from approximately \$1,550 to \$2,750, depending on the province or territory of residence.

Tax tips

- ▶ The CRA reviews all first-time DTC claims. To avoid delays in assessing personal returns for that first year, the CRA suggests that individuals send in their T2201 forms as early as possible and receive pre-approval of the disability claim.
- ▶ Starting in 2016, the DTC can be claimed online; however, you must submit the completed Form T2201 to the CRA within 30 days.
- ▶ If an elderly person is supported by more than one relative, it is possible for the supporting relatives to share the unused portion of the credit, as long as the total claimed does not exceed the maximum amount permitted.

If a disabled individual does not require the full amount of the DTC to eliminate taxes payable, the unused portion can be transferred to a supporting relative. A supporting relative is someone who assists in providing basic necessities of life, such as food, shelter and clothing, and can be a parent, spouse or common-law partner, or a supporting child, grandchild, brother, sister, aunt, uncle, niece or nephew. The credit can only be transferred to children, grandchildren, brothers, sisters, aunts, uncles, nieces or nephews if the disabled individual has no spouse or if the spouse has not claimed the married credit or other transferred credits in respect of the disabled individual.

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⁴⁸ Budget 2017 extended the list of medical practitioners that can certify eligibility for the DTC to nurse practitioners for certifications made on or after 22 March 2017.



Other tax deductions and credits that may be available

Infirm dependant credit and caregiver credit - before 2017

For 2016 and prior years, additional credits were potentially available for the supporting individual in respect of a dependent parent, grandparent, aunt or uncle: the infirm dependant credit and the caregiver credit.

The maximum value of the federal and provincial infirm dependant credit ranged from approximately \$850 to \$2,090 in 2016. However, the maximum was not always reachable, because the infirm dependant credit was income sensitive. This credit could only be claimed if the spousal credit or the equivalent-to-spouse credit was not claimed in respect of the individual.

The caregiver credit might have been available if you cared for an adult relative (other than a spouse or partner) in your home. In 2016, the maximum value of the combined federal and provincial credit ranged from approximately \$580 to \$1,770.

But, like the infirm dependant credit, it was income sensitive and could not be claimed if another individual claimed a spouse credit or equivalent-to-spouse credit for the individual.

An additional family caregiver tax credit was potentially available to individuals supporting dependants with mental or physical infirmities.

Certain provinces, such as Alberta, Saskatchewan and New Brunswick, continue to provide these credits.

Canada caregiver credit - after 2016 - Effective for 2017 and subsequent years, the Canada caregiver credit replaced the infirm dependant tax credit, the caregiver tax credit and the family caregiver tax credit with a new 15% non-refundable credit.

For 2019, an individual may claim up to \$7,140 for the care of a dependent relative with an infirmity, for a federal credit amount of \$1,071. The dependent relative can be a parent, grandparent, sibling, aunt, uncle, niece, nephew or adult child of the claimant, or of the claimant's spouse or common-law partner.

For federal purposes, the credit amount is reduced dollar for dollar when a dependent's net income exceeds \$16,766.

An individual may also claim up to \$2,230 for the following persons, for a federal credit amount of \$335:

- ▶ A dependent spouse or common-law partner with an infirmity, if the individual claims the spouse or common-law partner amount for that person
- ▶ An infirm dependant for whom the eligible dependant credit is claimed
- ▶ An infirm child who is under the age of 18 at the end of the taxation year

For 2019, the maximum value of the federal and provincial Canada caregiver credit ranges from approximately \$900 to \$2,200.

To date, British Columbia, Ontario and Yukon have also announced the consolidation of the infirm dependant credit and the caregiver credit.

While the amounts that may be claimed under the new credit are generally consistent with the previous system, there are some differences. For example, the Canada caregiver credit is not available in respect of non-infirm seniors residing with their adult children.

Home accessibility tax credit

The home accessibility tax credit (HATC) is a non-refundable tax credit designed to help seniors and other persons live more independently in their homes.

To qualify for the HATC, the eligible renovation or alteration work must be performed and paid for, or the goods acquired, after 2015. The renovation must be done to an eligible dwelling, which is generally one that is ordinarily inhabited by a qualifying individual during the year and is owned by the qualifying individual or that person's spouse or partner. The credit is equal to 15% of eligible renovation or alteration expenditures you incur, up to \$10,000 per calendar year.

You may claim the HATC if you meet any of the following criteria:

- ▶ Are 65 years of age or older at the end of the year
- ▶ Have a disability that makes you eligible for the DTC
- ▶ Are the qualifying senior or disabled person's spouse or common-law partner
- ▶ Are the parent, grandparent, child, grandchild, brother, sister, aunt, uncle, niece or nephew of a qualifying senior or disabled person

If more than one individual is eligible to claim the credit in relation to the same eligible dwelling, the total credit amount claimed for that dwelling cannot exceed \$10,000 in the year.

If your renovation expenses qualify for the medical expense tax credit (METC), you can claim both the HATC and the METC for those expenses.

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Provincial home accessibility tax credits

Similar provincial credits are available to seniors residing in British Columbia,⁴⁹ Quebec and New Brunswick. Qualifying individuals and renovations or alterations, eligibility periods, credit rates and expenditure thresholds vary by province.

Long-term elder care - attendant care

One of the most significant expenses of long-term elder care is the cost of attendant care. Tax assistance, in the form of non-refundable tax credits, helps to alleviate some of the burden for families, but the relief available depends on the level of care provided and whether the individual is eligible for the DTC. Depending on the circumstances, there may be an opportunity to optimize the credits.

What is a qualifying renovation or alteration expenditure?

To qualify for the HATC, the expenditure must allow a senior or disabled individual to gain access to or be more mobile or functional in the dwelling, or must reduce the risk of harm to the individual in the dwelling or in gaining access to the dwelling. Qualifying expenses that may include materials or labour must relate to renovations or alterations of an enduring nature and must be integral to the eligible dwelling.

Examples of renovations or alterations that qualify for the credit include:

- ▶ Walk-in bathtubs
- ▶ Wheelchair ramps
- ▶ Wheel-in showers
- ▶ Grab bars

The following are not eligible for the credit:

- ▶ Routine repairs and maintenance
- ▶ Lawn care, housekeeping, security or similar services
- ▶ Expenses made primarily to improve or maintain the value of the dwelling
- ▶ Household appliances
- ▶ Electronic home-entertainment devices
- ▶ Items that retain a value independent of the renovation (such as furniture or purchased tools)
- ▶ Financing costs for the renovations or alterations
- ▶ Expenses reimbursed (or reimbursable) through a non-government program
- ▶ Expenses incurred for the purpose of producing income from a business or property
- ▶ Expenses for work provided by a person related to you, unless that person is registered for GST/HST

The following discussion explores the tax credits available in respect of attendant care for elderly individuals who live at home, in a nursing home or in a long-term care facility.

Eligible attendant care and nursing home or long-term care facility fees may generally be claimed as a qualifying medical expense eligible for the federal METC. The federal METC is a non-refundable credit computed by applying the lowest marginal tax rate (currently 15%) to eligible medical expenses in the year in excess of the lesser of:

- ▶ 3% of net income; and
- ▶ \$2,352 (2019 amount).

The provinces and territories provide a comparable non-refundable credit.

An individual, or their spouse or common-law partner, may claim eligible attendant care expenses in respect of the couple. As such, it may be slightly more beneficial for the lower-income spouse or partner to make the claim (due to the 3% net income threshold).

An individual may also claim attendant care expenses incurred for a dependent relative (e.g., adult dependent relatives such as a parent, grandparent, brother, sister, aunt or uncle), subject to certain limitations. There is no requirement that the individual requiring care live with the supporting relative, or be claimed as dependent for any other purpose; they must, however, be dependent on the claimant for financial support.

Attendant care expenses for a dependent relative other than a spouse or common-law partner are limited to the total of eligible amounts as noted above; however, the dependant's net income is used in the calculation.

More than one person may claim the METC in respect of the same person, but the total amount claimed by all supporting persons cannot exceed the total expenses paid by them.

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⁴⁹ The Ontario healthy homes renovation tax credit was eliminated effective 1 January 2017, as announced in the 2016 Ontario budget.



Nursing home or long-term care facility fees

Although not defined for tax purposes, the CRA considers a nursing home to be a public facility offering 24-hour nursing care to patients. Generally, all regular fees paid for full-time care – including food, accommodation, nursing care, administration, maintenance, social programming and activities – qualify as eligible medical expenses. To claim these expenses, the individual receiving the care must either qualify for the DTC or have medical certification that they are and will continue to be dependent on others for their personal needs and care due to lack of normal mental capacity.

Additional personal expenses that are separately identifiable, such as hairdressing fees, are not allowable expenses.

An individual who resides in a nursing home may have supplementary personal attendants. The salaries paid to these attendants may be considered a qualifying medical expense (up to \$10,000 annually, \$20,000 in the year of death) along with the institution's fees.

A retirement home will generally not provide the care that is required to be classified as a nursing home, and thus the fees would not qualify as an eligible medical expense. To the extent that the attendant care component of the fee can be set out separately in an invoice, that portion of the fee will qualify as an eligible medical expense (proof of payment must be provided). However, it may only be considered part-time care (and limited to \$10,000 annually or \$20,000 in the year of death), as discussed below.

A particular floor or portion of a retirement home may qualify as a nursing home. For example, the home may provide independent or semi-independent accommodations, but have certain areas dedicated to full-time care. Whether the specific area qualifies as a nursing home will depend on the size of the facility's staff, the staff's qualifications and the equipment available to provide 24-hour nursing care to patients.

Full-time in-home attendant care

Eligible in-home attendant care expenses are not limited to assistance with basic living needs, such as dressing and bathing. Assistance with personal tasks such as cleaning, meal preparation, shopping, transportation and banking may also be claimed. Attendant care can also include providing companionship to an individual. However, costs for such services purchased individually or from a commercial provider (e.g., cleaning agency or transportation service) do not qualify.

To claim these expenses, the individual receiving care must either have an approved Form T2201 or certification from a medical practitioner that the individual is, and will likely continue to be, dependent on others for their personal needs and care due to a mental or physical impairment and needs a full-time attendant.

Full-time in-home attendant care expense can be claimed for only one attendant in a given period, although an individual may have several attendants over a period of time. The attendant must be 18 or over at the time the wages were paid and cannot be the spouse or common-law partner of the claimant.

A private attendant hired for in-home care is generally considered to be an employee. The payer should ensure that appropriate payroll deductions and remittances are made to the CRA. Although the source deductions and the employer portion of CPP, QPP, and EI contributions qualify as attendant care costs, in the case of a live-in attendant, imputed salary (e.g., the cost of board and lodging) does not qualify, as it is not considered to be an amount paid.



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Full-time care restriction on the DTC

If full-time attendant care or nursing home care expenses are claimed under the above-noted provisions of the METC, the DTC cannot be claimed by anyone in respect of the individual.

Part-time attendant care

Where in-home care is not deducted or perhaps not deductible under the above full-time provisions (for example in the case of a part-time attendant), an individual may be able to claim up to \$10,000 annually (\$20,000 in the year of death) for part-time attendant care provided in Canada. Again, the individual must be eligible for the DTC, but the DTC can be claimed along with the METC for these expenses, unlike for expenses claimed under one of the full-time care provisions discussed above. For 2019, the combination of the METC claim and the DTC provides relief in respect of \$18,416 of related costs. Depending on the expenses incurred, claiming attendant care expenses under this provision to benefit from the DTC may result in a larger METC (e.g., full-time attendant costs were only incurred for part of the year).

Planning considerations

Because of the interaction between the DTC and the METC, and the ability for supporting relatives to claim certain expenses, it's important to consider and choose the most advantageous combination each year. In making this determination, other medical expenses paid during the year, as well as other non-refundable credits, must be considered to maximize the benefits available.

Interaction between the METC and the DTC

Example 1

Lauren is 75 years old and she resides in a retirement home, where she receives care from a full-time attendant. Lauren has an approved Form T2201 on file with the CRA.

In 2019, Lauren earned pension income of \$45,000. The retirement home provided Lauren with a receipt indicating that she paid \$21,000 of eligible attendant care expenses during the year.

Lauren has the following two options to consider when preparing her 2019 tax return:

1. Claim \$10,000 of attendant care expenses (under the part-time care attendant provision) and the DTC.
2. Claim the full amount of eligible attendant care expenses.

ANALYSIS

	Option 1	Option 2
Disability amount	\$8,416	-
Medical expenses*	\$8,650	\$19,650
Sub-total	\$17,066	\$19,650
Lowest marginal tax rate	15%	15%
Federal non-refundable tax credit	\$2,559	\$2,948

* Eligible medical expenses in excess of the lesser of (1) 3% of net income (\$45,000 x 3% = \$1,350); and (2) \$2,352. Thus, eligible medical expenses total \$8,650 and \$19,650, respectively.

CONCLUSION

Option 2 yields a higher federal non-refundable tax credit.

Example 2

Assume the same facts as above, except that Lauren's eligible attendant care expenses total \$14,000, since the expenses were incurred for only a portion of the year.

ANALYSIS

	Option 1	Option 2
Disability amount	\$8,416	-
Medical expenses*	\$8,650	\$12,650
Sub-total	\$17,066	\$12,650
Lowest marginal tax rate	15%	15%
Federal non-refundable tax credit	\$2,559	\$1,898

* Eligible medical expenses in excess of the lesser of (1) 3% of net income (\$45,000 x 3% = \$1,350); and (2) \$2,352. Thus, eligible medical expenses total \$8,650 and \$12,650.

CONCLUSION

Option 1 yields a higher federal non-refundable tax credit.

Other considerations

The conclusions reached could change if Lauren is financially dependent on her two daughters. In this case, Lauren could claim the DTC, and each of her daughters could claim up to \$10,000 of attendant care expenses paid to the retirement home. As such, up to \$20,000 of attendant care expenses would be claimed for the METC (in excess of the threshold of 3% of Lauren's net income, or \$2,352) in addition to the DTC. If Lauren does not require the full amount of the DTC to eliminate taxes payable, the unused portion could be transferred to her daughters.

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The following chart, adapted from Guide [RC4065](#), *Medical Expenses*, summarizes the interaction between medical expense claims for attendant care and the DTC.

Type of expense	May the individual claim the disability amount?
Fees paid for full-time care in a nursing home	Eligible individuals may claim the disability amount or these expenses, but not both.
Remuneration for one full-time attendant outside a self-contained domestic establishment	Eligible individuals may claim the disability amount or these expenses, but not both.
Remuneration for attendant care provided in Canada (this may include the part of the nursing home fees paid for full-time care that relate only to salaries and wages as attendant care)	Eligible individuals may claim the disability amount and up to \$10,000 for these expenses (\$20,000 if the person died in the year).
Full-time attendant at home	Eligible individuals may claim the disability amount or these expenses, but not both.

Tax tips

- ▶ An individual can pay one parent to care for the other parent, and possibly claim the amount paid as an eligible medical expense, as the amount is not paid to the claimant's spouse. The parent providing care would be required to include the amount in taxable income; thus, this option may not be desirable if the individual is subject to a marginal income tax rate in excess of 15%.
- ▶ Since full-time attendant care or nursing home care expenses generally far exceed the DTC base (\$8,416 in 2019), it may be advantageous to forgo the DTC in favour of the METC.
- ▶ Since eligible medical expenses may be claimed by supporting relatives and the \$10,000 limit applies to each claimant, it may be beneficial to claim the costs under the part-time care provision, to reap the benefit of the DTC as well.
- ▶ An individual who resides in a nursing home may have supplementary personal attendants. The salaries paid to these attendants may be considered a qualifying medical expense (up to \$10,000 annually, \$20,000 in the year of death), along with the institution's fees.

Other medical expenses

In addition to the claims for attendant care and nursing home care, there are a host of additional medical expenses that may be claimed as part of the METC. Most people are aware of the standard medical costs that qualify, such as prescription drugs or glasses, but there may be other significant costs that are not obviously medical expenses, including:

- ▶ Transportation costs for travel to obtain medical treatment where such treatment is not available locally
- ▶ Renovations or alterations to a home to make it more accessible and/or more functional to the infirm individual
- ▶ Costs to alter a vehicle so that it can transport an individual in a wheelchair
- ▶ Limited moving expenses to relocate to housing that is more accessible or functional for the impaired individual
- ▶ Training costs in relation to appropriate care for the infirm dependant
- ▶ Scooters or other walking aids used in substitution for a wheelchair
- ▶ Specially trained animals that assist individuals who are deaf, blind or suffer from certain illnesses
- ▶ Diapers
- ▶ Orthopedic shoes
- ▶ Design of an individualized therapy plan where the individual qualifies for the DTC and other criteria are met
- ▶ Wheelchair
- ▶ Batteries for hearing aids

A list of authorized medical practitioners by province or territory for purposes of claiming **medical expenses** is posted on the [CRA's website](#).

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A group of hikers in a snowy mountain landscape. In the foreground, a woman with grey hair, wearing a dark brown jacket, a backpack, and sunglasses on her head, is hiking with poles. Behind her, two other hikers are visible, one in a green jacket and another in a dark jacket. The background shows a snowy, rocky mountain slope.

11 Retirement planning

Whether you're just starting your career or have years of service under your belt, you need to plan for retirement. And tax planning should be at the centre of your retirement strategy.

Registered pension plans

There are two types of registered pension plan (RPP):

- ▶ Defined benefit plans are based on a formula that includes employment earnings and years of service.
- ▶ Money purchase plans depend on the amount you contribute and the earnings on those contributions.

For a defined benefit plan, you can generally deduct all contributions you make for eligible service after 1989. You can also deduct up to \$3,500 (\$5,500 for Quebec tax purposes) in respect of past service contributions for a year before 1990 in which you were not contributing to any RPP. If you make past service contributions in respect of a year before 1990 in which you contributed to an RPP, the deduction limit is \$3,500 reduced by the amount of contributions for current or past service made in the year.

For a money purchase plan, the 2019 combined contribution that both you and your employer can make is the lesser of 18% of your 2019 compensation and \$27,230. The dollar limit is indexed for inflation. You can't make past-service contributions to this type of RPP.

Your employer will report a "pension adjustment" to the CRA, which will factor into your following year's RRSP deduction limit. In the case of a defined benefit RPP, the pension adjustment is an estimate of the cost of funding your retirement benefits. The pension adjustment for a money purchase RPP is the sum of your contributions and those of your employer.

Individual pension plans

An individual pension plan (IPP) is a defined benefit RPP established by an employer to provide retirement income to one or more employees on the basis of their years of service.

An IPP is most commonly established for one employee – typically a high-income earner such as an owner-manager, an incorporated professional or a senior executive. However, an IPP may also be established for more than one employee, provided that it meets the definition in the *Income Tax Act*. A plan is generally considered to be an IPP when it has fewer than four members and at least one of them is related to a participating employer in the plan.

An IPP is sponsored by the employer and funded by employer contributions or by employer and employee contributions. Funding amounts (or contributions) are calculated by an actuary to fund the expected retirement benefits and are based on factors such as the employee's age, employment income, post-1991 RRSP contributions, and actuarial assumptions (such as interest rates, inflation rates, and life expectancy). Contributions are only permitted in respect of service that is considered pensionable.

An initial lump-sum past-service contribution is permitted for the employee's years of service going back to 1991. An actuarial report is required to support the employer's initial contribution to the plan. For subsequent contributions, a periodic evaluation by an actuary is required. The 2019 budget proposed significant restrictions on the types of past service that could be considered as pensionable under the IPP. These proposals have not yet been implemented but are intended to apply to pensionable service credited under an IPP on or after 19 March 2019.

The cost of past service contributions to an IPP must first be satisfied by transfers from the RRSP assets of the IPP member, or a reduction in the IPP member's accumulated RRSP contribution room, before any new past service contributions can be made.

The IPP's key advantage is that it has more room for tax-deductible contributions than an RRSP for those over age 40. You can therefore accumulate more retirement income in an IPP. The large tax-deductible contributions often stem from significant initial contributions used to fund past service. However, the RRSP contributions made in those prior years reduce the deductible past-service amount.

Once a plan member reaches the age of 72, they will be required to withdraw annual minimum amounts similar to current minimum withdrawal requirements applicable to registered retirement income funds (RRIFs).

The IPP rules are complex. Consult your EY Tax advisor.

Pooled registered pension plans

Pooled registered pension plans (PRPPs) are intended to operate in a manner similar to multi-employer money-purchase RPPs, but with certain features drawn from the RRSP and RRIF systems. PRPPs are intended to provide a new option for retirement savings that will be attractive to smaller employers and self-employed individuals.

A PRPP enables its members to benefit from lower administration costs that result from participating in a large, pooled pension plan. It's also portable, so it moves with its members from job to job. The total amount that a member or employer can contribute depends on the member's RRSP deduction limit. The investment options within a PRPP are similar to those for other RPPs.

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Currently, PRPPs are available to individuals who are:

- ▶ Employed or self-employed in the Northwest Territories, Nunavut or Yukon
- ▶ Work in a federally regulated business or industry for an employer who chooses to participate in a PRPP
- ▶ Live in a province that has the required provincial standards legislation in place

An individual can be enrolled into a PRPP by:

- ▶ Their employer (if their employer chooses to participate in a PRPP)
- ▶ A PRPP administrator (such as a bank or insurance company)

Registered retirement savings plans

An RRSP is an investment account that can increase your retirement savings in two ways:

- ▶ Contributions are tax deductible, subject to statutory limits.
- ▶ The income you earn in your RRSP is not taxed until you withdraw the funds. The investment of the funds that would otherwise be paid as taxes results in your funds accumulating faster in an RRSP than they would outside one.

The tax advantage will be even greater if you purchase an annuity with accumulated RRSP funds or convert the RRSP to a RRIF on or before your RRSP matures. On maturity, the funds must be withdrawn, transferred to a RRIF, or used to purchase an annuity. For more information, refer to section **Maturity options** below.

If you select the option of an annuity purchase or a transfer to an RRIF, you will continue to defer tax on the accumulated funds until you actually receive the payments, at which time the gross withdrawal amount will be included in your income. In addition, you may benefit if your marginal tax rate decreases during retirement.

Timing for contributions

You may deduct RRSP contributions made before the end of the year (to the extent that they weren't deducted for a previous year) or up to 60 days after the end of the year. This deduction is subject to your yearly deduction limit.

Generally, it is advantageous to make your RRSP contribution in early January of the year, instead of late in February of the following year. That way, you can defer the tax on the income you earned on your funds during that 14-month period. Also, to take maximum advantage of the tax sheltering available through an RRSP, you should make contributions regularly each year and early in your career.

Deduction limit

Your RRSP deduction limit will determine the maximum tax-deductible contributions that you may make in a year. The limit applies to contributions made to either your own or a spousal RRSP. If you make a contribution to your spouse's or common-law partner's RRSP, it does not affect your spouse's or common-law partner's RRSP deduction limit for the year.

Tax tips

- ▶ The deadline for making deductible 2019 RRSP contributions is 2 March 2020.
- ▶ Make contributions early in your career and contribute as much as you can each year.
- ▶ Consider making your annual RRSP contribution as soon as you can each year to take maximum advantage of income tax sheltering.
- ▶ If you're an employee, ask your employer to withhold some of your salary or bonus and deposit it directly to your RRSP. If you demonstrate that you have sufficient RRSP deduction room, your employer is permitted to make the direct transfer without applying withholding taxes on the amount transferred.
- ▶ Consider paying RRSP administration fees outside the plan to maximize the capital in the plan for future growth for 2019. In November 2016, the CRA announced that it now considers that an increase in the value of a plan resulting from paying management fees outside the plan results in an advantage that may be subject to a tax at 100% of the fees. The CRA originally announced its intention to defer application of this position until 1 January 2018. The implementation date was then extended to 1 January 2019. However, CRA technical interpretation 2018-0779261E5 dated 28 September 2018 states that the implementation of its new position is deferred pending completion of a review of the issue by the Department of Finance Canada. For more information, see **What's new?** below.

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If you're not a member of an RPP or a deferred profit sharing plan (DPSP), your deductible 2019 RRSP contribution is limited to the lesser of 18% of your earned income for 2018 and a maximum of \$26,500. The dollar limit is indexed for inflation.

In addition to this amount, you would include your unused RRSP deduction room from 2018 (refer to the following section for a description of this amount).

If you're a member of an RPP or DPSP, the maximum annual RRSP contribution as calculated above is reduced by the pension adjustment for the prior year and any past-service pension adjustment for the current year. In addition, there may be an increase or decrease to your RRSP deduction limit if your company revises your benefits entitlement from the company pension plan.

If you do not contribute the maximum allowable amount in a particular year, you may carry forward the excess. Calculating your maximum RRSP contribution can be complex. As a result, the CRA provides the computation of your RRSP deduction limit on the Notice of Assessment for your income tax return.

Tax tips

- ▶ Contribute the maximum deductible amount to your RRSP. If this is not possible, plan to make up for the under contribution as soon as possible.
- ▶ Consider making a contribution of qualified property to your RRSP. Be aware, however, that any capital gain on the property transferred will be recognized for tax purposes, but a capital loss will be denied.

Unused deduction room

Generally, if you contribute less than your RRSP deduction limit, you can carry forward the excess until the year you reach age 71. For example, if your current-year RRSP deduction limit is \$10,000, but you make a contribution of only \$7,000, you can make an additional deductible RRSP contribution of \$3,000 in a future year. But if you make up the contribution in a later year, remember that you'll postpone the benefit of tax-free compounding of income that you would have earned from a current contribution and on any future income earned on this amount.

Carryforward of undeducted contributions

In addition to the carryforward of unused RRSP deduction room, you can carry forward undeducted RRSP contributions.

For example, if you make an RRSP contribution in 2019, but do not claim the full amount on your 2019 tax return, you can carry forward the unclaimed amount indefinitely and claim it as a deduction in a future year. It may be beneficial to delay deduction of your RRSP contribution if your 2019 taxable income is low and you expect to be subject to a higher marginal tax rate in a future year.

Be aware that making a contribution over the limit may result in penalties.

Tax tip

- ▶ If your taxable income for 2019 is low, consider carrying forward your deductible 2019 RRSP contribution and claiming a deduction in a future year when you'll be subject to a higher marginal tax rate.

Determination of earned income

Your earned income for the immediately preceding year is an important factor in determining your RRSP deduction limit for the current year. For example, your 2018 earned income is one of the factors in the calculation of your 2019 deduction limit.

If you were a resident of Canada throughout 2018, your earned income is generally calculated as follows:

- ▶ Additions to earned income
 - Net remuneration from an office or employment, generally including all taxable benefits, less all employment-related deductions other than any deduction for RPP contributions
 - Income from carrying on a business, either alone or as an active partner
 - Net rental income
 - Alimony and maintenance receipts included in your income
- ▶ Deductions from earned income
 - Losses from carrying on a business, either alone or as an active partner
 - Net rental losses
 - Deductible alimony and maintenance payments

Your earned income does not include superannuation or pension benefits, including Canada Pension Plan/Quebec Pension Plan (CPP/QPP) and Old Age Security (OAS) benefits, or retiring allowances.

If you became a resident of Canada in 2019 and did not earn Canadian income in 2018, you will not be able to make a deductible contribution to your RRSP for 2019, unless you have unused RRSP deduction room carried forward from a previous year.

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Tax tips

- ▶ In order to make the maximum RRSP contribution in 2019, your earned income for 2018 must have been at least \$147,222.
- ▶ Consider the impact that alimony or maintenance payments and business or rental losses have on your RRSP deduction limit.
- ▶ In limited circumstances, you may be eligible to make deductible contributions to your RRSP in addition to your RRSP deductible limit. The more common deductible contributions are retiring allowances and certain transfers from foreign pension plans.
- ▶ If you will receive a retiring allowance, consider making direct, as opposed to indirect, transfers of retiring allowances to an RRSP (up to the eligible amount) to avoid withholding tax.

Overcontributions

If you contribute an amount above your RRSP deduction limit for the year, it will result in an overcontribution. If the total RRSP overcontributions exceed \$2,000, on a cumulative basis, the excess is subject to a 1% per month penalty tax.

Under certain circumstances, making an RRSP overcontribution of \$2,000 could be advantageous because you can earn tax-deferred income on it. Although you cannot deduct the overcontribution in the year you make it, you may deduct it in a future year under the carryforward provisions. However, double taxation may result if you are unable to claim a deduction for the overcontribution in a future year.

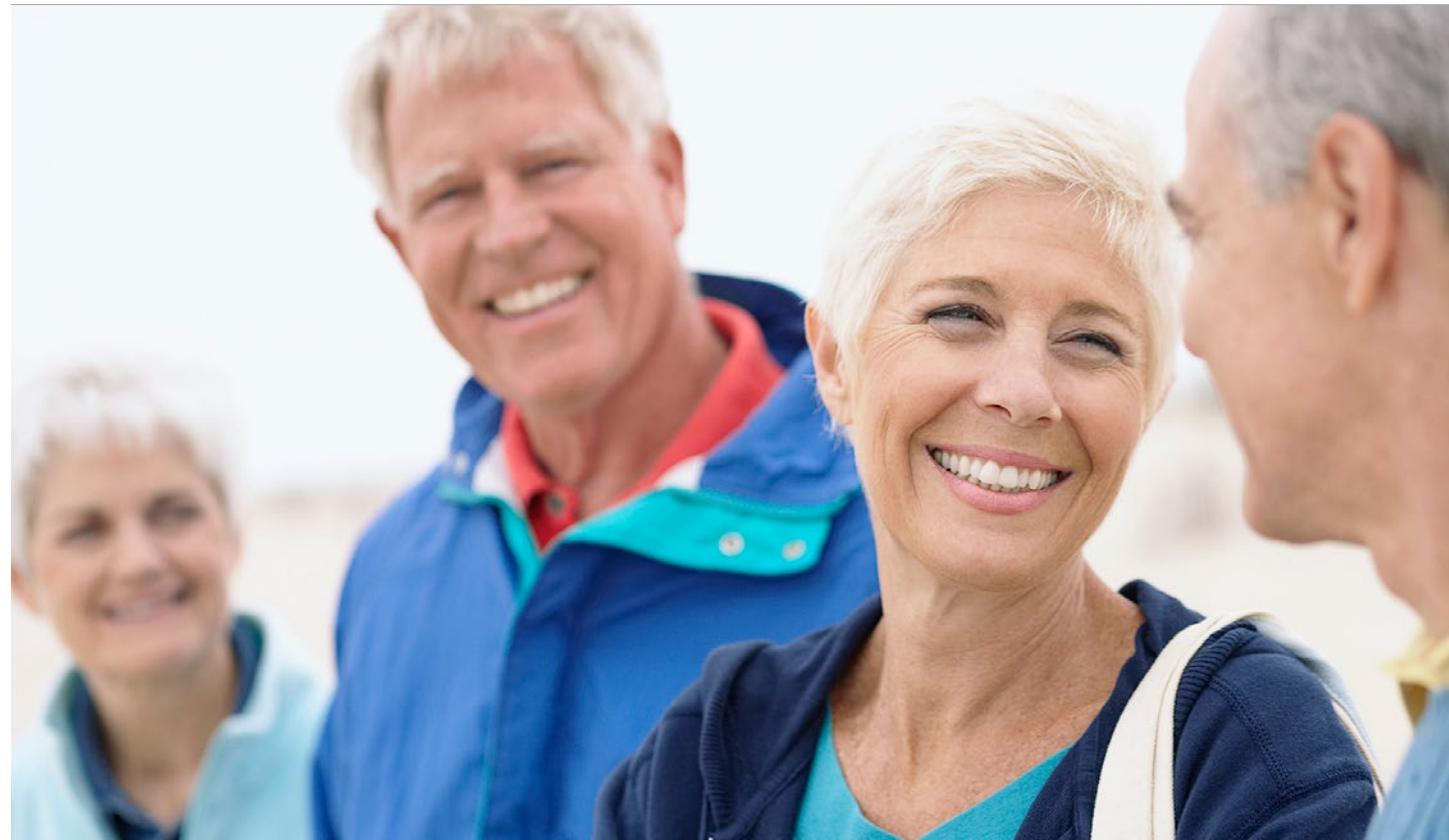
If you make contributions to your own or a spousal RRSP in excess of your deductible amount, you may withdraw them tax free only in the same year in which they were contributed, the year an assessment is issued for the year of contribution, or the year following either of these years. Also, there must be reasonable grounds to believe that the amount was deductible at the time you made the contribution. You must complete Form T3012A, *Tax Deduction Waiver on the Refund of your Unused RRSP, PRPP, or SPP Contributions from your RRSP*, to have the CRA authorize your RRSP issuer to refund the excess contribution without withholding tax.

If you have to pay the 1% per month penalty tax, you must file Form T1-OVP, *2017 Individual Tax Return for RRSP, SPP and PRPP Excess Contributions*, with the CRA and

pay the tax within 90 days after the end of the calendar year. Failure to file the T1-OVP return and pay the penalty tax before the 90-day deadline may result in interest and penalties.

Tax tips

- ▶ Be sure to transfer lump-sum amounts out of an RPP or a DPSP directly to an RRSP.
- ▶ Limit your RRSP overcontributions to \$2,000.
- ▶ If you've made an overcontribution and are about to retire, reduce your current-year contribution to avoid double taxation on any undeducted contributions.



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Qualified investments

It's important that your RRSP holds qualified investments only. If it acquires a non-qualified investment, a penalty tax equal to 50% of the value of the non-qualified investment may apply.

Qualified investments generally include the following:

- ▶ Cash
- ▶ Term deposits
- ▶ GICs
- ▶ T-bills
- ▶ Any security (other than a futures contract or certain other derivative instruments) listed on Canadian stock exchanges and most foreign stock exchanges
- ▶ Most government bonds
- ▶ Most Canadian mutual funds and segregated funds
- ▶ Options for the purchase of eligible investments
- ▶ Shares of certain private corporations in limited circumstances

For more information on what constitutes a qualified investment, refer to Income Tax Folio S3-F10-C1: *Qualified Investments - RRSPs, RESPs, RRIFs, RDSPs and TFSAs* (available on the CRA's website).

Prohibited investments

It's also important that your RRSP does not hold any prohibited investments.

A prohibited investment is generally one to which the annuitant is closely connected – for example, a share of a corporation in which the annuitant (or a non-arm's-length person) has a significant interest (generally 10% or more). An investment may be qualified, but still be considered prohibited.

If your RRSP acquires a prohibited investment, it will attract a 50% penalty tax similar to the non-qualified investment penalty tax. The penalty tax applies to prohibited investments acquired after 22 March 2011, and to those acquired before 23 March 2011 that first became prohibited after 4 October 2011.

For more information on the prohibited investment rules, refer to Income Tax Folio S3-F10-C2: *Prohibited Investments - RRSPs, RRIFs and TFSAs* (available on the CRA's website).

What's new?

In November 2016, the CRA announced a change to its administrative position regarding the payment of RRSP investment management fees by plan holders. In particular, the CRA will now consider an increase in the value of an RRSP resulting from investment management fees being paid outside the plan by the plan holder to be an advantage. As a result, the plan holder may be subject to the 100% tax on the amount of the investment management fees paid on behalf of the RRSP.

The CRA initially indicated that this change in administrative position would be effective for 2018 and later years. However, in a technical interpretation dated 15 September 2017, the CRA announced the deferral of the implementation date for applying these rules to 1 January 2019. Refer to EY's [Tax Alert 2017 Issue No. 45](#) for details. Accordingly, investment management fees reasonably attributable to 2018 and earlier years may be paid by either the registered plan or the plan holder without triggering the advantage tax.

The CRA also said that it would release a new Income Tax Folio by the end of summer 2017 dealing with this matter.

On 1 October 2018, the CRA released IT Folio S3-F10-C3: *Advantages - RRSPs, RESPs, RRIFs, RDSPs, and TFSAs*. Paragraph 3.35 of the Folio states that the CRA would provide "comments on the tax treatment of fees and expenses incurred in connection with a registered plan and its investments" in a future update. CRA technical interpretation 2018-0779261E5 dated 28 September 2018 states that the implementation of its position is deferred pending completion of a review of the issue by the Department of Finance Canada.

On 24 April 2019, the CRA released an update to the Folio. This update did not include the anticipated comments on the tax treatment of investment fees.

On 30 September 2019, the Department of Finance released a comfort letter, dated 26 August 2019, recommending changes to the *Income Tax Act* (the Act) that would exclude investment management fees incurred by a registered plan, but paid outside the plan by the annuitant, holder or subscriber of the plan, from the application of the advantage tax rules in Part XI.01 of the Act.

The recommended changes will need to be put forward as a proposed amendment by the minister of finance, and proceed through the normal legislative process for enacting tax legislation.

However, we expect that the CRA will administratively adopt this position prior to the enactment of the actual legislative changes, and that they will update their guidance on this issue in Income Tax Folio S3-F10-C3: *Advantages - RRSPs, RESPs, RRIFs, RDSPs and TFSAs*, in the near future.

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Advantage tax

Owning a prohibited investment may also result in a separate “advantage” tax. This tax is equal to 100% of certain advantages.

An advantage is generally a benefit that depends on the existence of the plan, and includes income and capital gains attributable to prohibited investments, as well as benefits from certain transactions that are intended to exploit the tax attributes of an RRSP or RRIF. Examples include benefits attributable to swap transactions, RRSP strips and deliberate overcontributions.

For more information on these rules, including how they apply to other registered plans, see [Chapter 5: Investors](#).

Tax payable on non-qualified or prohibited investments and advantages

If you owe tax as a result of any of the above penalty measures for non-qualified or prohibited investments and advantages, you must file Form RC339, *Individual Return for Certain Taxes for RRSPs and RRIFs*, and pay the tax owing no later than 30 June of the following year (e.g., 30 June 2019 for the 2018 taxation year).

If the prohibited or non-qualified investment is removed before the end of the calendar year following the acquisition year, you may be entitled to a refund of the penalty tax.

In addition, the CRA may waive all or a portion of the 50% tax on prohibited or non-qualified investments and the 100% advantage tax in certain circumstances if it considers it just and equitable to do so. Whether granting a waiver is just and equitable will depend on such factors as whether the tax arose as a consequence of a reasonable error, whether the transaction resulted in tax under another part of the *Income Tax Act*, and the extent to which amounts giving rise to the tax have been withdrawn from the plan.

Transferring between plans

You may transfer RRSP funds from one RRSP to another without attracting tax, provided the funds go directly to the new plan and are not available for you to use. You may choose this as an option when you’d like to change the types of investment in your portfolio or to change from one plan issuer to another. Remember that while you can transfer property between two RRSPs, if you transfer property between different types of plan (i.e., between an RRSP and a TFSA or other non-registered savings account), it will generally be considered a swap transaction, which may be subject to the advantage tax.

Withdrawing funds before retirement

You may make withdrawals from your RRSP at any time. However, you must include the gross withdrawal amount in your income. The trustee of the RRSP must withhold tax from the amount you withdraw.

Maturity

If you’re 71 years old at the end of 2019, your RRSP must mature by the end of the calendar year. You must make any final-year contributions on or before 31 December 2019, not 60 days after the end of the year.

Depending on your tax position, and provided you have sufficient earned income to make contributions, you may continue contributing to a spousal RRSP until the year your spouse or partner turns 71.

Tax tips

- ▶ Make any transfer between RRSPs directly from one plan issuer to another. Otherwise, the funds will be taxed on withdrawal and may not be returned to your RRSP without using contribution room.
- ▶ You may incur financial penalties if you transfer RRSP funds when the underlying investments have a fixed term, or if the issuer charges a fee for the transfer.
- ▶ If you withdraw funds from an RRSP, minimize the withholding tax by withdrawing \$5,000 or less per withdrawal. Remember, you’ll still be taxed on the gross amount of the withdrawal at your marginal tax rate, regardless of the amount of tax withheld, so you may have a balance of tax to pay as well as a future instalment obligation as a result.
- ▶ Remember that if you withdraw funds from an RRSP, you’ll lose tax-free compounding for the future. Instead, consider borrowing funds if your cash needs are temporary.
- ▶ Monitor your RRSP investments to ensure they do not become prohibited, and be aware of transactions with your RRSP (other than contributions or withdrawals) that may result in advantages.

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Maturity options

Although your RRSP must mature by the end of the year in which you reach age 71, you don't have to wait until then to obtain retirement income from your plan. This allows you to take an early retirement and may entitle you to the non-refundable pension income tax credit.

You can withdraw the accumulated funds from your RRSP or, alternatively, you can select one or a combination of available maturity options. These options provide you with retirement income in varying amounts over different periods of time. Tax is deferred until you actually receive your retirement income.

When you're deciding what maturity options would best suit your situation, you need to take into account a number of factors. In addition, consider whether the maturity options you choose will give you flexibility to change your mind should your situation change. In many cases, there is an opportunity to change from one maturity option to another if you properly structure your retirement options.

Maturity options currently available:

- ▶ Fixed-term annuities
 - Provide benefits up to age 90; if, however, your spouse or partner is younger than you, you can elect to have the benefits provided until your spouse or partner turns 90
 - May provide fixed or fluctuating income
- ▶ Life annuities
 - Provide benefits during your life or during the lives of you and your spouse or partner
 - May have a guaranteed payout option
 - May provide fixed or fluctuating income
- ▶ RRIFs
 - Essentially a continuation of your RRSP, except that you must withdraw a minimum amount each year (but there are no maximum limits)

- Provide retirement income from the investment of the funds accumulated in a matured RRSP

- If you only withdraw the minimum amount each year, your financial institution is not required to withhold tax

What's new?

The 2019 federal budget introduced two new types of annuities for certain registered plans for 2020 and subsequent taxation years, including advanced life deferred annuities (ALDAs) and variable payment life annuities (VPLAs). The budget materials outlined some of the features of these two vehicles. On 30 July 2019, the Department of Finance released for public comment draft legislation (and accompanying explanatory notes) to implement measures remaining from the 2019-20 budget, including measures concerning ALDAs and VPLAs.

ALDAs

The tax rules will be amended to permit an ALDA to be a qualifying annuity purchase under an RRSP, RRIF, DPSP, PRPP and a defined contribution RPP, as well as a qualified investment for a trust governed by an RRSP or RRIF. An ALDA will be a life annuity, the commencement of which may be deferred until the end of the year in which the annuitant turns 85. The value of an ALDA will not be included in calculating the minimum amount required to be withdrawn in a year from a RRIF, PRPP or a defined contribution RPP after the year in which the ALDA is purchased.

Individuals will be subject to both a lifetime ALDA limit in relation to a particular qualifying plan equal to 25% of the sum of the value of all property (other than most annuities) held in the qualifying plan at the end of the previous year, and any amounts from the qualifying plan used to purchase ALDAs in previous years. In addition, an individual will also be subject to a comprehensive lifetime ALDA dollar limit of \$150,000 for all qualifying plans (indexed to inflation for taxation years after 2020, rounded to the nearest \$10,000). Individuals who exceed their ALDA limit will be subject to a 1% per-month penalty tax on the excess; however, in certain circumstances this tax may be waived or cancelled.

VPLAs

Currently, the tax rules require that retirement benefits from a PRPP or defined contribution RPP be provided to a plan member by means of a transfer of funds from the member's account to an RRSP or RRIF of the member. Budget 2019 proposes to amend the tax rules to permit PRPPs and defined contribution RPPs to provide a VPLA to members directly from the plan. A VPLA will provide payments that vary based on the investment performance of the underlying annuities fund and on the mortality experience of VPLA annuitants.

Refer to EY [Tax Alerts 2019 Issue No. 9](#) and [2019 Issue No. 30](#) for more information.

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Locked-in plans

Under federal and most provincial pension legislation, the proceeds of locked-in RRSPs or locked-in retirement accounts (LIRAs) must generally be used to purchase a life annuity at retirement or be converted to a life income fund (LIF), a locked-in retirement income fund (LRIF) or a prescribed retirement income fund. Because these proceeds originate from a pension plan that is intended to provide retirement income for your life, you generally cannot use them to acquire a term annuity.

LIFs, LRIFs and PRIFs are all forms of RRIF, so there's a minimum annual withdrawal. However, there are also maximum annual withdrawals for LIFs and LRIFs, and in some provinces LIFs must be converted to life annuities by the time you turn 80.

Tax-deferred transfers are generally permitted between all of these plans, so you might transfer assets from a LIF back to a LIRA (if you're under age 71) if you change your mind about receiving an early pension. Another option is to transfer funds from a LIF to a LRIF to avoid annuitization when you turn 80.

Tax tips

- ▶ If you're going to be 71 at the end of 2018, make your annual RRSP contribution before 31 December.
- ▶ If you are over 71 and your spouse or partner is younger than you – and you have earned income or RRSP deduction room – consider making contributions to your spouse's or partner's RRSP until they turn 71.
- ▶ If you expect to have sufficient earned income after age 71, consider making the \$2,000 overcontribution before the end of the year that you reach age 71 and claim this deduction in later years.
- ▶ If you have sufficient earned income in the year you turn 71, consider making a contribution for the next year (in addition to one for the current year) just before the year end. Although you must collapse your RRSP before the end of the year in which you turn 71, you're still able to deduct excess RRSP contributions in later years. You will be subject to a 1% penalty tax for each month of the overcontribution (one month if the overcontribution is made in December of the year you turn 71), but this may be more than offset by the tax savings from the contribution.
- ▶ Investigate and arrange for one or more of the maturity options that are available if your RRSP is maturing in the near future.
- ▶ Where the minimum RRIF amount is withdrawn in a year, no tax is required to be withheld at source. Consider the effect of this on your income tax instalment planning.
- ▶ Consider receiving RRIF payments once a year in December to maximize the income earned in the plan.
- ▶ Give careful consideration with respect to designating the beneficiary of your RRSP or RRIF. Consider whether the named beneficiary qualifies to receive the funds on a tax-deferred basis. If not, be aware that the underlying tax liability will be the responsibility of the estate.⁵⁰

⁵⁰ The full value of RRSP and RRIF funds is included in income for the year of death. However, where such funds are received by a surviving spouse or common-law partner, or a financially dependent child, the funds can instead be included in the recipient's income. A surviving spouse or common-law partner, or a disabled child, can further defer taxation by transferring the funds to their RRSP or RRIF. In addition, these funds may be transferred to a disabled child's registered disability savings plan, within the limits for contributions to such plans. See [Chapter 9: Families](#).

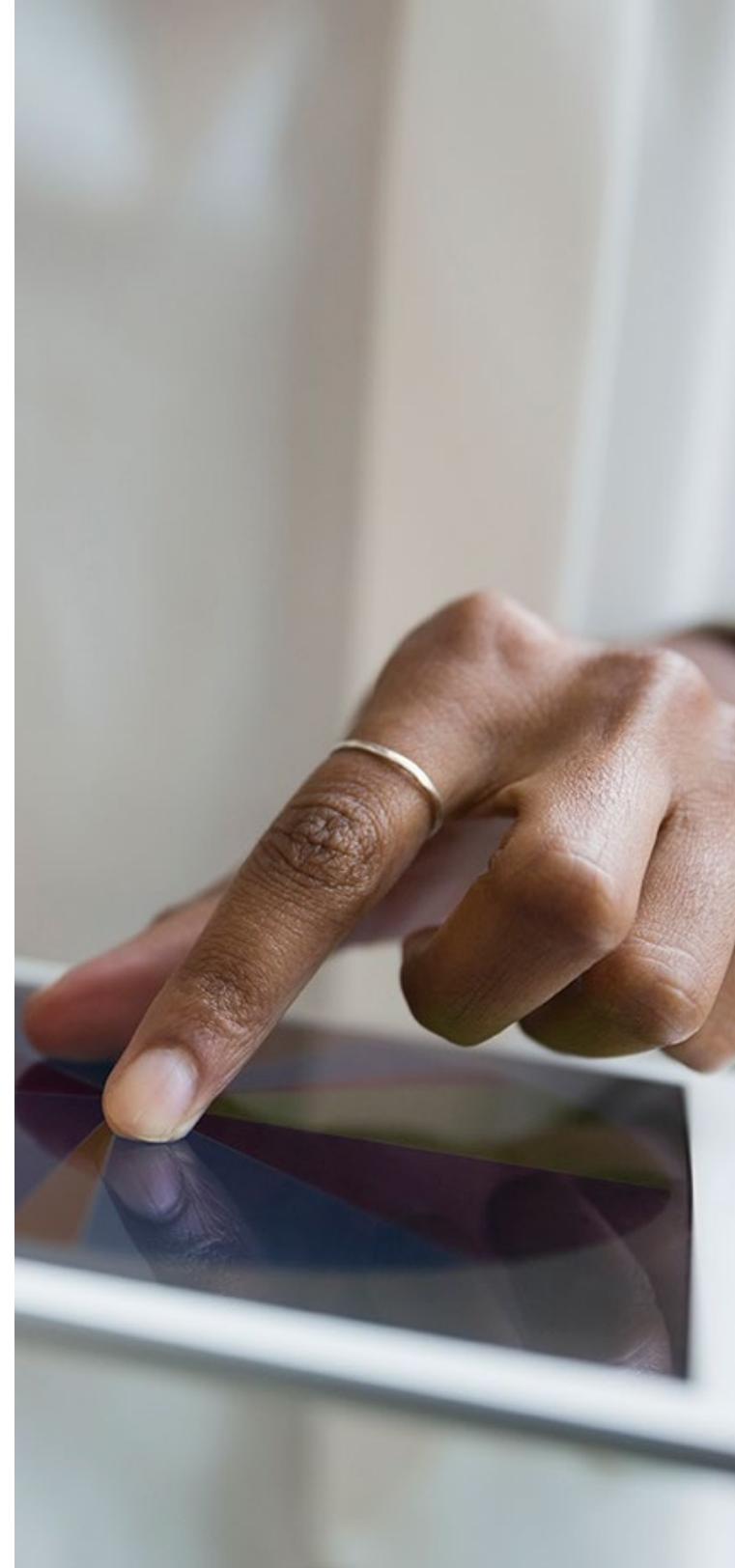
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Canada Pension Plan

In June 2016, Canada's finance ministers announced plans to strengthen the CPP for future generations by gradually increasing both contributions and benefits under the CPP. Among their proposals, which began to take effect in 2019, is a measure to provide a tax deduction – instead of a tax credit – for employee contributions associated with the enhanced portion of the CPP. The tax credit will continue to apply to the base employee CPP contributions, while the enhanced portion of the employee CPP contributions will be eligible for a tax deduction.

The CPP is an earnings-related social insurance program that provides basic benefits when a contributor to the plan retires or becomes disabled. When contributors die, the CPP may provide benefits to their survivors. The CPP operates in every province in Canada except Quebec, which administers its own program, called the QPP.

With very few exceptions, every person in Canada who is over the age of 18 who works and earns more than the minimum amount (\$3,500 per year) must contribute to the CPP (or to the QPP in Quebec). You and your employer each pay half of the contributions. If you are self-employed, you pay both portions.

Although employers used to stop deducting CPP when an employee aged 60 to 70 began receiving a CPP or QPP retirement pension, this rule has changed. As of 1 January 2012, employers must continue to deduct CPP from the earnings of an employee who receives a CPP or QPP retirement pension if that employee is 60 to 65 years old, or is 65 to 70 years old and has not filed an election to stop paying CPP contributions.

Tax tips

- ▶ Delaying receipt of your CPP pension past age 65 will enhance your monthly benefit. If you start receiving your CPP pension at the age of 70, your pension amount will be 42% more than it would have been if you had taken it at 65.
- ▶ Conversely, starting your CPP pension before age 65 will reduce your monthly benefit. If you start receiving your CPP pension at the age of 60, your pension amount will be 36% less than if you wait until you're 65.
- ▶ Individuals aged 65 to 70 are required to pay CPP premiums on their employment or self-employment earnings, but may elect out. In order to elect out, you must complete an election, Form CPT 30, file the original with the CRA and provide copies to each employer. The election is effective the month following the month of filing with the CRA. You can revoke this election to opt out and resume contributing to CPP.
- ▶ Individuals contributing to CPP while collecting benefits will receive a "post-retirement benefit," which will be effective the calendar year following the premium payment, so their CPP benefits will increase each year they continue their CPP contributions.

Old Age Security

The OAS pension is a monthly payment available to most Canadians aged 65 and older. In order to receive benefits, you may need to apply for OAS with Service Canada. You should apply six months before you turn 65. However, if you apply at a later date, the pension is payable up to 11 months retroactively from the date the application is received.

Canadians may voluntarily defer receipt of OAS benefits for up to five years. Those who take this option will receive a higher, actuarially adjusted pension, up to a maximum increase of 36% at age 70.

You can download an application package from Service Canada's website or you can order an application by mail.

Two other programs can provide you with additional income. The Guaranteed Income Supplement (GIS) and the Allowance program were designed to provide further assistance to low-income seniors. For more information, see the Service Canada website.

Financing retirement – additional options

Retiring allowance

A retiring allowance includes severance payments or an amount paid by your employer on your retirement in recognition of long service or for a loss of office or employment.

If you receive a retiring allowance, you may be able to transfer a limited amount into an RRSP in addition to your RRSP deduction limit. Any excess would be taxable in the year received at the applicable marginal tax rate.

Retirement compensation arrangement

A retirement compensation arrangement (RCA) is any arrangement where your employer makes contributions to a custodian in connection with benefits you receive on, after or in contemplation of any substantial change in your services to the employer. This includes your retirement and the loss of office or employment.

In general, contributions to an RCA, and any income and capital gains earned in the plan, are subject to a 50% refundable tax. Your employer would withhold and remit the tax at the time of funding. This tax is refundable at a rate of \$1 for every \$2 distributed to you.

Distributions from the plan are taxed as ordinary income. You are limited in the amounts you can transfer from an RCA to an RRSP if paid as a retiring allowance.

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Tax tips

- ▶ If you fall into a lower marginal tax bracket after retirement, receiving payment of a retiring allowance over a number of years may permanently reduce the amount of tax you will pay on it.
- ▶ You may be permitted to make contributions to the RCA. Generally, your contributions to the RCA would be deductible in the year you make them if (1) the contributions are required by the terms of your employment and (2) are no greater than the employer's contributions to the RCA. If you fall into a lower marginal tax rate after retirement, current contributions to the RCA may be tax advantageous.
- ▶ RCAs have prohibited investment and advantage rules that are similar to those that apply to TFSAs, RRSPs and RRIFs.

International workers

If you spend part of your career working outside Canada, you may find that working for a foreign company or living outside Canada means changing pension plans and forfeiting regular RRSP contributions. Being able to continue participating in Canadian pension and RRSP plans while working overseas can therefore be a significant benefit.

Canada-US Tax Convention

In 2008, Canada and the US ratified changes to the *Canada-US Tax Convention* that provided this type of relief, starting in 2009, for Canadians who work in the US. The changes allow short-term cross-border assignees to continue to make contributions to their home country pension plans, such as an RPP, DPSP or a group RRSP, and receive a tax deduction in the host country.

For example, let's say you're a Canadian expatriate on a three-year assignment in the US working for a company affiliated with your Canadian employer. You may be able to continue contributing to your Canadian employer's pension plan, and will be able to claim a deduction on your US tax return for your contributions, provided that you:

- ▶ Were a member of the Canadian employer's pension plan before starting work in the US and the Canadian employer's pension plan qualifies as a "qualified retirement plan" under the *Canada-US Tax Convention*
- ▶ Were a nonresident of the US before starting your US assignment
- ▶ Are on the US assignment for no longer than five out of the preceding 10 years
- ▶ Deduct only contributions that are attributable to services performed in the US
- ▶ Do not participate in any other pension plans (i.e., you cannot also participate in a US 401(k) plan or an individual retirement account)

The rules are similar for US workers on short-term assignment in Canada.

Commuters

The changes to the *Canada-US Tax Convention* referred to above also provide relief to cross-border commuters who live in Canada and commute to work in the US, or vice versa. If you are a cross-border commuter working and contributing to a pension plan in one country, but you live in the other country, you will also benefit from a tax deduction.

For example, you live in Windsor, Ontario, and commute to Detroit daily to work for a US employer, USco. You participate in USco's 401(k) plan. As a Canadian resident, your employment income is taxable in Canada. You will be able to claim a deduction for your 401(k) contribution in determining your Canadian taxable income. The amount of the deduction will be limited by the amount of the actual contribution, the amount allowed to be contributed to a 401(k) under US law, and the RRSP contribution limit for the year (after taking into account RRSP contributions otherwise deducted).

Just like an RPP, participation in USco's 401(k) will limit your ability to contribute to an RRSP, since participation will give rise to a pension adjustment that reduces your RRSP room.

US citizens who are residents of Canada

The changes to the *Canada-US Tax Convention* also provide relief to US citizens living in Canada who contribute to a pension plan in Canada. A US citizen living in Canada and working for a Canadian employer will be allowed a deduction for US tax purposes for contributions to an RPP, DPSP or group RRSP. The relief is restricted to the lower of Canadian tax relief and the amount that would be deductible in the US for a generally similar US plan. The contributions must be in respect of services taxable in Canada, and remuneration for such services must be paid by a Canadian employer in relation to services rendered during the period of Canadian residence.

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Estate planning

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An effective estate plan can minimize tax on and after your death, and provide benefits to your surviving family members over the long term.

Estate planning involves much more than the preparation and periodic update of your will. It's a multifaceted, lifelong process requiring reflection and expansion as you reach milestones in your life and your career.

Questions for you and your partner

The following questions, which are best answered by both spouses/partners, can help you when planning for the future:

- ▶ Do you know what would happen if you lost the physical or mental capacity to manage your affairs? Are you comfortable that you have an adequate structure in place to help deal with such a potential loss? Have you factored the cost of long-term care into your retirement and estate planning?
- ▶ Could you describe what happens to your estate(s) when you or your spouse or partner dies – that is, to whom and in what form (individually or in trust) each major asset will pass?
- ▶ If assets do pass to one or more trusts for the survivor's benefit, do you understand how they work (e.g., income payments, access to principal)? Are you still comfortable with this structure?
- ▶ Would your survivor and/or children know what there is, where it is and how it should be handled, what decisions will have to be made and by when, and whom to call for help?

The time spent reviewing these questions could be a most worthwhile investment. You might find that you have a good handle on where you are and how your plans work. You might pleasantly discover that everything is in order and now it's just a matter of keeping up the good work.

Or you might not. In which case a visit with one or more of your EY advisors could make a lot of sense, and perhaps save you a lot of dollars.

What is an estate plan?

An estate plan is an arrangement of your financial affairs designed to accomplish several essential financial objectives, both during your lifetime and on your death. The plan should accomplish the following goals:

- ▶ Provide tax-efficient income during your lifetime, before and after retirement
- ▶ Provide tax-efficient dependant support after your death
- ▶ Provide tax-efficient transfer of your wealth
- ▶ Protect your assets

Stages of an estate plan

Your estate plan starts as soon as you begin to **accumulate assets** for your estate, not when you draft your will. To maximize this accumulation, ask yourself the following questions:

- ▶ Subject to the new income-splitting rules,⁵¹ are there any possible income-splitting opportunities among my family members?
- ▶ Does my existing corporate structure allow for a tax-efficient distribution of funds?
- ▶ Am I claiming all the deductions possible, or do I need to make some changes to be eligible for deductions?
- ▶ Is all my interest deductible for income tax purposes?

Once your income sources have been secured, your estate plan should deal with the **preservation** of your family's wealth. At this stage, the focus should include saving and investing your excess funds for retirement, dealing with income tax and family law matters, protecting the assets from creditors and growing the goodwill of any business that is a substantial family asset.

The next stage of the plan is the **realization** of your wealth, either through selling your business, determining your succession or executing your retirement strategies.

The final step is the **transfer** of your wealth. During your lifetime, this can be accomplished by way of sale or gift, but on death the distribution of your assets should be documented in your will. Since in most cases you cannot predict the timing of this ultimate transfer, you should plan well ahead and not wait until you are ready to transfer your wealth to draft a will.

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⁵¹ See **New rules limit income splitting after 2017** and **Trust income and capital gains and the revised TOSI rules** below for a discussion of these rules.



Your will should be an evolving document. Once drafted, it should be reviewed regularly and updated, if necessary, to ensure that it reflects your current intentions and provides your beneficiaries with maximum tax efficiency and asset protection.

Your initial estate plan will not last a lifetime, so be prepared to review it often and modify it to keep pace with any significant changing circumstances and laws.

Components and goals of an estate plan

The components of your estate plan could include:

- ▶ If a business is a key family asset, a **shareholders' agreement** will govern the activities of the current and future shareholders by addressing termination, sale, death, divorce and wealth extraction.

- ▶ An effective **share ownership structure** of any business with your involvement can provide for the tax-efficient distribution of excess assets and protect these assets from creditors. A share structure can also facilitate business succession planning or bequests without compromising the operating business. For example, inherited shares could have terms such that they can only be redeemed over an extended period of time.
- ▶ Various **trust arrangements** (spouse trust or family trust) can hold shares for the benefit of others while they are controlled by a trustee. These arrangements are the primary tools for income splitting and multiplication of the capital gains exemption among family members and between generations. However, the revised tax on split income rules (TOSI) (see **New rules limit income splitting after 2017** below) may limit income splitting as well as capital gain splitting opportunities after 2017. See **Trust income and capital gains and the revised TOSI rules** below.

- ▶ A properly drafted and regularly updated **will** is an essential component of any estate plan.
- ▶ **Insurance arrangements**, including life insurance, key person insurance, critical illness insurance and disability insurance, may help provide dependent support or appropriately fund tax liabilities on your death.

The various components of your estate plan must work together to achieve your desired goals. As a result, if one component changes, the others should be examined to ensure your intentions will still be met.

A good estate plan will achieve three tax-related goals:

- ▶ Tax reduction
- ▶ Tax deferral
- ▶ Tax funding

Specifically, the taxes you are attempting to reduce, defer and fund include income tax on your earnings, the disposition of assets during your lifetime, monies from retirement plans (RRSP/RRIF), income tax arising on the deemed disposition of all your assets on death and probate tax, if applicable.

Tax reduction

During your lifetime, it may be possible to income split by way of arranging your finances or share structure to channel income or capital gains to family members who are taxed at a lower marginal tax rate than you, thereby reducing the overall family tax burden. A family trust is generally recommended for any substantial income splitting and to limit your children's access to significant funds until they are responsible enough to deal with them by having the trustee retain control of the trust's assets. Remember to consider potential attribution and the revised TOSI rules when contemplating income splitting goals in your estate plan (for details, see **New rules limit income splitting after 2017** below, and **Estate freeze and income splitting after 2017** below).

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New rules limit income splitting after 2017

Amendments enacted in June 2018 limit income-splitting arrangements that use private corporations to benefit from the lower personal tax rates of certain family members age 18 or over who are direct or indirect shareholders of the corporation, or who are related family members of direct or indirect shareholders.

Effective for 2018 and later years, the new rules limit the ability to share income within a family by expanding the base of individuals subject to the TOSI to include children age 18 and over and other related adult individuals who are resident in Canada (including spouses or common-law partners, grandparents and grandchildren, but not aunts, uncles, nephews, nieces or cousins) who receive split income⁵² from a related (family) business either directly from a private corporation (such as by the receipt of dividends) or through a trust or partnership. The TOSI is equal to the highest federal personal marginal rate of tax (33% federal rate in 2019) and highest applicable provincial tax rate. A related business exists, for example, when a related person is active in the business on a regular basis or owns at least 10% of the fair market value of the shares in a corporation that carries on the business.

The types of income that are subject to the TOSI have also been expanded to include interest income earned on a debt obligation of a private corporation, partnership or trust (subject to some exceptions), and gains from the disposition of property if income from the property would otherwise be split income.

Income-splitting strategies that use trusts, including within the context of an estate freeze, may also be limited after 2017 as a result of these new rules. See **Estate freeze and income splitting after 2017**, and **Trust income and capital gains and the revised TOSI rules**.

Under these rules, income received or gains realized from a related business by certain adult family members are excluded from the TOSI if any one of a number of exceptions is met. Adults who are 25 or older who receive split income are subject to a reasonableness test if they do not meet any of the exceptions. The test is based on the extent of their contribution of labour and capital to the business, risks taken and other payments already received from the business. The TOSI will then apply to split income received to the extent it is unreasonable under this test.

For a detailed listing of the exceptions to the application of the TOSI and further details about these rules, see [Appendix E: The revised tax on split income rules](#), [TaxMatters@EY February 2018](#), [Revised draft legislation narrows application of income sprinkling proposals](#), and [EY Tax Alert 2017 Issue No. 52](#).

Trust income and capital gains and the revised TOSI rules

Trusts may continue to be relevant and used for the multiplication of the capital gains exemption among family members and between generations to minimize the amount of tax paid on capital gains. However, the revised TOSI rules (see above) apply to trust beneficiaries who receive split income (from a related business) that is allocated by the trust to them, including the allocation of taxable capital gains.

For example, assume that your spouse operates a business through a private corporation. The corporation's shares are owned by her and a family trust. The beneficiaries of the trust consist of you and your adult children. During 2019, the trust receives taxable dividends that are then allocated to you and your children. In 2020, the trust sells some of the shares of the corporation, realizing a taxable capital gain that is also allocated by the trust to you and your children. In this situation, the dividends allocated to you and your children are split income and, therefore, you and your children would be subject to the TOSI.⁵³ The taxable capital gains allocated to you and your children are also considered to be split income and, therefore, subject to the TOSI,⁵⁴ because any income earned on these shares and allocated to you and your children was (or would have been) also considered as split income.

The revised TOSI rules include a number of exceptions from the application of the TOSI. For example, taxable capital gains realized on the disposition of qualified small business corporation (QSBC) shares or qualified farm or fishing property are exempt from the TOSI, whether or not the lifetime capital gains exemption is claimed on the gain. This particular exception also applies to trust beneficiaries if these types of taxable capital gains are realized by a personal trust and are then allocated to the trust beneficiaries in the year of disposition. The recipient beneficiaries could then claim their lifetime capital gains exemption with respect to those gains (if all required conditions are met).

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⁵² Effectively, split income arises when a stream of income is connected, either directly or indirectly, to a related business. According to the CRA, split income does not include salary.

⁵³ Unless one of the exceptions to the TOSI applies.

⁵⁴ Unless one of the exceptions to the TOSI applies.



Minor-age related family members are also able to access this exception, whether the shares are held directly or indirectly via a personal trust. However, this exception does not apply to taxable capital gains that are allocated to a minor-age beneficiary on the disposition of shares of a private corporation to a non-arm's-length party. In this case, the full amount of the gain (double the taxable capital gain amount) is deemed to be included in the minor's split income, and is taxed as a non-eligible dividend.⁵⁵

For a detailed listing of the exceptions to the application of the TOSI and further details about these rules, see [Appendix E: The revised tax on split income rules, TaxMatters@EY February 2018, Revised draft legislation narrows application of income sprinkling proposals](#), and [EY Tax Alert 2017 Issue No. 52](#).

Estate freeze: The primary tool used to reduce tax on death is a properly structured estate freeze, which results in the transfer of the future growth of a business, investments or other assets to other family members who are generally of the next generation. Since you are generally deemed to dispose of all your capital assets at fair market value immediately before death, the estate freeze moves the potential future growth of the “frozen” assets to the next generation, reducing the potential capital gains tax on your death.

An estate freeze can be implemented in a number of different ways, the simplest of which is selling or gifting assets to the next generation. If there are accrued gains inherent in these assets, a current tax liability will result from their disposition or transfer at fair market value.

This strategy would only be suggested if you are prepared to completely relinquish control of the assets you have built up to the next generation and pay the associated taxes immediately. This is rarely, if ever, appropriate if your children are young, and is often undesirable even when your family is older. In addition, keep in mind that such a strategy results in taxation of any growth accumulated to the date of transfer, and would thus typically be considered only if the anticipated growth of the assets is so significant that the payment of the current tax is negligible by comparison. The advantage of this approach is that it's simple and carries limited implementation and maintenance costs. However, this advantage is typically outweighed by the substantial drawbacks of loss of control and immediate tax costs.

The most common technique used to implement an estate freeze requires you to transfer, usually on a tax-deferred basis, the appreciated assets to a corporation in exchange for fixed-value preferred shares (freeze shares) at their fair market values. The family members who are to benefit from the future growth would subscribe for nominal-value growth shares (new common shares) either directly personally or indirectly as a beneficiary using a family trust.

If the asset you wish to freeze is a corporation, the freeze may be effected by creating a new class of fixed-value freeze preferred shares and exchanging your common shares, on a tax-deferred basis, for new fixed-value freeze preferred shares of equal value. The original growth shares would be eliminated on this exchange, and the next generation or family trust would own the new growth common shares.

The new growth common shares held by the trust will be controlled by the trustee(s). The terms of the trust may give the trustee the power to determine which of the beneficiaries will be entitled to the growth (thereby providing a certain amount of flexibility to the estate freeze).

It's also possible for the person implementing the freeze to continue to control the company by subscribing for the majority of the voting-control shares and using a shareholders' agreement restricting the rights of the growth shareholders. Legal counsel should be consulted in this case, as it may be possible for this agreement to be entered into by the trustee and the individual who froze the company prior to the distribution of the growth shares held by the trust. As a result, the new common shareholders (the children) would be subject to the agreement without actually signing it.

What has been described here is a complete freeze. But it is also possible to implement a partial freeze and staged freezes (over time). In a partial freeze, you can participate in the company growth by subscribing for a portion of the growth shares, either directly as an individual shareholder or indirectly by being named as a beneficiary of the family trust.

If you're considering including a US citizen or resident in your freeze (for example, as a beneficiary of a trust), you should seek professional advice on both sides of the border.

There could be adverse US tax implications, and the Internal Revenue Service (IRS) has specific reporting rules and charges onerous penalties to taxpayers who do not adhere to the rules.

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⁵⁵ This treatment also applies if the minor-age individual owned the shares directly.



Estate freeze and income splitting after 2017

An estate freeze can be structured in numerous ways. In certain complete or partial estate freeze transactions, with proper implementation it was possible to income split with a lower-income spouse and/or adult children prior to 2018. However, under the revised TOSI rules (see **New rules limit income splitting after 2017** above), it may no longer be possible to do so, unless certain conditions or exceptions are met.

For example, an individual sets up an estate freeze in respect of an operating company that she has owned and managed for many years. Once the freeze is set up, she owns preferred freeze shares and a family trust owns the new common shares of the operating company. The individual's adult child (age 26) is a beneficiary of the trust. The adult child is a full-time post-graduate student who does not, and has never, contributed to the family business. The operating company is profitable in 2019 and pays substantial dividends to both the individual and the trust, which in turn distributes the dividends to the adult child (for income-splitting purposes). No changes are made to the structure or ownership of the operating company shares in 2019. Under the revised TOSI rules, the adult child would be subject to tax at the highest marginal personal income tax rate (the TOSI) on the income received from the trust because none of the available exceptions to the revised rules applies.⁵⁶ (For details on the list of available exceptions and other information about the revised TOSI rules, see [Appendix E: The revised tax on split income rules, TaxMatters@EY February 2018](#), [Revised draft legislation narrows application of income sprinkling proposals](#), and [EY Tax Alert 2017 Issue No. 52](#).)

It's important to evaluate the options that will best meet your non-tax objectives for the use and ultimate distribution of your wealth in the most tax-effective manner possible. Consult your EY Tax advisor.

When to implement a freeze

Determining the best time to implement your freeze is not easy. Many factors other than tax will and should play a part in the decision. For example, if you freeze too early while being young or freeze too many of your assets, inflation or other market factors might leave you with insufficient assets to fund your retirement lifestyle. If the value of the future growth appreciates faster than anticipated, and no flexibility is built into the estate plan, your young children's net worth could soon be greater than yours.

While the common estate freeze often includes the use of a family trust to hold the future growth, it's usually advisable to give the trustee the power to distribute the growth asset before the 21st anniversary of the trust's creation due to the 21-year deemed disposition rules as explained below. Therefore, you'll want to ensure that the beneficiaries will be old enough in 21 years to be charged with the responsibility for a significant-value asset.

You should consider a freeze only for assets that are expected to be held by the family over the long term. If your children are likely to dispose of their growth shares soon after your death, the freeze will not have accomplished the tax-deferral objective, as your children will pay the capital gains tax on the disposition. If your children are old enough, they should be aware of the estate plan and also be consulted early on their plans in relation to holding the freeze assets. This discussion is extremely important if a family business is involved.



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⁵⁶ The adult child does not own at least 10% of the voting shares of the operating company; the adult child is not and has never been actively engaged in the family business on a regular, continuous and substantial basis; and the amount received by the adult child from the trust does not represent a reasonable return as the adult child has not contributed any labour or capital or assumed any risks with respect to the business.



Tax deferral

During your lifetime: Tax on the future growth of assets transferred to a family trust can only be deferred by up to 21 years if the assets are to remain in the trust. This is because family trusts are deemed to dispose of all their assets at their fair market value every 21 years from their setup. Therefore, any accrued gains on property held by the trust will be taxed at the top marginal rate for capital gains if the asset has not been distributed to the beneficiaries at its 21st anniversary date and each subsequent 21st anniversary.

If the trust deed allows the trustees to distribute the assets to the beneficiaries prior to the 21st anniversary, it may be possible to roll out the assets at their adjusted cost base to defer the capital gains tax either until the beneficiary sells the assets or on his or her death. This rollout is not available to a beneficiary who is not a resident of Canada. It is important that the trust is set up properly to avoid the application of the reversionary trust rules that prohibit the tax-free rollout to certain beneficiaries.

There are some important non-tax benefits to the family trust structure. For example, assets held in a family trust will be protected from the creditors of the beneficiaries and should not form part of their family assets for family law purposes, even after distribution from the family trust.

Post mortem: Trusts have an important role in post-mortem estate planning. It is possible to defer the capital gain realized on the deemed disposition on death by transferring your assets to either your spouse or a qualifying testamentary spouse trust, which would be created on your death. In this case, the tax on the accrued capital gain will be deferred until the earlier of the sale of the assets or the death of your spouse. The rollover to a spouse trust will only apply if no one other than your spouse is entitled to all the income of the trust and your spouse is the only discretionary capital beneficiary during his or her lifetime.

A testamentary spousal trust also allows you to control entitlement of your assets after the death of your spouse. If the assets are instead transferred directly to your spouse, it's your spouse's will that directs the distribution of the family assets. Spousal trusts have commonly been used by individuals with more complex family situations (such as second marriages) to ensure that assets are available to a current spouse for their remaining life, and then passed to persons chosen by the deceased. They have also been used to ensure a surviving spouse's remarriage will not change the ultimate distribution of the deceased's assets. Spousal trusts (testamentary or inter vivos) can exist for the life of the spouse; assets are deemed disposed of on the spouse's death, rather than every 21 years.

For 2015 and prior years, testamentary trusts (which must be created by your will) were taxed as a separate taxpayer and were subject to the graduated personal tax rates. As a result, it was possible to income-split, by having some of the income taxed in the testamentary trust and some taxed in the beneficiary's hands. In some situations, it was possible to access these benefits more than once, through the use of multiple trusts. Since 1 January 2016, these tax benefits can no longer be achieved due to changes to the tax rules for trusts. See the next page for further details.

Testamentary trusts - 2016 and subsequent years

All testamentary trusts are subject to flat top-rate taxation, with two exceptions. The first exception is for an estate during the first 36 months after the death of the individual. Graduated tax rates apply to a single trust known as a "graduated rate estate" (GRE), provided certain conditions are met. Only one trust may be designated as a GRE in respect of any individual, thereby eliminating the benefit of creating and using multiple trusts after death. During the first 36 months of the GRE, it is imperative not to taint the trust (e.g., the trust receiving loans from beneficiaries), as it will result in the trust losing GRE status, having a deemed year end at that time and being subject to the top flat rate taxation.

Some of the benefits previously enjoyed by testamentary trusts are now only available to GREs. These include:

- ▶ Taxation of income earned and retained in the estate at graduated rates
- ▶ Availability of certain post-mortem relief provisions
- ▶ A \$40,000 exemption from alternative minimum tax
- ▶ Flexibility on who may claim the tax credit for charitable donations made by will
- ▶ Ability to maintain a non-calendar year end
- ▶ Exemption from tax instalment requirements

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A deemed year end occurred on 31 December 2015 for testamentary trusts that were not GREs and did not already have a calendar year end. Testamentary trusts that no longer qualify as GREs (either because they are tainted or because 36 months after the date of death have elapsed) have a deemed taxation year end on the day on which the estate ceases to be a GRE. The subsequent year end of such a trust is 31 December.

The capital gain realized (from the deemed disposition of assets held by the trust) on the death of the life interest beneficiary (surviving spouse or partner or the contributor of an alter ego trust) is reported and taxed in the trust. The trustee typically pays the tax liability using the assets held in the trust and subsequently distributes the net assets to its capital beneficiaries.

On 1 January 2016, new rules took effect for life-interest trusts (includes alter ego, joint spousal and common-law partner trusts, and spousal and common-law partner trusts), which deem a taxation year to end at the close of the day on which the life interest beneficiary dies.

In very limited circumstances,⁵⁷ an election may be filed under these rules by the trustee of a testamentary trust that is a spousal or common-law partner trust and the executor of a life interest beneficiary's GRE to tax the deemed capital gain of the trust in the deceased life interest beneficiary's terminal return.

Under the former rules, income or capital gains payable to a beneficiary could be taxed in the trust if the trustees made an election to tax it in the trust. This was typically done where the trust had a lower tax rate than the beneficiary.

As of 1 January 2016, an election to tax the income or capital gains payable to a beneficiary in the trust can only be made if there are losses (including capital) that can be utilized such that the trust's taxable income for the year is not greater than nil.

A second exception to the flat top-rate taxation of testamentary trusts is for "qualified disability trusts." These testamentary trusts, created for the benefit of disabled individuals who are eligible for the federal disability tax credit, continue to be taxed at graduated tax rates, but there is a claw-back if capital is distributed to anyone other than the disabled beneficiary.

Existing estates and estate plans should be reviewed to assess the impact of the rules for testamentary trusts. Your EY Tax advisor can help plan with these rules.

Tax funding

An estate freeze will allow you to predetermine the tax liability on death in relation to the frozen assets. Once this liability has been estimated, you should consider whether your estate will have sufficient assets to fund the tax and enough left over to support any dependants or satisfy your charitable intentions. If you determine that you will not have sufficient assets, you can consider purchasing life insurance to provide additional funds. Insurance proceeds are received by your estate or beneficiaries tax free.

If your intention is to defer the tax liability until the death of the surviving spouse, consider last-to-die insurance to reduce premiums during your lifetime. Depending on your circumstances and mortality rates, life insurance premiums could end up costing more than the ultimate tax you are funding, so ensure that insurance is indeed the most efficient way to fund the ultimate tax liability. It's always prudent to review your insurance needs every few years or if there have been any significant changes to the income tax rates to ensure you're carrying the right amount of coverage.

If you haven't attended to your estate plan – or if it needs to be reviewed to ensure your intentions will still be met under your current situation – contact your EY Tax advisor.

Trust reporting

A trust is required to file an annual income tax return, the T3 Trust Income Tax and Information Return (T3 return), within 90 days of the end of its taxation year. However, there are a number of statutory and administrative exceptions to this filing requirement. Generally, a trust only has to file a T3 return for a taxation year if it earns more than \$500 of taxable income from all sources and it has income tax payable, or it has disposed of capital property, or it has realized a taxable capital gain, or if it makes a distribution of all or part of its income (exceeding \$100), gains or capital to one or more of its beneficiaries.

Additional reporting requirements proposed

The 2018 federal budget announced, and draft legislation released on 27 July 2018 included, proposals for additional information reporting that will be required on an annual basis for express trusts (trusts that are created with the settlor's express written intent, as opposed to other trusts arising by operation of law) that are resident in Canada, and for nonresident trusts that are currently required to file a T3 return, effective for taxation years ending after 30 December 2021. Therefore, the proposed rules will create an annual T3 return filing requirement for certain trusts that are currently not required to file a T3 return due to statutory or administrative exceptions.

Trusts subject to the proposed reporting requirements will have to report the identity of all trustees, beneficiaries and settlors of the trust, as well as the identity of each person who has the ability, as a result of the trust terms or a related agreement, to exert control over trustee decisions regarding the allocation of trust income or capital (e.g., a protector). A new beneficial ownership schedule will be added to the T3 return to report this information.

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⁵⁷ Specific conditions must be satisfied. For instance, the trust must have been created by the will of a taxpayer who died before 2017, the individual was a Canadian resident immediately before the DoD, the trust is a post-1971 spousal or common-law trust, and so on.



The CRA will provide further information about this new schedule on its website when it becomes available. Certain types of trusts will be excluded from these additional reporting requirements. New penalties will apply for failure to file a T3 return, including the new beneficial ownership schedule where applicable, that is required to be filed, effective for taxation years ending after 30 December 2021. These proposed penalties will be equal to the greater of \$2,500 and 5% of the highest total fair market value of all property held by the trust in the year.

Wills

Your will is a key part of your estate plan. You and your spouse or partner should each have a will and keep it current to reflect changes in your family status and financial situation, as well as changes in the law. Your lawyer and tax advisor should review it every three to five years, at a minimum.

If there is no valid will at death, then the deceased's estate passes under predetermined rules known as intestate succession. The intestacy rules are different depending on the province or territory of which the person was resident at the time of his or her death.

Tax tips

- ▶ Conducting an annual review of your estate plan will help you prepare for life's unexpected turns.
- ▶ Consider freezing the value of your assets and arranging for funds to be set aside, or purchasing life insurance, to cover the payment of your estimated income tax liability arising on death.
- ▶ There are different types of estate freezes. Your choice would depend on your particular family situation:
 - Complete freeze: It's possible for you to continue to control the company by subscribing for all or the majority of the voting-control shares and by using a shareholders' agreement restricting the rights of the growth shareholders.
 - Partial and staged freezes: You can continue to participate in the company's growth by subscribing for a portion of the growth shares, either directly or by being named as a beneficiary of the family trust.
- ▶ Only consider a freeze for assets you expect the family to hold over the long term.
- ▶ Note that income-splitting opportunities with estate freezes are limited after 2017, based on the revised TOSI rules (see above).
- ▶ If you're 65 or older, consider using an alter-ego or joint partner trust as a will substitute and for probate tax savings. Consult with tax and legal advisors on drafting the terms to take the new trust rules into account.
- ▶ Review and update your will periodically to ensure it reflects changes in your family status and financial situation, as well as changes in the law.
- ▶ Remember to weigh the continuing non-tax benefits of using trusts for post-mortem planning, since the tax benefits have been reduced due to the new trust and TOSI rules.
- ▶ Remember that an individual may have only one qualifying GRE that will benefit from the historical testamentary trust advantages.

Alter-ego and joint partner trusts

Alter-ego trusts and joint partner trusts offer estate planning options for seniors. These are *inter vivos* trusts established by individuals who are at least 65 years of age. In these trusts, only the contributor (or their spouse or partner, in the case of a joint partner trust) is entitled to the income or capital of the trust during their lifetime.

In the case of an alter-ego trust, the trust document should name contingent beneficiaries, who will be entitled to receive the income and/or capital of the trust after your death. For a joint partner trust, the document must specify that the last to die (you or your spouse or partner) will be the beneficiary, and the trust deed should name contingent beneficiaries after both spouses die.

Like other *inter vivos* trusts, you can use these trusts as will substitutes, bypassing provincial probate fees on death and maintaining privacy. But unlike most other *inter vivos* trusts, you can transfer assets into these trusts on a rollover basis (at cost), deferring the tax on any accrued gains until they are realized, or until the time of your death or that of your spouse or partner.

These trusts can also act as substitutes for powers of attorney.

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Estate administration tax/ probate tax

Probate is the judicial process when a court confirms an executor's authority. In most cases, you, as the executor of an estate, will have to go through this process in order to efficiently carry out the administration of the estate.

Whether the deceased has a will or not, probate entails paying tax, which is determined as a percentage of the estate's value. Several provinces levy probate tax on all property that belonged only to the deceased at the time of death. Property that passes to a named beneficiary outside the will (e.g., the proceeds of a life insurance policy) is not subject to probate tax. In some provinces, probate taxes for large estates can be substantial.

For a summary of probate fees by province and territory, see [Appendix C](#).

Inter vivos gifts

If you gift capital property before death to anyone other than your spouse or partner, you're deemed to have disposed of that property at its fair market value. Transferring property into "joint tenancy" with a child, however, is considered to be a gift. This technique may be attractive in times of depressed market values and disposition of certain types of assets that may result in minimal taxes.

Life insurance

Life insurance plays a key role in providing liquidity to your estate, by enabling the payment of funeral expenses and other debts (such as the income tax liability on any accrued capital gains that may be payable as a result of your death) and providing your dependants with money

to replace your earnings. In addition, life insurance can be used to facilitate the transfer of a business in the event of the death of one of the partners.

Life insurance proceeds received on your death are not subject to tax; consequently, life insurance premiums are generally not tax deductible.

There are two basic types of life insurance:

Term policies: These policies provide insurance protection for a specified period (e.g., 10 years). They typically have no explicit investment component and provide the policyholder's beneficiary with a tax-free fixed sum on the policyholder's death. Term insurance policies generally have no guaranteed cash values and are usually not participating (i.e., no policy dividends are payable).

Term insurance policies typically have a fixed premium for the duration of the policy and may contain features such as a guaranteed right to renew the policy at the end of the term or the right to convert the policy to permanent insurance subject to certain conditions.

Term policies are typically the lower-cost option for obtaining life insurance.

Permanent policies: There are various types of permanent insurance policies. At a basic level, there are those policies that may allow the policyholder to receive benefits in the form of policy dividends (which are referred to as participating policies) and those that do not pay policy dividends (which are referred to as non-participating policies). Some policies provide for significant flexibility and transparency with respect to investment options and cash value accumulation. These policies are referred to as universal life policies.

Tax tips

- ▶ You should seek advice on how the family's wealth should be distributed when you die, and regularly monitor the advice in light of your changing personal circumstances.
- ▶ It's essential that you have a will that's fairly current – and possibly more than one will to deal with different assets and jurisdictions. To date, the CRA has stated that using multiple wills does not create more than one estate in the context of the new GRE rules.
- ▶ Reduce potential probate tax by transferring assets, such as the family cottage or non-appreciated assets, to a family or alter-ego trust, so that they won't be owned by an individual on death. Note that the principal residence designation rules have changed with respect to certain trusts. See [Chapter 8: The principal residence exemption](#).
- ▶ Keep beneficiary designations up to date for any assets that typically are not covered by a will, including assets from life insurance policies, retirement plans and TFSAs. Beneficiary designations supersede any instructions in a will for these specific assets. Remember that as circumstances in your life evolve (due to events like birth, marriage, divorce or death), your beneficiary designations may need to change accordingly.
- ▶ A letter of instructions informs your family members of the estate planning documents you've created, what their purposes and contents are and where they're located. The letter should also include contact information for lawyers, accountants, insurance agents, financial advisors, bank representatives and other persons your survivors might need to get in touch with. The simple and straightforward step of preparing a letter of instructions can spare your survivors from confusion and anguish during what will be a time of great stress.

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All permanent policies provide insurance for the life of the insured as long as all premiums are paid as required. These life insurance policies usually have an investment component in addition to the pure insurance component. Most permanent life insurance policies sold in Canada are exempt policies, meaning they are exempt from annual accrual taxation on the accrued growth in value within the life insurance policy. The ability to accrue growth on a tax-deferred basis within an exempt life insurance plan can provide significant value over the long term. This tax deferral becomes permanent if the policy is held until the death of the life insured. For an insurance policy to be considered exempt, the investment component within the policy cannot exceed certain permitted limits. The insurer, on behalf of the policyholder, will monitor the status of the policy annually and, where agreed to, will make any necessary changes to ensure the policy remains exempt from accrual taxation.

Premiums for permanent policies may be fixed over the life of the policy or may increase over time, depending on the terms of the policy. Generally, premiums for permanent policies are higher than premiums for term policies, in recognition of the need to pay a death benefit at some point, and to accumulate savings within the policy.

One added benefit of permanent insurance policies is that the investment component usually has a cash surrender value, which can provide funds before death. You can borrow against or withdraw this cash surrender value to supplement your retirement income or for emergency situations – but there may be an associated tax cost.

Adjusted cost basis for tax purposes

As with other types of property acquired, it is necessary to calculate the tax cost, or adjusted cost basis (ACB), for life insurance policies. In broad terms, premiums paid on a life insurance policy are added to the ACB, while money withdrawn reduces the ACB of the policy. Other factors may also increase or reduce the ACB. In addition, for policies issued or last acquired after 1 December 1982, there is an annual deduction from the ACB for a notional cost of insurance (the net cost of pure insurance) provided under the policy. The purpose of this adjustment is for the ACB to reflect only the investment component within the policy.

Because the ACB calculation in Canada is complex, Canadian insurers maintain the calculation on behalf of their policyholders and issue a tax slip for any taxable amounts withdrawn in the year.

Withdrawals and policy loans

When a policyholder withdraws money from a policy, including policy dividends or partial withdrawals of the cash surrender value, the policyholder is considered to have disposed of all or a portion of the interest in the policy for tax purposes. If the proceeds exceed the ACB at the time of the disposition, the policyholder must include the excess in income. It should be noted that in general, life insurance policies are not considered capital property. Therefore, the entire 100% gain realized on the disposition is subject to tax, on account of income, to the policyholder.

In addition, when a policyholder obtains a policy loan under the terms of the policy, the loan proceeds in excess of the policy's ACB are taxed as income. Any subsequent repayment of the policy loan may entitle the policyholder to an income tax deduction to the extent of amounts previously included in income. Many insurers will send a letter to their policyholders to advise them when a deduction may be available in respect of a policy loan repayment. However, such notification is not required, so policyholders should take care in determining the availability of potential deductions for policy loan repayments.

If a policyholder obtains a policy loan and uses the proceeds to earn income from a business or property, the interest on the policy loan should be deductible for income tax purposes (similar to the treatment of interest on other types of investment loans). To obtain the deduction, the policyholder should complete Part I of Form T2210, *Verification of Policy Loan Interest by the Insurer*, and forward the form to the insurer for completion of the remainder. The insurer will certify the amount of the policy loan interest and return one copy of the completed form to the policyholder. The insurer should retain the other copy for possible future review by the CRA.

Tax tip

Before withdrawing any portion of the cash surrender value of your policy, speak with your tax or insurance advisor to determine the tax implications of making such a withdrawal.

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Changes in ownership

Generally speaking, a change in ownership of a life insurance policy is a taxable disposition if the transferor and transferee deal at arm's length. The transferor realizes a gain to the extent that the transfer price paid by the new policyholder exceeds the transferor's ACB in the policy, and 100% of that gain is included in the transferor's taxable income for that year. The transferee's ACB in the policy is equal to the proceeds of disposition received by the transferor.

Many non-arm's-length changes in ownership are deemed to occur at proceeds equal to the greatest of the cash surrender value of the policy, fair market value of any consideration provided, and the ACB of the policy (for dispositions occurring after 21 March 2016). This deemed disposition also applies if the policy is gifted (no consideration provided) in an arm's-length transaction. To the extent that the deemed proceeds exceed the ACB of the policy, the transferor realizes a taxable gain, and 100% of the gain is included in the transferor's income for that year. Non-arm's-length dispositions occurring before 22 March 2016 were deemed to be disposed of for proceeds equal to the cash surrender value of the policy.

There are, however, specific non-arm's-length transfers of ownership that can occur on a tax-deferred basis. Transfers of ownership to a child or grandchild for no consideration are deemed to occur at proceeds equal to the ACB of the policy, provided the child or grandchild is the life insured and certain other conditions are met. Similarly, a transfer to a spouse or common-law partner

as a consequence of the policyholder's death is deemed to occur at proceeds equal to the policy's ACB, provided the policyholder and successor spouse or common-law partner are resident in Canada for tax purposes at the time of death. A tax-deferred transfer to a spouse or common-law partner is also available during the lifetime of the policyholder if certain conditions are met.

Deductibility of premiums

As mentioned previously, premiums paid on life insurance policies are generally not deductible. However, if an interest in a life insurance policy is assigned to a financial institution (i.e., a chartered bank, trust company or credit union) as required collateral on a loan or indebtedness, the policyholder may be able to deduct a portion of the premiums paid, as long as the interest on the loan is deductible.⁵⁸ Caution should be taken with flexible premium policies, as only the premiums contractually payable under the policy may qualify for deduction.

Beneficiary designations

Unlike other types of investments, life insurance policies allow the policyholder to designate beneficiaries under the policy, which may be advantageous when compared to other types of investments. Designating beneficiaries may protect the policy from creditors and excludes the proceeds from the estate's value when calculating probate tax.

Business use

In addition to providing protection to a policyholder's spouse or common-law partner and/or dependants who are beneficiaries, life insurance is also commonly used by closely held businesses to fund the purchase of the shares held by the deceased's estate. If the company receives the death benefit, the proceeds can generally be distributed to the estate or the surviving shareholders free of tax. However, tax legislation restricts the ability to use corporate-owned life insurance to fund a redemption of shares and to create a capital loss that may reduce the income tax exposure on the death of a shareholder.

Tax tip

If you wish to use life insurance for investment or business planning purposes, speak with your tax advisor to ensure the tax benefits are being optimized. The rules are complex, and significant unintended consequences can result if proper planning is not done.

Tax tip

Periodically review your life insurance requirements to ensure you have the appropriate amount and type of coverage, and have named the correct beneficiaries of the policy.

⁵⁸ Under paragraph 20(1)(e.2) of the *Income Tax Act*, the amount of premiums deductible in this case (with certain exceptions) would be the least of: (a) the premiums payable under the policy in respect of the year; (b) the net cost of pure insurance in respect of the interest in the policy in the year; and (c) the portion of the lesser of the amounts in (a) and (b) that can reasonably be considered to relate to the amount owing from time to time during the year by the taxpayer under the loan. For example, if the life insurance coverage under the assigned policy is \$500,000, and the average balance owing under the loan during the taxation year is \$200,000, the amount deductible would likely be limited to 40% of the lesser of the premiums payable and the net cost of pure insurance for the policy in respect of the year.

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Charitable bequests (gifts made by will)

The rules relating to charitable donations and gifts of Canadian cultural or ecological property are also applicable to gifts made in your will.

Prior to 2016, gifts made by will were deemed to be made by the deceased immediately prior to death and could be reported on the terminal return or carried back to the immediately preceding year.

Gifts made from the estate, however, could only generate credits against the estate's income taxes payable.

If charities were listed as direct beneficiaries of an RRSP, RRIF, TFSA or a life insurance policy, the bequests were treated as charitable bequests and considered gifts made in the year of death.

Charitable bequests and gifts made by GRE

A deeming rule applies to deaths occurring after 2015, for gifts made by will and designation gifts (under an RRSP, RRIF, TFSA or life insurance policy). Charitable bequests are no longer deemed to be made by an individual immediately before the individual's death. Instead, these gifts are deemed made by the estate. The value of the gift is determined at the time the property is transferred to a qualified donee and not immediately prior to death. Provided the gift is made by the deceased's GRE, the estate trustee has the flexibility to claim the gift in an estate return or to allocate the gift to the deceased's terminal return or the immediately preceding personal tax return.

The deceased's spouse or common-law partner is no longer able to claim gifts made by will.

If an estate or trust is not a GRE, then the donation credit can only be claimed in the year of the donation and the subsequent five years. There is no ability to allocate the gift to a prior year of the estate or to a deceased's personal tax return.

For deaths occurring after 2015, additional flexibility may be available in allocating a gift made by an individual's former GRE after 36 months but no later than 60 months after the individual's death in certain situations.

Consult with your EY Tax advisor to ensure that these rules do not adversely impact your gifting strategy.

Tax tips

Consider starting your charitable donation program while you're alive, or consider alternative ways of creating a legacy, such as:

- ▶ Gifting capital property (such as shares)
- ▶ Gifting a life insurance policy (the premiums may be donations)
- ▶ Gifting a residual interest in property
- ▶ Donating a charitable gift annuity

The 21-year trust rule

As previously mentioned, trusts – other than qualifying spouse or partner trusts, alter-ego trusts and joint partner trusts – are deemed to dispose of their assets at fair market value every 21 years. Accrued capital gains or losses on capital property are thus recognized and subject to tax. For example, trusts created in 1998 will have a deemed disposition in 2019.

Trusts may elect to pay the resulting tax in up to 10 annual instalments. The trust will be charged interest on the unpaid balance of tax at the prescribed rate.

It's important to have your trust reviewed by your EY Tax advisor to help reduce the impact of the 21-year deemed disposition rule and to identify other planning opportunities.

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A guide to US citizenship



Given the complexity of US citizenship and nationality law, it's not surprising that many people have no knowledge of their US citizen status.

Such people are often referred to as "accidental Americans" because an individual can obtain US citizenship "accidentally" by birth in the US⁵⁹ through birth abroad to a US-citizen parent or as the result of a parent's naturalization. If the legal requirements for citizenship are met, then a person becomes a US citizen by operation of law, irrespective of their intent.

Below is a brief summary of the current rules regarding acquisition and renunciation of US citizenship.

US citizenship by birth in the United States

Jus soli (the law of the soil) is a common law rule under which a person's place of birth determines his or her citizenship. The principle of *jus soli* is embodied in the Fourteenth Amendment to the US Constitution and various US citizenship and nationality statutes, including the *Immigration and Nationality Act* (INA). Thus, nearly all persons born in the US are endowed with US citizenship. US citizenship may be acquired by a child born in the US even if her/his parents were in the country temporarily or illegally.

There is one exception. INA 301(a) provides that persons born in the US *and subject to the jurisdiction thereof* acquire US citizenship at birth. Therefore, children born in the US to foreign sovereigns, consuls, diplomats and other people who are not subject to US law are not considered US citizens at birth.

Birth abroad

Jus sanguinis (the law of the bloodline) is a civil law rule under which a person's citizenship is determined by the citizenship of one or both parents. The principle is often referred to as "citizenship by descent" or "derivative citizenship."

Jus sanguinis is not embodied in the US Constitution. Citizenship by descent is, however, granted under US statute. The statutory requirements for conferring and retaining derivative citizenship have changed significantly over time. In order to determine whether US citizenship is transmitted in a particular person's case, you need to look to the laws that were in effect at the time the person was born.

Birth abroad to two US-citizen parents in wedlock

Pursuant to INA 301(c), a person born abroad to two US-citizen parents is deemed to have acquired US citizenship at birth if at least one of the parents resided in the United States or one of its outlying possessions prior to the child's birth. No specific period of time is required. In this context, a child is considered to be born in wedlock if the child is the genetic issue of a married couple.

Birth abroad to one US-citizen parent in wedlock

A child born abroad in wedlock on or after 14 November 1986 acquires US citizenship if the child has one US-citizen parent who was physically present in the US or one of its outlying possessions for at least five years prior to the child's birth. At least two of the five years must have accrued after the US-citizen parent reached the age of 14.

Under INA 301(g), a child born abroad in wedlock between 24 December 1952 and 13 November 1986 is deemed a US citizen provided that one US-citizen parent was physically present in the US for a period of at least 10 years prior to the birth of the child. At least five of those years must have accrued after the US-citizen parent reached the age of 14.

Birth abroad of an out-of-wedlock child with a US-citizen mother

Under INA 309(c), a person born abroad out of wedlock is considered a US citizen if the mother was a US citizen at the time of the birth and physically present in the US or one of its outlying possessions for a continuous period of one year prior to the birth.

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⁵⁹ For citizenship purposes, the "United States" refers to the continental US, Alaska, Hawaii, Puerto Rico, Guam and the US Virgin Islands [INA 101(a)(38)], as well as US ports, harbours, bays and other territorial waters. By virtue of Public Law 94-241, persons born in the Northern Mariana Islands after 4 November 1986 are also considered US citizens.



Birth abroad of an out-of-wedlock child with a US-citizen father

Under INA 309(a), a person born abroad out of wedlock with a US-citizen father acquires US citizenship under INA 301(g) provided that the following conditions are met:

- ▶ A blood relationship between the person and the US-citizen father is established by clear and convincing evidence.
- ▶ The father was a US national at the time of the birth.
- ▶ The father was physically present in the US or its outlying possessions for at least five years prior to the child's birth, at least two of which were after reaching the age of 14.
- ▶ The father (unless deceased) has agreed in writing to provide financial support for the person until the person reaches the age of 18.
- ▶ While the person is under the age of 18:
 - The person is legitimated under the law of his or her residence or domicile;
 - The father acknowledges paternity in writing under oath; or
 - The paternity is established by adjudication of a competent court.

Birth abroad of an out-of-wedlock child with a US-citizen father under the "old" INA 309(a)

The "old" INA 309(a) applies to individuals who were 18 years of age on 14 November 1986, as well as to individuals whose paternity was legitimated prior to that date.

People who were between 15 and 17 years of age on 14 November 1986 may elect to have their claim to US citizenship determined in accordance with either the old or the new INA 309(a).

A child born out of wedlock to a US-citizen father is eligible for US citizenship under the former INA 301(a) (7) – as made applicable by the former INA 309(a) – if both the following conditions are met:

- ▶ Prior to the person's birth, the father had been physically present in the US or one of its outlying possessions for at least 10 years, five of which were after the age of 14.
- ▶ The person's paternity had been legitimated prior to the child reaching the age of 21.

Renunciation of US citizenship

Once an individual acquires US citizenship, it's difficult to lose. The process of renunciation is quite complex and involves many considerations.

A person cannot avoid an outstanding tax liability by formally renouncing US citizenship, as renunciation can typically only occur after all outstanding tax filings and tax debts have been resolved. Moreover, individuals who renounce US citizenship may be subject to expatriation taxes and special reporting requirements upon departure.

It's important to note that persons who renounce US citizenship will then be subject to US immigration laws and regulations, just like all other non-citizens.

In light of the potential consequences, it is recommended that anyone considering renouncing their US citizenship seek professional advice before taking any action.

If you have any questions concerning US citizenship or renunciation, please consult with a US immigration attorney at [EY Law LLP](#), a law firm affiliated with EY in Canada.

For questions relating to the tax implications of US citizenship or renunciation, please contact your EY or EY Law advisor.

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US tax for Canadians



If you're a Canadian resident (but not a US citizen) who spends significant amounts of time in the US for either work or leisure, you may be required to file US federal income tax returns. That's because, under US law, you may be considered a US resident as well as a resident of Canada.

You're considered a US resident if you hold a green card or if you meet the "substantial presence" test.

Snowbirds

You have a "substantial presence" in the US if you spend at least 31 days there during the year, and the result of a prescribed formula for presence in the US is equal to or greater than 183 days.

The prescribed formula for 2019 is as follows:

- ▶ The sum of the days you spent in the US in 2019
- ▶ Plus one-third of the number of days spent there in 2018
- ▶ Plus one-sixth of the number of days spent there in 2017

This means that people who regularly spend four months a year in the US will be considered a resident under this test, and should be filing the Internal Revenue Service (IRS) closer connection statement (Form 8840). This form should be filed even if you have no income from US sources, in order to avoid reporting your worldwide income on a US tax return.

Certain days you spend in the US are not counted for this test, including:

- ▶ Days on which you commute to work in the US, if you regularly commute to work in the US on more than 75% of the workdays during your working period
- ▶ Days you spend in the US beyond your intended stay due to a medical emergency
- ▶ Days you are in the US for less than 24 hours when in transit between two places outside of the US
- ▶ Days spent in the US by certain students

Even if you meet the substantial presence test, however, you won't be considered a US resident if, for the entire year, you have a "closer connection" to another country. A closer connection means that you:

- ▶ Were present in the US less than 183 days during the calendar year
- ▶ Have a tax home in another country for the entire year
- ▶ Establish that you have a closer connection to that tax home compared to the home you have in the US
- ▶ File IRS Form 8840, *Closer Connection Exception for Aliens Statement by the tax return due date*, including extension to file

The normal US tax return filing due date is 15 April, but for individuals without US-source employment income, the due date is 15 June. This filing is often called a "snowbird filing," since Canadians who spend the winter in the US each year and meet the substantial presence test must file this statement to avoid being treated as US residents and subject to US tax on their worldwide earnings.

If you're considered a resident of both Canada and the US under each country's domestic tax law, you can avoid double taxation on worldwide income by being treated as a resident of either the US or Canada under the Canada-US Tax Treaty.

Nonresidents who take advantage of the treaty to reduce their US tax liability, including those who claim nonresident status under the treaty, are required to file a US treaty disclosure form attached to Form 1040NR. This return is due on 15 April of the following calendar year for people who have US-source wage income. In all other cases, the date is 15 June of the following calendar year. Failure to file a treaty disclosure return could result in a minimum penalty of US\$1,000.

The rules regarding filing returns are very complex. Contact your EY Tax advisor if you have questions on this topic.

Tax tips

- ▶ Review your situation and determine whether you're considered a US resident for US income tax purposes.
- ▶ If you have a green card, you should be aware that you are considered a US-resident alien and that you are subject to US tax on all your worldwide income.
- ▶ Ensure that you track the number of days you're present in the US.
- ▶ To substantiate your arrival and departure dates to and from the United States, you should keep copies of travel tickets, stamped passports and other relevant documentation in your tax files.

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Tax issues for Canadians with US real estate

Are you planning to purchase your dream retirement home in the US in the near future? Or have you already taken the plunge and are the proud owner of a vacation home south of the border? In either case, there are a number of sometimes complex US income, estate and gift tax issues that you should be aware of. If you take these issues into consideration, you could reduce your overall tax exposure.⁶⁰

The following US tax considerations apply to Canadian residents who are neither US citizens nor green card holders.

US estate tax

After you've figured out where you want to vacation each year and have found the ideal home, one of the next questions that you should ask yourself is: what do I need to know about US tax – especially the ominous US estate tax?

Canadian residents who own US real estate for business or personal use are exposed to US estate tax on the gross value of US property (subject to some reductions) owned at the time of an individual's death.⁶¹

The maximum US estate tax rate is 40% and the IRS allows a Unified Credit, with the effect that the first US\$11.4 million⁶² is not subject to US estate tax.

US citizens are allowed the full amount of the Unified Credit, which in most circumstances is transferrable to the surviving spouse. However, for non-US citizens, the Unified Credit is adjusted proportionately to reflect the

value of the US-based assets in relation to the value of their worldwide estate. If the US property is not a significant portion of a non-US citizen's worldwide estate, the amount of the Unified Credit available is reduced substantially.

In Canada, a limited foreign tax credit is allowed for the US estate tax paid to the extent Canadian income tax was payable related to the capital gains on the same property, provided that the Canadian capital gains tax would apply in the same year. This foreign tax credit is of nominal value if the accrued gain in the US real estate was relatively small in relation to the gross value of the US real estate.

Single-purpose corporation

Before 2005, a common planning technique to avoid US estate tax was the use of a Canadian company, commonly called a single-purpose corporation, to hold US real estate. Because the corporation owning the US property does not "die" with its shareholder, there is no death that triggers US estate tax.

Under general principles of Canadian taxation, a shareholder would ordinarily be assessed a taxable benefit for the personal use of an asset of the corporation. However, before 23 June 2004, the Canada Revenue Agency (CRA) administratively permitted these arrangements without assessing a taxable benefit. This administrative concession was eliminated as of 31 December 2004, and a shareholder benefit will be assessed in any new arrangements. As a result, single-purpose corporations are generally no longer considered an effective strategy for new purchases of US real estate.⁶³

Co-ownership

Where there are multiple owners of a property, the US estate tax liability will be divided among the co-owners. The IRS will usually allow a discount on the value of each co-owner's share of the property, based on valuation principles, as it is more difficult to sell a partial interest in a property than to sell the entire property.

As well, with co-ownership, each individual can use the Unified Credit. As a result, the aggregate US estate tax payable by the co-owners on the discounted value would usually be less than the aggregate amount that would be payable had there been a single owner.

To implement this plan properly, all co-owners must fund their share of the purchase price so that the IRS does not view the planning as a "sham," and to avoid potential US gift tax issues when the property is sold in the future.

As well, you should be aware that the IRS automatically presumes that the entire value of the jointly held property is included in the deceased person's gross estate, unless the executor provides evidence sufficient to show that the property was not acquired entirely with consideration furnished by the deceased, or that it was acquired by the deceased and the other joint owner by gift, bequest or inheritance. Therefore, properties held in joint tenancy by spouses may be subject to US estate tax twice. So make sure you keep proof that all joint owners paid for their share of the property.

While this ownership structure can significantly reduce US estate tax, it might make a future disposition of the property more complicated and cumbersome. All owners would have to agree to the disposition and be available to sign the legal documents for the transaction.

⁶⁰ This information is not intended or written to be used, and cannot be used, for the purpose of avoiding penalties that may be imposed under the US Internal Revenue Code or applicable state or local tax law provisions.

⁶¹ Note that if the value of your US situs assets is generally greater than US\$60,000, a representative of your estate will need to file a US estate tax return regardless of whether or not there is a US estate tax liability. In certain instances, a US estate tax return may be required even if the value of the decedent's US situs assets is less than US\$60,000. Consult your EY Tax advisor.

⁶² Under the *US Tax Cuts and Jobs Act* (TCJA), which passed into law on 22 December 2017, the US estate tax exemption (upon which the Unified Credit is based) was increased to US\$11.18 million for 2018, and it has been increased to US\$11.4 million for 2019. The TCJA increased the exemption amount from US\$5 million to US\$10 million to be indexed annually. The increase is effective for 2018 through 2025. Unless permanent legislation is enacted, the exemption will return to values based on prior laws (i.e., US\$5 million indexed).

⁶³ There are exceptions. Consult your EY Tax advisor.

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Life insurance

Another option to counter US estate tax is the use of life insurance to fund the estate tax liability on death. The amount of premiums will depend on the age and health of the owner(s). Accordingly, if there is any insurability issue, this may not be a cost-effective plan. Insurance policy premiums to fund the US estate tax liability are not deductible for income tax purposes.

It should be noted that insurance proceeds on the life of a nonresident, non-citizen of the US are not considered US-based property and will not be subject to US estate tax. However, the insurance proceeds will reduce the Unified Credit amount available to the deceased, as the insurance proceeds payable to the estate or beneficiaries will be included in the gross value of the deceased's worldwide estate if he or she is the owner of the policy.

Non-recourse mortgage

In determining the value of property for US estate tax purposes, the IRS allows a deduction for an arm's-length non-recourse mortgage registered against the property. This deduction would reduce the value subject to US estate tax, thereby reducing the US estate tax liability. In order for a mortgage to be considered non-recourse, the only claim that the lender may have on the borrower's assets would be the specific property that has been pledged as security.

These loans may not be easily negotiated. As well, financial institutions usually will not lend more than 60% of the value of the property. Therefore, if a financial institution holds the mortgage, there may not be the possibility of eliminating all of the exposure to US estate tax.

As an added benefit, the interest paid on the non-recourse mortgage could be deductible for Canadian income tax purposes if the loan proceeds were used to purchase income-generating assets.



Canadian trust

A non-US citizen (the settlor) could establish a Canadian trust to purchase a US recreational property with a life interest for their spouse and capital interest for their spouse and children. The trust would be settled with sufficient cash to purchase the real estate.

It is important that the settlor be neither a trustee nor a beneficiary of the trust. This restriction is necessary to avoid the application of US Internal Revenue Code section 2036, which would attribute the value of the property to the settlor for purposes of calculating their US estate tax liability.

In addition to the original funding, the settlor will likely need to contribute additional amounts to the trust to fund the annual operating costs and capital improvements.

Generally, with this planning, the trust would not generate any income while it is holding the real estate, and therefore no annual Canadian or US income tax return filings should be required.

You should also be aware that Canadian income tax rules for trusts deem the trust to have disposed of its capital property every 21 years. Therefore, the trust deed should be drafted to provide flexibility in the future to avoid the potentially adverse implications of the 21-year rule.

Trust reporting

A trust is required to file an annual income tax return, the T3 Trust Income Tax and Information Return (T3 return), within 90 days of the end of its taxation year. However, there are a number of statutory and administrative exceptions to this filing requirement. Generally, a trust has to file a T3 return for a taxation year only if it earns more than \$500 of taxable income from all sources and has income tax payable, or if it has disposed of capital property, or has realized a taxable capital gain, or if it makes a distribution of all or part of its income (exceeding \$100), gains or capital to one or more of its beneficiaries.

The 2018 federal budget announced, and draft legislation released on 27 July 2018 included, additional reporting requirements that will be required on an annual basis for express trusts (trusts that are created with the settlor's express written intent, as opposed to other trusts arising by operation of law) that are resident in Canada, and for nonresident trusts that are currently required to file a T3 return effective for taxation years that end 30 December 2021. The proposed rules will create an annual T3 return filing requirement for certain trusts that are currently not required to file a T3 return due to statutory or administrative exceptions. For more information, see [Chapter 12: Estate planning](#).

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Canadian partnership⁶⁴

The property could be purchased by a Canadian partnership. In this case, it could be argued that the deceased owned a Canadian partnership interest rather than the actual US real estate.

However, it is not clear how the IRS views the location of a partnership. It may see it as the location of the partnership's trade or business, the domicile of the partner, the location of the partnership assets or the location where the partnership was legally organized. Therefore, there is no guarantee that the IRS will not look through the partnership to the underlying assets and apply US estate tax on the property held.

As well, there is uncertainty as to whether a Canadian partnership can be legally created if its sole purpose is to hold personal-use US real estate.

It may be possible to obtain more certainty that the partnership structure is protected from US estate tax by having the Canadian partnership elect (or "check the box") in US filings to be treated as a corporation for US purposes. The partnership would still be considered a partnership in Canada, but would be considered a corporation for US estate and income tax purposes.

Like the single-purpose corporation, the individual/partner would be considered to own shares of a Canadian corporation on death, rather than US real estate. However, unlike the single-purpose corporation, this hybrid structure would not give rise to a shareholder benefit issue in Canada.

The main tax disadvantage of this hybrid structure was formerly the higher US income tax rate that would have applied to any capital gain realized on the disposition of the property. However, due to US tax reform,⁶⁵ this difference is much smaller; i.e., in 2019 a capital gain realized by a corporation is subject to a US corporate income tax of 21% (rather than the previous 35%) (plus state income tax, if applicable), compared to the 15%/20% (plus state tax and Medicare contribution tax, if applicable) US long-term capital gain rate for individuals that would apply if the structure were considered a partnership for US tax purposes. Nevertheless, high set-up fees and annual maintenance costs are still disadvantages.

Some US estate tax planners believe that the check-the-box election can be made after death, since the effective date of an election may be up to 75 days prior to the date the election is filed. By delaying the election until after death, the US corporate tax rate on capital gains would not apply if the property is disposed of prior to death, because the structure would be considered a partnership for US income tax purposes.

In using this strategy, additional complex post-mortem planning will be required to avoid double taxation. As well, you should keep in mind that it is uncertain whether the IRS would accept a post-mortem check-the-box election for US estate tax purposes, or whether that election would result in a deemed transfer of property that may be subject to an adjustment to the calculation of US-based assets on death if it is considered a gift within three years of death.

The appropriate structure for holding US recreational property will, of course, depend on your personal situation. But in all cases, it is important to consult with a tax advisor to ensure the structure is tax effective as well as practical.

Tax tips

- ▶ You can take advantage of many strategies to reduce US estate tax on US real property, including:
 - Co-ownership
 - Life insurance to fund the US estate tax
 - Non-recourse mortgage
 - Using a Canadian trust to purchase the property
 - Using a Canadian partnership
- ▶ Your EY Tax advisor can help you select and implement the strategy that's right for you. If you have a single-purpose corporation, consider transferring the property out of the corporation. Consult your EY Tax advisor.
- ▶ While corporate ownership no longer works for personal use property, consider whether owning US investment property in a corporation may work to reduce US estate tax on that property.

⁶⁴ A thorough analysis of the relevant provisions of US tax law as well as Canadian tax rules would be necessary before proceeding with this structure. One of the complicating factors is that the TCJA introduced new provisions to provide that an amount realized from the sale of a US partnership interest by a nonresident may be taxable in the US, and that the purchaser or the partnership itself may be required to withhold 10% of the proceeds if certain conditions are met. In addition, the anti-hybrid rules under Article IV of the Canada-US tax treaty would need to be considered. Consult your EY Tax advisor for further guidance.

⁶⁵ For general comments on US Tax Reform, refer to EY Global Tax Alert [US House and Senate release the Conference Report on the Tax Cuts and Jobs Act](#).

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Renting US property

If you are thinking about renting your US vacation home to help defray the costs of ownership, there are a few things you should understand with respect to your US income tax reporting.

While nonresident aliens generally are not required to file US tax returns to report this rental income, the gross rents are subject to a flat 30% US tax, which the tenant or management agent is required to withhold and remit to the IRS.

This US tax cost can be reduced by providing the tenants or agents with IRS Form W-8ECI to reduce or eliminate the up-front withholding tax, and by filing a note with the first US 1040NR that states that the election is being made to tax the net rental income and provides details about the location and ownership of the property.

The US tax rules relating to claiming expenses against rental income are more restrictive than the Canadian rules. The property must be rented for a minimum of 15 days to report rental income or deduct rental expenses. If the property is used for personal purposes for more than 15 days in a year (and rented for at least 15 days), a loss cannot be reported, but excess expenses can be carried forward to be used against future rental income.

If you end up with net rental income and pay US income tax, you may claim any US tax paid as a foreign tax credit in Canada up to the amount of Canadian income tax paid on the rental income.

If you don't file the US tax return electing to be taxed on net rents in a timely manner, you'll generally lose the benefit of your deductions and credits. Also, you will be required to pay the federal 30% US tax (plus state tax, if any) on the gross rents.⁶⁶ (Exceptions to this rule may be available in certain cases if you can demonstrate that you acted reasonably and with good faith in failing to file.)

State implications vary based on the individual state's income tax rules.

Tax tips

- ▶ Be sure you track and maintain support for the income and expenses you incurred on US rental properties for purposes of preparing your US tax return.
- ▶ Keep backups for renovations, which need to be submitted to reduce withholding tax under the *Foreign Investment in Real Property Act (FIRPTA)*.
- ▶ Also keep proof of tax remitted under the FIRPTA on the original purchase for future reference.
- ▶ Be aware that if the property is primarily used to earn rental income rather than for personal use, and its cost together with the cost of any other foreign property or properties exceeds CDN\$100,000, Form T1135 must be filed in Canada. For an individual, the due date is the same as the due date of their T1 return.

Co-ownership and US gift tax

In Canada, many couples hold property in joint tenancy, often because it can simplify estate administration and can be a simple and inexpensive means of avoiding probate. If you've chosen this option to reduce your exposure to US estate tax, you should be aware that there may be unexpected Canadian and US tax consequences if the joint owners do not have enough money to fund their share of the property's purchase price.

Certain transfers of property by US citizens and individuals considered resident in the US for estate and gift tax purposes are subject to taxation. However, a US citizen is entitled to an unlimited marital deduction for spousal transfers if the spouse is also a US citizen.

In addition, US citizens and resident aliens are entitled to a cumulative lifetime gift tax exemption (indexed), along with annual exclusions for gifts to non-US citizen spouses (indexed), and for gifts to other individuals (indexed in US\$1,000 increments). The cumulative lifetime gift exemption for 2019 is US\$11.4 million, the annual exclusion for gifts to other individuals for 2019 is US\$15,000 and the annual exemption for gifts to a non-US citizen spouse for 2019 is US\$155,000.⁶⁷

Canadians who are neither US citizens nor resident in the US for estate and gift tax purposes are subject to US gift tax on transfers of tangible property situated in the US if less than full and adequate consideration is exchanged. Tangible property includes US real estate. As a result, Canadians should also consider the US gift tax rules before buying or selling any US real property.

Depending on when a US home was purchased, different US gift tax rules apply on the creation and termination of a joint tenancy. For property purchases after 13 July 1988, a gift does not arise at the time of purchase, regardless of who funded the acquisition. When the property is disposed of (other than by reason of the death of the spouse), the spousal joint tenancy is terminated and one spouse could be treated as having made a gift to the other spouse. The gift would be the proportion of the total purchase cost funded by one spouse, multiplied by the proceeds of disposition, in excess of the proceeds received by the other spouse.

For example, if one spouse funded the entire purchase, his or her proportion would be 100%. However, if only 50% of the proceeds are received by this spouse, the other 50% would be considered a gift and subject to US gift tax, which ranges from 18% to 40%.

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⁶⁶ <https://www.irs.gov/pub/irs-pdf/p515.pdf>

⁶⁷ <https://www.irs.gov/businesses/small-businesses-self-employed/whats-new-estate-and-gift-tax>



For purchases of property before 13 July 1988, creating a joint tenancy without a corresponding contribution of funds for the purchase was considered to be a gift, and therefore subject to US gift tax at the time of purchase.

So what can you do if you are planning to sell your US property that you purchased after 1988, and funded entirely yourself but held in joint tenancy with your spouse?

Consider assigning all rights in the property, including any right to proceeds (note: without title changing), to the spouse who funded the purchase. This could avoid completion of the gift, as the spouse that funded the original purchase would be entitled to all the proceeds on closing.

While this strategy may be sufficient to eliminate the US gift tax exposure, it may increase your US estate tax exposure, and also likely will not solve a problem with the mismatch of the foreign tax credits on your Canadian income tax return, as explained below.

You should consult legal counsel where the property is located to determine if such a contractual agreement is valid.

Foreign tax credit issues when Canadian attribution is applicable

If a capital gain is realized on the sale of US real estate owned by spouses as joint tenants, each spouse will be taxable on one-half of the gain for US income tax purposes, even if the proceeds go to only one spouse. Each spouse may claim this tax as a foreign tax credit against Canadian taxes payable on the gain they report in their respective Canadian income tax returns.

However, if only one spouse provided the funds to purchase the US property, the attribution rules require that spouse to report 100% of the gain for Canadian tax purposes. As a result, only 50% of the US income taxes paid may be claimed as a foreign tax credit, since the attribution rules do not apply to foreign taxes.

It may be possible to solve both the US gift tax issue and the mismatch of the foreign tax credits by filing a quitclaim deed to remove the non-contributing spouse from title to the property prior to its sale. This should not have any adverse Canadian or US tax consequences. There will be no gift on the sale of the property, the spouse who funded the purchase will be liable for 100% of the US and Canadian tax on the gain, and all of the US tax will be allowed in computing the foreign tax credit in Canada.



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Selling US real estate: compliance matters you need to know

If you've decided to sell your US home – whether due to financial need, limited use as your health declines in older age or to upgrade to a larger home – there are a number of things that Canadian residents⁶⁸ should know.

US tax implications

If you sell US real property, you must report the disposition on a US personal income tax return and pay US tax on any resulting gain. The US federal income tax rate on long-term capital gains (i.e., assets held for more than one year) is a maximum of 20% (before Medicare contribution tax where applicable). Depending on which state your property is in, you may also be required to file a state personal income tax return.

If you do not have a Social Security number or an individual taxpayer identification number, you should obtain one prior to the sale, to ensure the tax withheld is properly credited to your account and applied on filing the return.

There is mandatory US withholding tax under the FIRPTA. If the seller of a property is a US nonresident alien, the buyer must generally withhold 15% of the gross proceeds and remit it to the IRS as a prepayment of the seller's tax.⁶⁹ This withholding requirement applies irrespective of the amount of gain or loss on the property.

There are three exceptions that could reduce or even eliminate this withholding tax:

- ▶ If the property is sold for US\$300,000 or less, and the buyer intends to use it as a principal residence, withholding tax is not required. It is advisable for the buyer to sign a personal use certification at closing so that both parties have a written record of the requirements provided by IRS guidelines and the buyer's intention to meet them.
- ▶ If the amount realized on the sale exceeds US\$300,000 but not US\$1 million and the buyer has acquired the property for use as a principal residence, a 10% withholding tax rate applies rather than 15%.⁷⁰
- ▶ If the seller's expected US tax liability is less than 15% of the proceeds, the seller can apply for a reduced withholding amount (or no withholding if there is no gain) using IRS Form 8288-B.

Canadian income tax implications

The disposition of a US property must also be reported on your Canadian personal income tax return, and any US tax paid (as reported on the federal 1040NR and the state tax return) is eligible for foreign tax credit in Canada. However, the gain or loss for Canadian purposes could be very different than the amount reported on the US returns. This is because the exchange rates used to report the transaction in Canada are those in effect at the time of purchase and sale, respectively.

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⁶⁸ This does not include Canadian residents who are US citizens or green card holders.

⁶⁹ <https://www.irs.gov/individuals/international-taxpayers/firpta-withholding>

⁷⁰ As in the previous exception, the buyer should sign a personal use certification. If the property is bought as an investment property, the exception would not be met, and accordingly the higher withholding rate would apply.



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Emigration and immigration



When an individual immigrates to or emigrates from Canada in a calendar year, he or she is treated as a Canadian resident for the period he or she is resident in Canada, and a nonresident for the period he or she is a nonresident of Canada, and is usually referred to as a part-year resident.

As a part-year resident, an individual is taxed on worldwide income for the portion of the year the individual is a resident of Canada. A part-year resident is also subject to Canadian tax on certain Canadian-source income received for the part of the year prior to establishing residence or subsequent to relinquishing residence.

An individual who is resident for part of a year, because he or she is an immigrant or emigrant, will find that certain federal non-refundable credits may be claimed only to the extent they relate to the period of residence, and other credits must be prorated on the basis of the number of days of residence in the year.

Because an individual's Canadian tax liability is based on residence, the date on which an individual becomes or ceases to be a resident of Canada is relevant in determining how, and how much of, the individual's income is subject to Canadian tax. Often, the date of the physical move is recognized as the date Canadian residence begins or ends. However, other factors must be taken into consideration, including the extent to which the individual establishes or ceases to have residential ties with Canada.

Residential ties of an individual that are almost always considered to be significant for the purpose of determining residence status are the location of the individual's, spouse's or common-law partner's and dependants' dwelling place(s). In addition, the CRA has stated that where an individual entering Canada applies for and obtains landed immigrant status and provincial health coverage, these ties will usually constitute significant residential ties with Canada and, subject to certain exceptional circumstances, such an individual will be determined to be resident in Canada.⁷¹

Secondary residential ties are also considered collectively in determining residential status. A few examples include personal property in Canada (e.g., furniture, clothing, automobiles and recreational vehicles), social ties with Canada (e.g., memberships in Canadian recreational or religious organizations), economic ties with Canada (e.g., employment with a Canadian employer and active involvement in a Canadian business, and Canadian bank accounts, retirement savings plans, credit cards and securities accounts).⁷²

Date an individual changes residence

The CRA considers the date on which an individual becomes a nonresident of Canada to be the date on which the individual severs all residential ties to Canada. This date is usually the latest of the following:

- ▶ The date on which the individual leaves Canada;
- ▶ The date on which the individual's spouse (or common-law partner) or dependants leave Canada; and
- ▶ The date on which the individual becomes a resident of the country to which he or she is immigrating (unless the individual is re-establishing residence in that country, in which case the individual becomes

a nonresident on the day he or she leaves Canada, regardless of whether a spouse or dependants remain behind temporarily).

Individuals who cannot be considered nonresidents because they have retained sufficient residential ties with Canada remain factual residents of Canada and are subject to Canadian tax on worldwide income. However, an income tax treaty between Canada and the other country may modify this determination.

Determination of an individual's residence status can only be made based on the specific facts of each case. The CRA has published a summary of factors to consider in its Income Tax Folio S5-F1-C1: *Determining an Individual's Residence Status*.

Emigration

Except in very unusual circumstances, individuals who become nonresidents of Canada for income tax purposes become residents of another country. Accordingly, the assessment of tax considerations that arise must include both Canadian tax and the tax rules of the host country.

For example, many countries are like Canada, in that there is one set of rules for residents and another for nonresidents. However, some jurisdictions have a subset of rules for short-term residents or expatriate employees. It may also be necessary to consider any tax treaty between Canada and the destination country to determine residence status and the best way to reduce any double tax that may arise as a result of the departure.

Because Canada taxes its residents on their worldwide income but taxes nonresidents on only certain Canadian-source income, an individual leaving Canada and becoming a nonresident will be concerned about how this change in tax status will affect his or her future personal taxes.

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⁷¹ Income Tax Folio S5-F1-C1: *Determining an Individual's Residence Status*, paragraph 1.25.

⁷² Income Tax Folio S5-F1-C1: *Determining an Individual's Residence Status*, paragraphs 1.14 and 1.25.



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Employment income

Determining what employment income to report in the year of departure from Canada is not always a simple matter. Often, employment income earned must be allocated between the resident and nonresident periods; employment income may also need to be sourced to determine whether income earned while resident in Canada is from a foreign source (which is relevant if that income is also subject to tax in another country). It is also important to determine if any income earned in the nonresident period is from a Canadian source and therefore subject to Canadian tax.

The allocation of employment income to determine the amount earned in a certain period is most often determined by reference to time. It's important to note that identifying the payor as a Canadian or a foreign company has no bearing on the preliminary determination of the income's source.

Frequently, the date of departure does not correspond to the date of change from the Canadian company's payroll to the foreign company's payroll. In this case, it is necessary to determine what income was earned as a resident (and is therefore taxable in Canada) and what Canadian-source income was earned as a nonresident (and is therefore also taxable in Canada). It is also necessary to determine whether any of the income earned during the resident period is taxable in the host country, as foreign-source income may be eligible for a foreign tax credit to reduce Canadian tax.

Stock options

Stock options exercised by a nonresident of Canada are taxable in Canada to the extent they were granted in relation to Canadian employment.

The exercise of stock options while resident in a foreign country is also likely to be subject to tax in that country. The issue of relief from double taxation where stock option benefits are subject to tax in more than one jurisdiction is complex, as the method of determining the source of a security option benefit – both for jurisdiction to tax and for foreign tax credit purposes – is not universal.

The CRA's longstanding administrative position (which applies for stock options exercised before 2013) was that the security option benefit is attributable to services rendered in the year of grant (i.e., past services), unless there is compelling evidence to suggest another period would be more appropriate.

On 25 September 2012, the CRA announced a change to its longstanding administrative position. For stock options exercised after 2012, the determination of the amount of the stock option benefit relating to Canadian employment is based on future services rendered in the grant-to-vesting period (the approach set out by the OECD), rather than past services rendered in the year of grant, unless provisions of an income tax treaty apply a different methodology. For example, under the Fifth Protocol to the *Canada-US Tax Convention*, the determination of the amount of the stock option benefit relating to Canadian employment is based on the grant-to-exercise period of the option.⁷³

It is important to note that a nonresident of Canada exercising stock options that were granted prior to departure from Canada must file a Canadian T1 return in the year of exercise, reporting the security option benefit resulting from the exercise of the stock options.

Canadian benefits

Canada generally retains the right to tax Canadian benefit payments made to nonresidents. See [Chapter 16: Canadian tax for nonresidents](#) for details.

Personal assets

Generally, when you're no longer a resident of Canada, you are deemed to dispose of all property owned at that date, with specific exceptions, for proceeds equal to fair market value at that time.

The exceptions include:

- Real property in Canada
- Capital property and inventory used for a business you carry on through a permanent establishment in Canada
- Pension rights, such as RPPs, RRSPs, RRIFs and DPSPs and the right to CPP or OAS benefits
- Other excluded rights and interests, such as TFSAs, RESPs and RDSPs
- Employee stock options
- Life insurance policies in Canada (other than segregated fund policies)
- For certain short-term residents of Canada (i.e., resident for no longer than 60 months in the 10-year period before emigration), the property you owned when you became a Canadian resident or inherited after becoming a resident of Canada

⁷³ In other words, the proportion of the option benefit relating to Canadian employment or treated as Canadian source income and not US source income is equal to the number of days between the option grant date and the option exercise date during which the employee's principal place of employment was in Canada as a proportion of the total number of days during that same period in which the employee was employed by the employer. For example, you are granted options by your employer on 1 March 2017 and exercise them on 1 March 2019. During this two-year period, you were employed by the same employer but worked primarily in Canada for only 18 months and thereafter became a nonresident of Canada and worked in the US. Under this scenario, three-quarters of the option benefit (18 out of 24 months) is taxable in Canada and is treated as Canadian source income.

This means that any accrued gains on your properties at the date you leave will be taxed in the year of your departure. Instead of having to pay the tax liability from the deemed disposition immediately, emigrating taxpayers are allowed to file an election to post security with the CRA and pay the tax when the property is actually sold. The CRA will not charge interest on the tax due from the date you leave to the date of disposition. It's important to note, however, that the liability is generally fixed at the time of departure. Filing the election to defer payment of tax only postpones the payment of the liability, which will remain the same even if the properties decline in value subsequent to departure from Canada. Consult your EY Tax advisor.

In addition, Canada allows a credit for the taxes you paid as a resident in relation to pre-departure gains if your property is disposed of in the new country of residence, and if that country has a tax treaty with Canada.

If the value of all of the assets you own when you cease your Canadian residence exceeds \$25,000, you must report their total value and details of each property. Certain assets are excluded from this requirement, including personal-use properties individually valued at less than \$10,000, pension plans including registered plans, and cash or bank deposits.

If you return to Canada (regardless of the period of non-residence), you can elect to unwind the deemed disposition on departure for property you still owned on resumption of Canadian residence.

Taxation of rental income

Under both its domestic law and tax treaties, Canada generally retains the right to tax nonresidents on income from Canadian real property and on income from the disposition of Canadian real property. Real property means land and whatever is erected or growing on or affixed to it.

See [Chapter 16: Canadian tax for nonresidents](#) for details on the taxation of rental income from Canadian real property.

Tax tips

An individual who is leaving Canada should establish the date on which he or she becomes a nonresident and ensure that it can be supported. It's also important to keep detailed travel logs to substantiate travel inside and outside Canada during the year.

- ▶ **Canadian bank or investment accounts** - If these accounts are to be retained, notify the Canadian payers of interest and dividends so that they can withhold and remit the appropriate amount of withholding tax.
- ▶ **Canadian rental property** - If you rent your Canadian home or another property after ceasing Canadian residence, you'll be subject to 25% Canadian nonresident withholding tax on the gross rental income.

A better alternative may be to elect to file a Canadian income tax return, reporting net rental income (deducting applicable expenses), in which case Canadian marginal tax rates will apply.

- ▶ **RRSP contribution room** - Consider making RRSP contributions for the year of departure.
- ▶ **RRSP investments** - It's generally beneficial to leave RRSPs in place when you end your Canadian residence, provided that maintaining funds in a Canadian RRSP does not give rise to any tax problems in your new country of residence.

Advise your RRSP administrators of your departure, as certain RRSP trading restrictions may exist for nonresidents under local securities law.
- ▶ **RRSP Lifelong Learning or Home Buyers' Plan loans** - Repay within 60 days of departure from Canada to avoid the outstanding loan balances coming into income in the year of departure.
- ▶ **RESP contributions** - These may be made only when the beneficiary is a resident of Canada. Accordingly, RESP contributions should be made prior to the beneficiary's departure.
- ▶ **TFSA contributions** - You may continue to hold a TFSA after ceasing residency in Canada, but you cannot make contributions or accrue contribution room while a nonresident. Accordingly, you should make your contributions before you leave Canada. Note that your new country of residence may not necessarily treat the accrued income and gains in a TFSA as tax free within the plan or when withdrawn from the plan.

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Immigration

Canada taxes residents and immigrants on worldwide income earned while they are Canadian residents. Once an individual establishes Canadian residence, the individual's worldwide income is taxable in Canada at graduated tax rates. Any foreign-source income received after an individual becomes a resident of Canada will likely be subject to foreign tax, as well as Canadian tax. However, to avoid double taxation, a foreign tax credit is available (within certain limits) for foreign taxes paid on this income. Therefore, if income tax rates in the country from which the individual is emigrating are lower than Canadian rates, the individual should arrange to receive or earn as much income as possible in that country before establishing Canadian residency.

Employment income

When an individual becomes a resident of Canada for employment reasons, the employee typically works for one employer in his or her home country prior to entering Canada and begins to work for another employer in Canada.

However, determining what employment income to report in the year of entry is not always a simple matter. Often, employment income earned must be allocated between the resident and nonresident periods; employment income may also need to be sourced to determine whether income earned while resident in Canada is from a foreign source (which is relevant if that income is also subject to tax in the home country). It is also important to determine whether any income earned in the nonresident period is from a Canadian source and therefore subject to Canadian tax.

The allocation of employment income to determine the amount earned in a certain period is most often determined by reference to time.

Frequently, the date of entry does not correspond to the date of change from the foreign company's payroll to the Canadian company's payroll. In this case, it is necessary to determine what income was earned as a resident (and is therefore taxable in Canada) and what Canadian-source income was earned as a nonresident (and is therefore also taxable in Canada). It is also necessary to determine whether any of the income earned during the resident period is taxable in the host country, as the host country tax on foreign-source income may be eligible for a foreign tax credit to reduce Canadian tax.

Personal assets

When you become a Canadian resident, you're deemed to have disposed of and reacquired each property you owned immediately before establishing residence (with the exception of taxable Canadian property (TCP), inventory and intangible assets included in CCA Class 14.1 in respect of a business carried on in Canada, and certain excluded rights or interests) for proceeds equal to the fair market value of the properties at that time. This does not trigger a taxable transaction but merely establishes a new cost base for the individual's property.

TCP includes Canadian real or immovable property, capital property used in carrying on a business in Canada, certain shares of Canadian private corporations, certain shares of public companies, and Canadian resource properties. TCP excludes your rights or interests in a superannuation or pension fund. In addition, TCP excludes certain shares and other interests that do not derive their value principally from real or immovable property in Canada, Canadian resource property or timber resource property.

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For those properties you're deemed to have acquired, striking a new adjusted cost base means gains that accrued before you began your Canadian residence are not subject to Canadian tax. If your property has fallen in value since you purchased it, you're deemed to have acquired it at its fair market value. Consequently, it may be better to dispose of loss properties before you enter Canada, if the resulting loss can be offset against other gains or income in the country from which you are emigrating.

Reporting on foreign investment assets

Residents of Canada holding foreign investments are subject to certain reporting rules. The rules require individuals who own foreign property to file annual information returns.

The following rules are particularly relevant to individuals commencing Canadian residence:

- ▶ **Form T1135, Foreign income verification statement** - Individuals with an interest in specified foreign property – such as shares, bank accounts, and real property (other than personal-use property) – with an aggregate cost amount of at least CDN\$100,000 at any time in the year must report and provide details of these holdings annually. However, if the aggregate cost amount is less than CDN\$250,000 throughout the year, a simplified reporting method is available.
- ▶ **Form T1141, Information return in respect of contributions to nonresident trusts, arrangements or entities** - Individuals who have transferred or loaned property to a nonresident trust, arrangement or entity must file an annual information return.
- ▶ **Form T1142, Information return in respect of distributions from and indebtedness to a nonresident trust** - Beneficiaries of certain nonresident trusts must file an information return for the year in which they receive a distribution or loan from the trust.

- ▶ **Form T1134, Information return relating to controlled and not-controlled foreign affiliates** - Individuals who have an interest in a nonresident corporation or nonresident trust that is considered a foreign affiliate must file an annual information return.

Note that individuals are not required to file these information returns for the year in which they first become resident in Canada, although individuals who were resident in Canada in the past will be subject to these filing requirements in the year they resume Canadian resident status.

Relief granted to short-term residents

The term “short-term resident” is not defined in the *Income Tax Act*, but it's generally used to refer to individuals who move to Canada and are resident for less than five years. Short-term residents are granted some relief from the departure tax rules, as well as from the rules relating to participation in a foreign pension plan while a Canadian resident.

An individual who is resident in Canada for no more than 60 months in the 120 months preceding departure from Canada is not subject to departure tax on property that he or she owned before becoming a Canadian resident, or that was acquired while a Canadian resident by bequest or inheritance.

In general, it is possible for an individual who moves to Canada as a result of an employer request, and remains a member of the former employer's pension plan in the employee's home country, to continue to participate in that pension plan for the first five years of Canadian residence. After five years, certain steps must be taken to avoid the Canadian tax rules deeming the foreign plan to be a retirement compensation arrangement under which the employer's contributions become subject to Canadian tax.

Tax tips

An individual who is immigrating to Canada should establish the date on which he or she becomes a resident and ensure that it can be supported. It's also important to keep detailed travel logs to substantiate travel inside and outside Canada during the year.

- ▶ **Date residence commences** - It may also be possible to plan the date of commencement of Canadian residence to take advantage of lower marginal tax rates in Canada.
- ▶ **Investment portfolios** - Review your portfolio prior to establishing Canadian residence. It may be advantageous to sell investments with accrued losses before becoming a Canadian resident if those losses may be used in the country of residence.
- ▶ **Relocation expenses** - Review the tax consequences of any employer benefits paid relating to the relocation to Canada and, if possible, structure the benefits so that they are not taxable in Canada or are received before you become a resident. Certain moving expense reimbursements are not taxable.
- ▶ **Stock option plans** - Review the tax consequences of exercising stock options from a foreign employer prior to establishing Canadian residence.
- ▶ **Foreign pension plan** - The employer may be allowed to continue to contribute to that plan. However, the contributions may restrict the employee's eligibility to use Canadian RPPs, DPSPs and RRSPs.

In some cases, the employee may be allowed to transfer the pension benefits on a tax-deferred basis to an RRSP (although the transfer may not be free of foreign tax).

- ▶ **Social security premiums** - Review the tax consequences of continuing coverage under the social security system of your former country and opting out of the Canada (or Quebec) Pension Plan. Canada and Quebec have social security totalization agreements with a number of countries.

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Canadian tax for nonresidents



If you're not a Canadian resident but you receive Canadian-source income, that income may be subject to Canadian income tax.

Certain types of Canadian-source income, such as dividends, rental income, royalties, trust income, pensions and alimony, are subject to Canadian withholding tax at a general rate of 25% (which may be reduced under a tax treaty Canada has with your country of residence). Most arm's-length interest payments to nonresidents are exempt from Canadian withholding tax.

Nonresidents receiving real estate rental income may choose to file a tax return and be taxed on the net rental income at the same tax rates that apply to Canadian residents (that is, at graduated rates on net income rather than at withholding tax rates on gross income). Similarly, nonresidents receiving certain pension and benefit income may elect to be taxed on such income at the same graduated tax rates as Canadian residents, rather than at the withholding tax rate.

If you earn Canadian-source employment or business income, or sell taxable Canadian property⁷⁴ as a nonresident, you must file a Canadian income tax return reporting this income and pay any resulting tax. If you're required to include this Canadian-source income in your taxable income in your country of residence, you may be able to claim a foreign tax credit for the Canadian tax paid.

Employees performing services in Canada

As the global workforce has become more mobile, there's been an increase in nonresident employees working on short-term assignments in Canada. While many of these employees may not ultimately be liable for Canadian tax due to treaty provisions, employers and employees need to observe certain withholding and reporting requirements.

Many short-term nonresident employees are subject to Canadian tax under domestic law but are exempt by virtue of the employment services article of a tax treaty (e.g., Article XV of the *Canada-US Tax Convention*). Such individuals can be exempt from Canadian tax under either a de minimis rule if permitted under the terms of the relevant tax treaty (CDN\$10,000 under the *Canada-US Tax Convention*) or the "less than 183 days" rule.

Under the "less than 183 days" rule, short-term employees in Canada for less than 183 days (whether work related or personal) in any 12-month period commencing or ending in the fiscal year concerned can be taxable in Canada if their salary:

- ▶ Was charged to an employer resident in Canada, or
- ▶ Was borne by a permanent establishment or fixed base the employer has in Canada.

For example, when the short-term employee is seconded to a Canadian operation – which does not directly pay the seconded employee's wages but pays its original employer for the employee's services in Canada – the employee will generally be subject to Canadian personal income tax and must file the appropriate return.

These rules consider a number of questions of fact that must be carefully reviewed before concluding whether a particular employee is treaty-exempt from Canadian tax.

Canadian and nonresident employers are required to withhold and remit Canadian employee income tax withholdings and report the employment income and tax withheld on the Canada Revenue Agency (CRA) prescribed form, T4. The employer will be liable for the amount of tax that should have been withheld, plus interest and penalties, if it fails to withhold and remit the required taxes.

Even if payments are made to nonresident employees who are exempt from Canadian tax under the terms of a treaty, the nonresident employer is required to apply these employment withholdings or face the risk of liability. Before recent changes that are described below were made, only payments to a nonresident employee who obtained a tax withholding waiver from the CRA qualified for an exemption from these withholdings.

Recognizing the administrative difficulties involved in obtaining individual tax withholding waivers, the federal government introduced changes in the 2015 federal budget to create a new regime for nonresident employers to obtain an exemption from withholdings on payment to certain nonresident employees working in Canada. The changes apply to withholding obligations that arise on payments made after 2015. Under the new regime, a nonresident employer that is resident in a country with which Canada has a treaty may apply for an exemption from this obligation to withhold Canadian income taxes on employment income paid to certain nonresident employees for work performed in Canada, subject to certain limitations.

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⁷⁴ Taxable Canadian property generally includes real property situated in Canada, property used in a business carried on in Canada and interests in certain entities deriving a specified proportion of their value from Canadian real property or resource properties. There are several specific exclusions from the definition of taxable Canadian property. If you're a nonresident disposing of Canadian property, consult your EY advisor to navigate the complicated rules.



To apply for this exemption, a qualifying nonresident employer must complete Form RC473, *Application for Non-Resident Employer Certification*. If the CRA approves the application, the nonresident employer will not be required to withhold Canadian income taxes from payments made to qualifying nonresident employees for the period of certification.

A qualifying nonresident employee:

- ▶ Is resident in a country with which Canada has a tax treaty at the time of payment
- ▶ Is exempt from income tax on the payment because of that treaty
- ▶ Either works in Canada for less than 45 days in the calendar year that includes the time of payment, or is present in Canada for less than 90 days in any 12-month period that includes the time of that payment

Nonresident employers will be liable for any withholding for employees who do not meet these conditions.

It should be noted that in order to maintain this exemption, the nonresident employer must fulfill certain obligations, including tracking and recording the number of days of each qualifying nonresident employee and determining if each employee is resident in a country with which Canada has a tax treaty, among other obligations.

Tax tips

An employee who spends a substantial amount of time travelling to Canada from other taxing jurisdictions should keep a travel log to identify the following information for any given period:

- ▶ Number of days spent in Canada (identified between work and personal)
- ▶ Number of days spent outside Canada (identified between work and personal)
- ▶ Total number of workdays in the period



Nonresident employees who do not qualify as nonresident qualifying employees, but remain exempt from tax under a tax treaty, or whose employer has not received an exemption from withholding described above, may continue to apply for individual tax withholding waivers.

The CRA expects nonresidents performing services in Canada to file Canadian income tax returns so that a final tax liability can be determined upon assessment of the tax returns. In addition, a Canadian tax return filed in a timely manner provides the employee with the protection of the statute of limitations in the *Income Tax Act*.

Services rendered in Canada

Every person who pays a fee, commission or other amount to a nonresident person for services rendered in Canada, other than in the course of regular and continuous employment, is required to withhold and remit 15% of the gross amount. This withholding is required even though the recipient of the payment may not be taxable in Canada under either Canadian domestic law or an income tax treaty.

The amount withheld is not a definitive tax, but rather an instalment to be applied against the nonresident's ultimate Canadian income tax liability. The nonresident individual is required to file a Canadian personal income tax return reporting the income earned and the amount withheld as shown on the T4A-NR slip.

Tax tips

- ▶ In determining whether certain self-employment business income is subject to tax in Canada or in another country, it is important to also consider the provisions of any applicable tax treaty.
- ▶ Many of the tax treaties Canada has entered into provide that an individual will only be subject to Canadian tax on self-employment business profits that can be attributed to a permanent establishment maintained in Canada.

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Disposition of real property

If an individual (and his or her spouse) is a nonresident when their Canadian home is sold, the sales process may include obtaining a tax certificate from the CRA that either wholly or partially exempts from withholding tax any gain realized on the sale. The CRA typically accepts that the gain on which tax must be withheld at the date of sale may be reduced by the principal residence exemption.

If the certificate is not obtained, the purchaser must withhold and remit 25% of the gross proceeds. In this case, the seller must also inform the CRA of the sale within 10 days of the closing. If the certificate is not obtained at the time of sale and the purchaser withholds the required amount, no applicable refund may be obtained until the individual files a T1 return for the year in which the sale took place. However, the funds may be held in escrow where there is a delay in processing the certificate application.

The disposition of a Canadian home must be reported on a Canadian T1 return filed by the nonresident for the year of sale. A loss on the sale of a home is denied if the house has never been rented and, therefore, is considered to be personal property. Any gain that results after applying the principal residence exemption is taxable.

Where a nonresident disposes of a former home that has been rented, and has claimed capital cost allowance on the property, the allowance is “recaptured” and brought into income when the property is disposed of, provided the proceeds of disposition exceed the undepreciated capital cost of the property. The recaptured amount is reported on a separate subsection 216(5) return, which must include all Canadian-source real property rental income earned in the year of recapture (see **Taxation of rental income**).

Tax tips

- ▶ Where a certificate has been obtained prior to the actual sale, and the actual sale price turns out to be more than the estimated price on the certificate, the purchaser’s liability to withhold tax is adjusted to 25% of the revised gain.
- ▶ If the certificate is filed after the transaction is completed and the nonresident vendor pays an amount equal to 25% of the gain, the purchaser is relieved from the withholding obligation when CRA issues the certificate.
- ▶ The issuance of a certificate by CRA does not relieve the nonresident vendor of the obligation to file a Canadian T1 return reporting the sale.

Principal residence exemption – 2016 update

On 3 October 2016, federal Finance Minister Bill Morneau announced new measures relating to the special exemption that may apply to shelter a gain on the sale of a principal residence. These measures were included in Bill C-63, *Budget Implementation Act, 2017, No. 2*, which received Royal Assent on 14 December 2017.

The amendments revise the calculation of the principal residence exemption by removing one year of exemption room for individuals who are nonresidents of Canada throughout the year of acquisition of the property. The revised calculation applies to dispositions that occur after 2 October 2016. In addition, the amendments ensure that certain trusts (including those with nonresident beneficiaries) will no longer qualify to designate a property as a principal residence for taxation years that begin after 2016. However, gains accruing up to the end of 2016 on a qualifying principal residence of the trust may still qualify for the exemption.

Additional amendments include an extended assessment period for taxpayers who do not report the disposition of property on their tax return.

Individuals who purchase property in Canada while they’re nonresidents of Canada and beneficiaries of certain trusts should review the new rules and the tax implications of disposing of property that may no longer qualify for the principal residence exemption.

For more information, contact your EY Tax advisor.

Taxation of rental income

Canada retains the right to tax nonresidents on income from Canadian real property. Under the general provisions of the *Income Tax Act*, a nonresident of Canada earning rental income is subject to a 25% withholding tax on gross rental income. The person who pays the rent to a nonresident must withhold and remit this tax. Where rental payments are made to an agent, the agent is responsible for withholding and remitting the tax.

With respect to the payment of tax on Canadian rental property, a nonresident owner has three options:

- ▶ Under the default option, an agent or tenant must withhold 25% tax from the gross rent, remit the funds withheld directly to the CRA throughout the year, and report the gross rents and tax withheld on Form NR4 by 31 March of the following year. Where the NR4 information return is filed on time, the nonresident owner does not need to file a Canadian T1 return to report the receipt of rental income. Because this option does not allow for any deductions against gross rent, it is usually not the preferred alternative.

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- ▶ The nonresident owner elects to file a Canadian section 216 return within two years from the end of the taxation year in which the rents were received and to pay tax at graduated tax rates on net rental income. Generally, all reasonable expenses that relate to earning the rental income are deductible in computing the net rental income. The agent or tenant is still required to withhold and remit tax from the gross rent at a 25% rate; however, this withholding tax is creditable against the tax liability as determined on the individual's T1 return, and any excess tax withheld is refundable.
- ▶ The nonresident owner may elect to have the initial 25% withholding tax be based on the anticipated net rental income (excluding depreciation claims) rather than the gross rent. To have the withholding tax reduced in this manner, the individual must appoint an agent who is resident in Canada and must file the section 216 return within six months from the end of the taxation year in which rents were received. The nonresident makes this election by filing Form NR6 before the beginning of each taxation year (1 January), or in the year in which the property is first being rented before the date on which the first rental payment is due.

The net income reported on the section 216 return and deductions allowed are the same for the second and third alternatives. Where the nonresident owns multiple rental properties and a section 216 return is filed, all of the Canadian rental income and expenses must be reported together on one return.

Taxation of Canadian benefits

Canada generally retains the right to tax Canadian benefit payments made to nonresidents. A nonresident is subject to a flat 25% withholding on gross Canadian benefits. The 25% tax represents the nonresident's final Canadian tax liability, and the nonresident does not need to file a T1 return to report the Canadian benefits. Where an individual is a resident of a treaty country, the withholding rate may be reduced under the treaty.

Alternatively, a nonresident may elect under section 217 to report Canadian benefits on a T1 return and pay Part I tax at incremental tax rates and claim applicable deductions and credits. Making the section 217 election may result in a refund of all or some of the 25% tax withheld under Part XIII.

Additionally, a nonresident who intends to make the Section 217 election may apply to the CRA for a reduction of the withholding taxes by completing Form NR5, *Application by a Non-Resident of Canada for a Reduction in the Amount of Non-Resident Tax Required to be Withheld for Tax Year*. If the CRA approves this application, the Canadian benefits will be subject to a reduced withholding rate, as determined by the CRA based on the information provided on the application. Generally, this reduced rate will be valid for a period of five years, unless there are changes in the amount of income that the nonresident receives, in which case an updated application must be made.

Canadian benefits for this purpose include the following:

- ▶ Old age security pension
- ▶ Canada Pension Plan or Quebec Pension Plan
- ▶ Superannuation or pension benefits
- ▶ DPSP, RRSP, PRPP and RRIF payments
- ▶ Retiring allowances
- ▶ Payments from a retirement compensation arrangement
- ▶ Death benefits
- ▶ Employment insurance benefits
- ▶ Certain prescribed benefits under a government assistance program
- ▶ Supplementary unemployment benefit plan payments
- ▶ Auto Pact benefits

If the election is made, all Canadian benefits paid or credited in that year must be reported on the section 217 T1 return. The section 217 return must be filed within six months after the end of the year.

Tax tips

The section 217 return must be filed within six months after the end of the year.

- ▶ For an individual making a section 217 election for 2019, the T1 return is due on or before 30 June 2020. If an individual must report other income on the return, such as Canadian-source employment income or taxable capital gains, the due date is 30 April 2020.
- ▶ For returns due 30 June 2020, any tax balance owing for 2019 must be paid by 30 April 2020, to avoid interest charges.

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Tax payments and refunds



Now that we've given you some good ideas on how to save on your taxes, let's take a look at how you can make the final part of the process as efficient and effective as possible.

Payments

Source deductions

Your employment income is subject to withholding at source. This is generally determined without taking into consideration certain deductions and credits that are available when you file your tax return. It's possible, with the consent of the Canada Revenue Agency (CRA) or Revenu Québec, to adjust the tax withholding on your employment income to take these deductions and credits, such as registered retirement savings plan (RRSP) and interest expense deductions, into account.

You must complete and file Form T1213, *Request to Reduce Tax Deductions at Source*. The form states which CRA office you must file the form with. If the request is approved, your employer will take the amount approved (within the approval letter or letter of authority the CRA sends to you) into account in calculating the amount to be withheld. Generally, a separate application for reduced withholding must be made each year.

Tax tip

If you expect to have substantial tax deductions, consider applying to the CRA or Revenu Québec early in the year for a reduction to tax withholding at source.

Instalments

If the difference between your federal tax payable and amounts withheld at source is greater than \$3,000 (for residents of Quebec, \$1,800) in both the current year and either of the two preceding years, you are required to pay quarterly income tax instalments. For this purpose, tax payable includes the combined federal and provincial income tax (except in Quebec).⁷⁵

If you're a resident of Quebec, you're required to pay provincial tax instalments if the difference between Quebec tax payable and withheld at source is greater than \$1,800.

If you're required to make quarterly instalment payments, you must remit them by 15 March, 15 June, 15 September and 15 December.⁷⁶ The same general requirements apply for Quebec tax purposes.

If you're required to make instalments, the CRA (or Revenu Québec) will send you instalment notices that set out your payments.

There are three allowable methods of calculating instalments:

- ▶ **No-calculation option** – You may simply choose to pay the suggested amount on the instalment notices that the CRA sends you. The CRA's instalment notice uses the method that requires each of your first two 2020 instalments to be one-quarter of your balance due for 2018, and your second two instalments to aggregate to your 2019 balance due, less the amounts payable in your first two instalments. Each of the final two instalments would be equal to one-half of this amount. If you do not receive an instalment notice from the CRA, no instalment payment is required.
- ▶ **Prior-year option** – You may choose instead to calculate each instalment as one-quarter of your 2019 balance due.

- ▶ **Current-year option** – A third alternative allows you to calculate each instalment as one-quarter of your anticipated 2020 balance due.

The third alternative can result in a lower instalment requirement if your tax is expected to be lower in 2020 than in 2019. But if you underestimate your 2020 balance due and pay insufficient instalments, you will be charged interest.

Interest

Non-deductible interest, payable on late or deficient instalments and unpaid taxes, is calculated using prescribed rates, varying quarterly and compounded daily. The federal prescribed rate for 2019 was 6% for Q1, Q2, Q3 and Q4.

The interest charge is calculated from the date each instalment is due. However, you are permitted to reduce or eliminate interest charged on late or deficient instalments by overpaying subsequent instalments or paying other instalments before their due dates.

Penalties

In addition to the interest charged on late or deficient payments, there may be a federal penalty equal to one-half of the interest payable. The penalty applies only to instalment interest owing after any offset of interest payable to the taxpayer, and does not apply to the first \$1,000 of interest or to interest on up to 25% of the tax payable by instalments, whichever is greater.

This penalty does not apply for Quebec tax purposes. In that province, where the amount paid is less than 75% of the required instalment, additional interest of 10% per year, compounded daily, is charged on the unpaid portion of the instalment.

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⁷⁵ However, instalments may not be required if the individual had no tax payable for the prior year and selects the prior year method (see below) for calculating instalment payments.

⁷⁶ Farmers and fishermen use the same instalment base but are required to make an instalment payment equal to two-thirds of that base by 31 December and pay the balance on filing.



Relief provisions (formerly known as the fairness provisions)

The taxpayer relief provisions provide the CRA with authority to exercise certain discretion in the administration and enforcement of the tax rules. For example, they allow the CRA to cancel or waive penalties and interest payable in extraordinary circumstances (including cases of natural disaster, serious illness, financial hardship or CRA delays or errors).

In general, the CRA has the discretion to be lenient with taxpayers who, because of circumstances beyond their control, are unable to meet deadlines or otherwise comply with certain rules. This discretion is available for requests made for a taxation year ending in the 10 previous calendar years. For example, a request made in 2019 will only be accepted for 2009 and later taxation years.

Tax tips

The relief provisions include the following allowances:

- ▶ Tax refunds may be paid even though a return is filed more than three years late.
- ▶ Penalties and interest may be waived where there are extraordinary circumstances.
- ▶ Late-filed, amended or revoked elections may be accepted.

You generally have to apply in writing and give reasons why the CRA should exercise this discretion (Revenu Québec has a similar fairness package).

If you believe you may benefit from the relief provisions, contact your EY Tax advisor.

Voluntary disclosures

The voluntary disclosures program (VDP) is an administrative program administered by the CRA. The goal of the VDP is to promote voluntary compliance with Canadian tax law.

Under the VDP, individuals may correct inaccurate or incomplete information they have previously provided to the CRA or disclose information they have not previously provided. There are strict limits on eligibility for the program and, as a general rule, an individual may use the program only once, unless the circumstances surrounding a second application by the individual under the program are both beyond the individual's control and related to a different matter. Also, because the CRA does not want individuals to use the VDP as a means of retroactive tax planning, the CRA will not accept late-filed elections through the VDP.

Usually, an individual makes a voluntary disclosure to protect himself or herself from the significant penalties – or in extreme cases, prosecution – that may result if the errors or omissions are detected by the tax authorities. A valid disclosure must include a written submission and must meet several conditions, including the requirements that it is voluntary and complete. Where an individual makes a valid disclosure that is accepted by the CRA, he or she is liable for the taxes owing (plus interest), but is not subject to penalties or prosecution under the General Program. Under the Limited Program, he or she is still subject to late filing penalties, but not to prosecution (see below). In some cases under the General Program, the interest may be reduced.⁷⁷

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⁷⁷ The minister of national revenue also has the authority to waive or cancel penalties or interest under the Taxpayer Relief provisions of the *Income Tax Act* (see the CRA's Information Circular IC 07-1R1 for details).



Voluntary disclosures - 2018 tax changes

On 15 December 2017, the CRA released Information Circular IC00-1R6 - Voluntary Disclosures Program, which included significant changes to the VDP that narrow its application and offer less generous relief or, in some cases, no relief, to non-compliant taxpayers. The new information circular follows the release of the draft circular on 9 June 2017. The release of the draft circular, in turn, followed an extensive review of the VDP recommendations made in 2016 by both the House of Commons Standing Committee on Finance and the Offshore Compliance Advisory Committee. The new circular applies to VDP applications received on or after 1 March 2018. Applications received prior to that date were processed under the old rules.

Notably, the CRA has separated the VDP policy for disclosures involving income tax and source deductions from the VDP policy for GST/HST, excise tax, excise duties, softwood lumber products export charges and air travellers security charges.

The new rules include the following major changes to the CRA's VDP policy for income tax and source deductions:

- ▶ **General Program and Limited Program for VDP relief:** Rather than a “one size fits all” program, applications are now processed under one of two different tracks. Applicants processed under the Limited Program⁷⁸ are offered more limited relief, as the successful applicant under this track is not assessed gross negligence penalties, and is not subject to criminal prosecution, but is also not eligible for any relief from interest or late filing penalties.
- ▶ **Restricted entry:** The CRA is excluding VDP applications involving transfer pricing matters (these relief requests are now handled by the Transfer Pricing Review Committee) and competent authority matters in respect of a tax treaty.
- ▶ **Reduction of interest relief:** Under the General Program, successful applicants may obtain interest relief for 50% of the amount of interest for the years prior to the three most recent years of the disclosure, while no interest relief is provided under the Limited Program. The previous VDP program did not place a limit on interest relief.
- ▶ **Reduction of objection rights:** Applicants under the Limited Program must waive objection and appeal rights with respect to the specific matter disclosed under the VDP and any related assessment of taxes (subject to certain exceptions).
- ▶ **Elimination of “no name” disclosures:** Under the old rules, an applicant could enter the VDP on a no-name basis, which provided the applicant with a 90-day protective period to prepare the complete disclosure without the risk of losing access to the program because of an enforcement action. Under the new rules, applicants must disclose their identity and file a complete disclosure in order to enter the VDP. The no-name method effectively ceased to exist with the elimination of the 90-day protective period on 1 March 2018.
- ▶ **Imposing additional conditions on applicants:** For example, taxpayers are now required to pay the estimated taxes owing at the time they apply for VDP relief, unless a payment arrangement can be made with CRA collections officials. Taxpayers must also disclose the names of any advisors from whom they received assistance in respect of the subject matter of the VDP application.

For more information, refer to EY [Tax Alert 2017 Issue No. 26](#), *Proposed changes to income tax VDP*, and [2017 Issue No. 53](#), *Changes to income tax VDP revised*.

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⁷⁸ Generally includes corporations with gross revenue in excess of \$250 million in at least two of their last five taxation years, and applicants disclosing non-compliance where there is an element of intentional conduct on the part of the taxpayer, or a closely related party (e.g., use of offshore vehicles or other means in an effort to avoid detection).



Refunds

Direct deposit

You can have your income tax refund deposited directly into your personal bank account at any financial institution across the country.

Interest on refunds

The CRA and Revenu Québec pay interest for current-year overpayments of tax. As noted on the CRA's website, interest is paid for federal purposes commencing 31 days (for Quebec purposes, 45 days) after the later of 30 April of the following year and the date the return is filed.

Refund interest is taxable. On the other hand, arrears interest and penalties are not deductible.

Communicating with the CRA

Keep your receipts for your personal income tax return

The CRA review of personal income tax returns includes pre-assessment reviews, post-assessment reviews and audits. Individuals who file their personal income tax returns electronically, or who do not file information slips and receipts with their paper-filed returns, must keep their receipts for six years following the filing of the return in case the CRA comes calling.

Returns selected for review

Each year, the CRA processes almost 30 million personal income tax returns, without conducting any manual review on the majority of them. Some, however, are selected for further review at varying points in the CRA's processing timeline. The process of selecting returns for review is the same, whether the return is filed on paper or electronically.

There are a number of reasons why a return may be selected for review, including:

- ▶ Random selection
- ▶ Comparison of information on returns to information received from third-party sources, such as T4 information slips
- ▶ Types of deductions or credits claimed and an individual's review history (for example, if a taxpayer's return was selected in a previous year and the review resulted in an adjustment)

When a tax return is selected for review, it's important to note that it does not represent a tax audit. The selection for review may occur at any point in the assessment cycle:

- ▶ Pre-assessment review, before the notice of assessment is issued
- ▶ Processing review, after the notice of assessment is issued
- ▶ Matching programs, which are post-assessment reviews to compare the information on an individual's income tax return to information provided by third-party sources such as employers or financial institutions
- ▶ Special assessment programs, either pre- or post-assessment, to identify and gather information on trends and situations of non-compliance

Matching programs include matching the return information with the T slips that are in the CRA's system (employment income from your employer, interest and dividends from the payors, etc.), and linking returns between spouses and other family members. The family linking ensures that appropriate family income is used for claims like the GST/HST credit or the Canada Child Benefit (formerly the Canada Child Tax Benefit), that valid personal amounts or other credits are being claimed (for example, where credits are transferred to partners or parents) or to ensure that certain deductions are valid (such as the child-care deduction, which is generally only available to the lower-income spouse). If discrepancies arise during this matching and linking stage, reassessments may be issued or, in some cases, where additional information is necessary, the CRA will request that the taxpayer provide that information.

As part of this post-assessment review, the CRA selects a percentage of the returns filed for further scrutiny. It targets specific claim items and asks the selected taxpayers to provide support, usually copies of receipts, for those claims. Items that have been subject to post-assessment review in the past include donations, moving expenses, child-care expenses, tuition and education amounts,⁷⁹ foreign tax credits, medical expenses and carrying charges. Depending on the results of the review, the CRA may choose to target the same claim items for a number of years.

Once a return has been selected for review, the CRA will try to verify the claim based on the information in their file. If additional information is required, the CRA contacts the taxpayer or the authorized representative who prepared the return. The requested information may be submitted by mail, fax or electronically using "My Account" or "Represent a Client."

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⁷⁹ The education and textbook credits were eliminated effective 1 January 2017. However, any unused amounts carried forward from years prior to 2017 remain available to be claimed in 2017 and subsequent years. See [Chapter 9: Families](#) for further details.



If the taxpayer does not respond on a timely basis, or is unable to provide adequate support for a claim, the CRA will issue a reassessment, perhaps denying a claim completely, or adjusting an income or expense figure based on the information on file, so it is always important to respond to these requests on a timely basis.

Educational letters

Since 2010, the CRA has implemented a letter campaign, sending “educational letters” to inform selected taxpayers about their tax obligations and to encourage them to correct any past inaccuracies, if applicable. These letters are mailed to individuals in selected groups in which the CRA feels that taxpayers are at risk of misunderstanding their obligations about their rental, business, professional or employment activities. Some letters may notify taxpayers that the CRA may conduct an audit in their activity group.

The CRA website notes that it sent approximately 32,500 letters in the year ended 31 March 2018. Receiving this kind of letter does not mean that the taxpayer will be selected for audit. Sometimes it just identifies areas where common errors or misunderstandings of the tax law have occurred. It also does not mean that the tax returns filed were incorrect.

If you receive a letter, review your returns and make sure that your income and deductions have been reported correctly. If you find errors, you should request an adjustment to correct them.

CRA e-services

The CRA has been expanding its online services to help individuals manage their tax affairs.

My Account

My Account is an online service that provides secure access to an individual’s own personal tax and benefit information via the internet. Using this service, you can see information about your:

- ▶ Online mail from CRA
- ▶ Tax returns and carryover amounts
- ▶ Tax-free savings account
- ▶ RRSP, Home Buyers’ Plan and Lifelong Learning Plan
- ▶ Account balance and statement of account
- ▶ Principal residence designation
- ▶ Instalments
- ▶ Tax refund or balance owing
- ▶ Direct deposit
- ▶ Pre-authorized payment plan
- ▶ Marital status
- ▶ Tax information slips - T4, T4A, T4A(P), T4A(OAS), T4RSP, T4RIF, T5007, T3, T5, T5008, T5013, RRSP contribution receipt and T4E
- ▶ Disability tax credit
- ▶ Children for whom you are the primary caregiver
- ▶ Canada Child Benefit (and related provincial and territorial programs) payments, account balance and statement of account
- ▶ GST/HST credit (and related provincial programs) payments, account balance, and statement of account

- ▶ Canada Workers Benefit advanced payments
- ▶ Notice of Assessment or Re-assessment
- ▶ Authorized representative
- ▶ Emigration date
- ▶ Addresses and telephone numbers

With My Account, you can also manage your personal income tax and benefit account online by:

- ▶ Changing your return(s)
- ▶ Changing your address or telephone numbers
- ▶ Changing your marital status
- ▶ Applying for child benefits
- ▶ Applying for a non-resident account number
- ▶ Arranging your direct deposit
- ▶ Authorizing your representative
- ▶ Setting up a payment plan
- ▶ Formally disputing your assessment or determination
- ▶ Filing a service complaint
- ▶ Submitting documents in response to a CRA request
- ▶ Registering to receive email notifications when there is new correspondence from the CRA available to view online (such as notices of assessment or T1 adjustment letters)
- ▶ Using the Auto-fill My Return service (see below)
- ▶ Submitting audit enquiries and receiving responses from an auditor/compliance program officer, and viewing your audit history (provided you have an audit case number)

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Auto-fill My Return

This service allows you to automatically complete certain parts of your tax return online if you are registered for My Account and use compatible software for preparing your return. It pre-populates certain fields on the return using information the CRA has on file such as T3, T4 or T5 slips, RRSP information, certain carryover amounts, and instalment payments.

MyCRA mobile app

The MyCRA mobile app lets you access and view personalized tax information on your mobile device such as your Notice of Assessment, return status, benefits and credits, and TFSA and RRSP contribution limits. The app also lets you manage your contact and direct deposit information or make a payment from your mobile device, as well as register to receive email notifications when correspondence is available for viewing in My Account.

MyBenefits CRA mobile app

The MyBenefits CRA mobile app allows you to view all your benefit and credit information on your mobile device, including the amount of your payments, when your benefits or credits will be paid and the status of your Canada Child Benefit application. It also lets you update some of your personal information that may affect benefit and credit eligibility, such as your marital status and children under your care. You can access the MyBenefits CRA mobile app through My Account or by visiting <https://www.canada.ca/en/revenue-agency/services/e-services/cra-mobile-apps.html>.

CRA email notifications service

Effective 11 February 2019, the CRA merged its online mail and account alert services into its new email notification service. Email notifications send you an email to let you know when you have new CRA mail to view in My Account (see above). It also provides you with an account alert email from the CRA whenever there is a change to your account, such as a change to:

- ▶ Your address (home and mailing)
- ▶ Your banking information for direct deposit
- ▶ An authorized representative on your account

Email notifications also let you know if mail that the CRA sent to you has been returned to them.

This service can be beneficial, since it effectively provides you with a confirmation of requested changes made to your address, direct deposit information or authorized representative. If you receive an email for a change that you have not requested, you can report it to the CRA as soon as it happens. The email notification for mail returned to the CRA can prevent you from missing out on any payments made by the CRA by paper mail, such as a cheque. You must be registered for My Account in order to sign up for email notifications.

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Putting these ideas into practice

We hope you've found this guide helpful in understanding your tax position today and where you're going in the future. Some of these ideas will require immediate action, while others require your year-round attention.

Stay on top of ongoing changes in the tax environment by visiting us at ey.com/ca/tax. Here, you'll find our frequent Tax Alerts and monthly newsletter *TaxMatters@EY*, both of which deal with current and relevant tax issues. You'll also find our easy-to-use, interactive [personal tax calculator](#) and RRSP calculator.

You can subscribe to our tax and other email alerts at ey.com/ca/emailalerts.

For more information on our Tax services, contact your EY advisor.

This publication does not attempt to discuss all circumstances in which an individual may be subject to income tax. For example, the taxation of nonresidents, part-year residents, partnerships and owner-managed businesses is not dealt with in detail. For further information on these or other topics, please consult your EY Tax advisor.

This publication incorporates all announced government initiatives to 30 September 2019. It reflects our understanding of the CRA's and Revenu Québec's administrative practices as at the date of writing. While every effort has been made to ensure the accuracy and timeliness of the material contained in this publication, it is neither a comprehensive review of the subject matter covered nor a substitute for specific professional advice. Readers should consult their professional advisors prior to acting on the basis of material in this publication.



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A Combined personal income tax rates



Alberta

Combined federal and provincial personal income tax rates - 2019¹

Taxable income		Alberta					
Lower limit	Upper limit	Basic tax ²	Rate on excess	Marginal rate on			Capital gains ⁴
				Eligible dividend income ³	Other dividend income ³		
\$ -	to \$ 12,069	\$ -	0.00%	0.00%	0.00%	0.00%	
12,070	to 19,369	-	15.00%	0.00%	6.87%	7.50%	
19,370	to 47,630	1,095	25.00%	0.00%	15.85%	12.50%	
47,631	to 95,259	8,160	30.50%	7.56%	22.18%	15.25%	
95,260	to 131,220	22,687	36.00%	15.15%	28.50%	18.00%	
131,221	to 147,667	35,633	38.00%	17.91%	30.80%	19.00%	
147,668	to 157,464	41,883	41.00%	22.05%	34.25%	20.50%	
157,465	to 209,952	45,900	42.00%	23.43%	35.40%	21.00%	
209,953	to 210,371	67,945	43.00%	24.81%	36.55%	21.50%	
210,372	to 314,928	68,125	47.00%	30.33%	41.15%	23.50%	
314,929	and up	117,267	48.00%	31.71%	42.30%	24.00%	

- The tax rates reflect budget proposals and news releases to 15 June 2019. Where the tax is determined under the alternative minimum tax provisions (AMT), the table is not applicable. AMT may be applicable where the tax otherwise payable is less than the tax determined by applying the relevant AMT rate to the individual's taxable income adjusted for certain preference items.
- The tax determined by the table should be reduced by the applicable federal and provincial tax credits, other than the basic personal tax credits, which have been reflected in the calculations.
- The rates apply to the actual amount of taxable dividends received from taxable Canadian corporations. Eligible dividends are those paid by public corporations and private companies out of earnings that have been taxed at the general corporate tax rate (the dividend must be designated by the payor corporation as an eligible dividend). Where the dividend tax credit exceeds the federal and provincial tax otherwise payable on the dividends, the rates do not reflect the value of the excess credit that may be used to offset taxes payable from other sources of income. This assumption is consistent with prior year rates.
- The rates apply to the actual amount of the capital gain. The capital gains exemption on qualified farm and fishing property and small business corporation shares may apply to eliminate the tax on those specific properties.

British Columbia

Combined federal and provincial personal income tax rates - 2019¹

Taxable income		British Columbia					
Lower limit	Upper limit	Basic tax ²	Rate on excess	Marginal rate on			Capital gains ⁴
				Eligible dividend income ³	Other dividend income ³		
\$ -	to \$ 12,069	\$ -	0.00%	0.00%	0.00%	0.00%	
12,070	to 20,189	-	15.00%	0.00%	6.87%	7.50%	
20,190	to 33,702 ⁵	1,218	23.62%	0.00%	14.53%	11.81%	
33,703	to 40,707	4,410	20.06%	0.00%	10.43%	10.03%	
40,708	to 47,630	5,815	22.70%	0.00%	13.47%	11.35%	
47,631	to 81,416	7,386	28.20%	7.56%	19.80%	14.10%	
81,417	to 93,476	16,914	31.00%	7.56%	23.02%	15.50%	
93,477	to 95,259	20,653	32.79%	7.96%	25.07%	16.40%	
95,260	to 113,506	21,237	38.29%	15.55%	31.40%	19.15%	
113,507	to 147,667	28,224	40.70%	18.88%	34.17%	20.35%	
147,668	to 153,900	42,128	43.70%	23.02%	37.62%	21.85%	
153,901	to 210,371	44,852	45.80%	25.92%	40.04%	22.90%	
210,372	and up	70,715	49.80%	31.44%	44.64%	24.90%	

- The tax rates reflect budget proposals and news releases up to 15 June 2019. Where the tax is determined under the alternative minimum tax provisions (AMT), the table is not applicable. AMT may be applicable where the tax otherwise payable is less than the tax determined by applying the relevant AMT rate to the individual's taxable income adjusted for certain preference items.
- The tax determined by the table should be reduced by the applicable federal and provincial tax credits, other than the basic personal tax credits, which have been reflected in the calculations.
- The rates apply to the actual amount of taxable dividends received from taxable Canadian corporations. Eligible dividends are those paid by public corporations and private companies out of earnings that have been taxed at the general corporate tax rate (the dividend must be designated by the payor corporation as an eligible dividend). Where the dividend tax credit exceeds the federal and provincial tax otherwise payable on the dividends, the rates do not reflect the value of the excess credit that may be used to offset taxes payable from other sources of income. This assumption is consistent with prior year rates.
- The rates apply to the actual amount of the capital gain. The capital gains exemption on qualified farm and fishing property and small business corporation shares may apply to eliminate the tax on those specific properties.
- Individuals resident in British Columbia on 31 December 2019 with taxable income up to \$20,189 generally pay no provincial income tax as a result of a low-income tax reduction. The low-income tax reduction is clawed back on income in excess of \$20,190 until the reduction is eliminated, resulting in an additional 3.56% of provincial tax on income between \$20,190 and \$33,702.

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Manitoba

Combined federal and provincial personal income tax rates - 2019¹

Taxable income		Manitoba					
Lower limit	Upper limit	Basic tax ²	Rate on excess	Marginal rate on			Capital gains ⁴
				Eligible dividend income ³	Other dividend income ³		
\$ -	to \$ 9,626	\$ -	0.00%	0.00%	0.00%	0.00%	0.00%
9,627	to 12,069	-	10.80%	3.86%	11.52%	5.40%	
12,070	to 32,670	264	25.80%	3.86%	18.38%	12.90%	
32,671	to 47,630	5,579	27.75%	6.56%	20.63%	13.88%	
47,631	to 70,610	9,730	33.25%	14.12%	26.95%	16.63%	
70,611	to 95,259	17,371	37.90%	20.53%	32.30%	18.95%	
95,260	to 147,667	26,713	43.40%	28.12%	38.62%	21.70%	
147,668	to 210,371	49,458	46.40%	32.26%	42.07%	23.20%	
210,372	and up	78,553	50.40%	37.78%	46.67%	25.20%	

- The tax rates reflect budget proposals and news releases to 15 June 2019. Where the tax is determined under the alternative minimum tax provisions (AMT), the table is not applicable. AMT may be applicable where the tax otherwise payable is less than the tax determined by applying the relevant AMT rate to the individual's taxable income adjusted for certain preference items.
- The tax determined by the table should be reduced by the applicable federal and provincial tax credits, other than the basic personal tax credits, which have been reflected in the calculations.
- The rates apply to the actual amount of taxable dividends received from taxable Canadian corporations. Eligible dividends are those paid by public corporations and private companies out of earnings that have been taxed at the general corporate tax rate (the dividend must be designated by the payor corporation as an eligible dividend). Where the dividend tax credit exceeds the federal and provincial tax otherwise payable on the dividends, the rates do not reflect the value of the excess credit that may be used to offset taxes payable from other sources of income. This assumption is consistent with prior year rates.
- The rates apply to the actual amount of the capital gain. The capital gains exemption on qualified farm and fishing property and small business corporation shares may apply to eliminate the tax on those specific properties.

New Brunswick

Combined federal and provincial personal income tax rates - 2019¹

Taxable income		New Brunswick					
Lower limit	Upper limit	Basic tax ²	Rate on excess	Marginal rate on			Capital gains ⁴
				Eligible dividend income ³	Other dividend income ³		
\$ -	to \$ 12,069	\$ -	0.00%	0.00%	0.00%	0.00%	0.00%
12,070	to 17,134	-	15.00%	0.00%	6.87%	7.50%	
17,135	to 39,301 ⁵	760	27.68%	0.00%	18.28%	13.84%	
39,302	to 42,592	6,895	24.68%	0.00%	14.83%	12.34%	
42,593	to 47,630	7,708	29.82%	1.13%	20.75%	14.91%	
47,631	to 85,184	9,210	35.32%	8.69%	27.07%	17.66%	
85,185	to 95,259	22,474	37.02%	11.04%	29.03%	18.51%	
95,260	to 138,491	26,204	42.52%	18.63%	35.35%	21.26%	
138,492	to 147,667	44,586	43.84%	20.45%	36.87%	21.92%	
147,668	to 157,778	48,609	46.84%	24.59%	40.32%	23.42%	
157,779	to 210,371	53,345	49.30%	27.99%	43.15%	24.65%	
210,372	and up	79,273	53.30%	33.51%	47.75%	26.65%	

- The tax rates reflect budget proposals and news releases to 15 June 2019. Where the tax is determined under the alternative minimum tax provisions (AMT), the table is not applicable. AMT may be applicable where the tax otherwise payable is less than the tax determined by applying the relevant AMT rate to the individual's taxable income adjusted for certain preference items.
- The tax determined by the table should be reduced by the applicable federal and provincial tax credits, other than the basic personal tax credits, which have been reflected in the calculations.
- The rates apply to the actual amount of taxable dividends received from taxable Canadian corporations. Eligible dividends are those paid by public corporations and private companies out of earnings that have been taxed at the general corporate tax rate (the dividend must be designated by the payor corporation as an eligible dividend). Where the dividend tax credit exceeds the federal and provincial tax otherwise payable on the dividends, the rates do not reflect the value of the excess credit that may be used to offset taxes payable from other sources of income. This assumption is consistent with prior year rates.
- The rates apply to the actual amount of the capital gain. The capital gains exemption on qualified farm and fishing property and small business corporation shares may apply to eliminate the tax on those specific properties.
- Individuals resident in New Brunswick on 31 December 2019 with taxable income up to \$17,134 pay no provincial income tax as a result of a low-income tax reduction. The low-income tax reduction is clawed back for income in excess of \$17,134 until the reduction is eliminated, resulting in an additional 3% of provincial tax on income between \$17,135 and \$39,301.

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Newfoundland and Labrador

Combined federal and provincial personal income tax rates - 2019^{1,5}

Taxable income		Newfoundland and Labrador				
Lower limit	Upper limit	Marginal rate on				
		Basic tax ²	Rate on excess	Eligible dividend income ³	Other dividend income ³	Capital gains ⁴
\$ -	to \$ 12,069	\$ -	0.00%	0.00%	0.00%	0.00%
12,070	to 19,184	-	15.00%	0.00%	6.87%	7.50%
19,185	to 20,354	1,067	23.70%	4.55%	12.85%	11.85%
20,355	to 25,667 ⁶	1,345	39.70%	26.63%	31.25%	19.85%
25,668	to 37,591	3,454	23.70%	4.55%	12.85%	11.85%
37,592	to 47,630	6,280	29.50%	12.56%	19.52%	14.75%
47,631	to 75,181	9,241	35.00%	20.12%	25.84%	17.50%
75,182	to 95,259	18,884	36.30%	21.91%	27.34%	18.15%
95,260	to 134,224	26,172	41.80%	29.50%	33.66%	20.90%
134,225	to 147,667	42,460	43.30%	31.57%	35.39%	21.65%
147,668	to 187,913	48,281	46.30%	35.71%	38.84%	23.15%
187,914	to 210,371	66,914	47.30%	37.09%	39.99%	23.65%
210,372	and up	77,537	51.30%	42.61%	44.59%	25.65%

1. The tax rates reflect budget proposals and news releases to 15 June 2019. The rates do not include the Newfoundland and Labrador Temporary Deficit Reduction Levy (see note 5 below). Where the tax is determined under the alternative minimum tax provisions (AMT), the table is not applicable. AMT may be applicable where the tax otherwise payable is less than the tax determined by applying the relevant AMT rate to the individual's taxable income adjusted for certain preference items.
2. The tax determined by the table should be reduced by the applicable federal and provincial tax credits, other than the basic personal tax credits, which have been reflected in the calculations.
3. The rates apply to the actual amount of taxable dividends received from taxable Canadian corporations. Eligible dividends are those paid by public corporations and private companies out of earnings that have been taxed at the general corporate tax rate (the dividend must be designated by the payor corporation as an eligible dividend). Where the dividend tax credit exceeds the federal and provincial tax otherwise payable on the dividends, the rates do not reflect the value of the excess credit that may be used to offset taxes payable from other sources of income. This assumption is consistent with prior year rates.
4. The rates apply to the actual amount of the capital gain. The capital gains exemption on qualified farm and fishing property and small business corporation shares may apply to eliminate the tax on those specific properties.
5. Individuals resident in Newfoundland and Labrador on 31 December 2019 with taxable income in excess of \$50,000 must pay the Temporary Deficit Reduction Levy. The levy ranges from \$nil to \$1,800 depending on the individual's taxable income, with the maximum levy being payable by individuals with taxable income in excess of \$600,999.
6. Individuals resident in Newfoundland and Labrador on 31 December 2019 with taxable income up to \$19,184 pay no provincial income tax as a result of a low-income tax reduction. The low-income tax reduction is clawed back for income in excess of \$20,354 until the reduction is eliminated, resulting in an additional 16% of provincial tax on income between \$20,355 and \$25,667.

Northwest Territories

Combined federal and territorial personal income tax rates - 2019¹

Taxable income		Northwest Territories				
Lower limit	Upper limit	Marginal rate on				
		Basic tax ²	Rate on excess	Eligible dividend income ³	Other dividend income ³	Capital gains ⁴
\$ -	to \$ 12,069	\$ -	0.00%	0.00%	0.00%	0.00%
12,070	to 14,811	-	15.00%	0.00%	6.87%	7.50%
14,812	to 43,137	411	20.90%	0.00%	6.87%	10.45%
43,138	to 47,630	6,331	23.60%	0.00%	9.86%	11.80%
47,631	to 86,277	7,392	29.10%	7.56%	16.18%	14.55%
86,278	to 95,259	18,638	32.70%	8.53%	20.32%	16.35%
95,260	to 140,267	21,575	38.20%	16.12%	26.65%	19.10%
140,268	to 147,667	38,768	40.05%	18.67%	28.77%	20.03%
147,668	to 210,371	41,732	43.05%	22.81%	32.22%	21.53%
210,372	and up	68,726	47.05%	28.33%	36.82%	23.53%

1. The tax rates reflect budget proposals and news releases to 15 June 2019. Where the tax is determined under the alternative minimum tax provisions (AMT), the table is not applicable. AMT may be applicable where the tax otherwise payable is less than the tax determined by applying the relevant AMT rate to the individual's taxable income adjusted for certain preference items.
2. The tax determined by the table should be reduced by the applicable federal and territorial tax credits, other than the basic personal tax credits, which have been reflected in the calculations.
3. The rates apply to the actual amount of taxable dividends received from taxable Canadian corporations. Eligible dividends are those paid by public corporations and private companies out of earnings that have been taxed at the general corporate tax rate (the dividend must be designated by the payor corporation as an eligible dividend). Where the dividend tax credit exceeds the federal and territorial tax otherwise payable on the dividends, the rates do not reflect the value of the excess credit that may be used to offset taxes payable from other sources of income. This assumption is consistent with prior year rates.
4. The rates apply to the actual amount of the capital gain. The capital gains exemption on qualified farm and fishing property and small business corporation shares may apply to eliminate the tax on those specific properties.



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Nova Scotia

Combined federal and provincial personal income tax rates - 2019¹

Taxable income		Nova Scotia				
Lower limit	Upper limit	Basic tax ²	Rate on excess	Marginal rate on		
				Eligible dividend income ³	Other dividend income ³	Capital gains ⁴
\$ -	to \$ 11,894	\$ -	0.00%	0.00%	0.00%	0.00%
11,895	to 12,069	-	8.79%	0.00%	6.67%	4.40%
12,070	to 15,000	15	23.79%	0.00%	13.53%	11.90%
15,001	to 21,000 ⁵	713	28.79%	6.82%	19.28%	14.40%
21,001	to 29,590	2,440	23.79%	0.00%	13.53%	11.90%
29,591	to 47,630	4,484	29.95%	8.42%	20.62%	14.98%
47,631	to 59,180	9,887	35.45%	15.98%	26.94%	17.73%
59,181	to 93,000	13,981	37.17%	18.35%	28.92%	18.59%
93,001	to 95,259	26,552	38.00%	19.50%	29.87%	19.00%
95,260	to 147,667	27,410	43.50%	27.09%	36.20%	21.75%
147,668	to 150,000	50,208	46.50%	31.23%	39.65%	23.25%
150,001	to 210,371	51,293	50.00%	36.06%	43.67%	25.00%
210,372	and up	81,478	54.00%	41.58%	48.27%	27.00%

1. The tax rates reflect budget proposals and news releases to 15 June 2019. Where the tax is determined under the alternative minimum tax provisions (AMT), the table is not applicable. AMT may be applicable where the tax otherwise payable is less than the tax determined by applying the relevant AMT rate to the individual's taxable income adjusted for certain preference items.
2. The tax determined by the table should be reduced by the applicable federal and provincial tax credits, other than the basic personal tax credits, which have been reflected in the calculations.
3. The rates apply to the actual amount of taxable dividends received from taxable Canadian corporations. Eligible dividends are those paid by public corporations and private companies out of earnings that have been taxed at the general corporate tax rate (the dividend must be designated by the payor corporation as an eligible dividend). Where the dividend tax credit exceeds the federal and provincial tax otherwise payable on the dividends, the rates do not reflect the value of the excess credit that may be used to offset taxes payable from other sources of income. This assumption is consistent with prior year rates.
4. The rates apply to the actual amount of the capital gain. The capital gains exemption on qualified farm and fishing property and small business corporation shares may apply to eliminate the tax on those specific properties.
5. Individuals resident in Nova Scotia on 31 December 2019 with taxable income up to \$11,894 pay no provincial income tax as a result of a low-income tax reduction. The low-income tax reduction is clawed back for income in excess of \$15,000 until the reduction is eliminated, resulting in an additional 5% of provincial tax on income between \$15,001 and \$21,000.

Nunavut

Combined federal and territorial personal income tax rates - 2019¹

Taxable income		Nunavut				
Lower limit	Upper limit	Basic tax ²	Rate on excess	Marginal rate on		
				Eligible dividend income ³	Other dividend income ³	Capital gains ⁴
\$ -	to \$ 12,069	\$ -	0.00%	0.00%	0.00%	0.00%
12,070	to 16,000	-	15.00%	0.00%	6.87%	7.50%
16,001	to 45,414	590	19.00%	0.00%	8.47%	9.50%
45,415	to 47,630	6,178	22.00%	2.06%	11.92%	11.00%
47,631	to 90,829	6,666	27.50%	9.62%	18.24%	13.75%
90,830	to 95,259	18,546	29.50%	12.38%	20.54%	14.75%
95,260	to 147,667	19,852	35.00%	19.97%	26.87%	17.50%
147,668	to 210,371	38,195	40.50%	27.56%	33.19%	20.25%
210,372	and up	63,590	44.50%	33.08%	37.79%	22.25%

1. The tax rates reflect budget proposals and news releases to 15 June 2019. Where the tax is determined under the alternative minimum tax provisions (AMT), the table is not applicable. AMT may be applicable where the tax otherwise payable is less than the tax determined by applying the relevant AMT rate to the individual's taxable income adjusted for certain preference items.
2. The tax determined by the table should be reduced by the applicable federal and territorial tax credits, other than the basic personal tax credits, which have been reflected in the calculations.
3. The rates apply to the actual amount of taxable dividends received from taxable Canadian corporations. Eligible dividends are those paid by public corporations and private companies out of earnings that have been taxed at the general corporate tax rate (the dividend must be designated by the payor corporation as an eligible dividend). Where the dividend tax credit exceeds the federal and territorial tax otherwise payable on the dividends, the rates do not reflect the value of the excess credit that may be used to offset taxes payable from other sources of income. This assumption is consistent with prior year rates.
4. The rates apply to the actual amount of the capital gain. The capital gains exemption on qualified farm and fishing property and small business corporation shares may apply to eliminate the tax on those specific properties.



Ontario

Combined federal and provincial personal income tax rates - 2019^{1,5}

Taxable income		Ontario				
Lower limit	Upper limit	Basic tax ²	Rate on excess	Marginal rate on		
				Eligible dividend income ³	Other dividend income ³	Capital gains ⁴
\$ -	to \$ 12,069	\$ -	0.00%	0.00%	0.00%	0.00%
12,070	to 15,414	-	15.00%	0.00%	6.87%	7.50%
15,415	to 20,245 ⁶	502	25.10%	0.00%	10.92%	12.55%
20,246	to 43,906	1,714	20.05%	0.00%	8.89%	10.03%
43,907	to 47,630	6,458	24.15%	0.00%	13.61%	12.08%
47,631	to 77,317	7,358	29.65%	7.56%	19.93%	14.83%
77,318	to 87,813	16,160	31.48%	8.92%	22.04%	15.74%
87,814	to 91,098	19,464	33.89%	12.24%	24.81%	16.95%
91,099	to 95,259	20,578	37.91%	17.79%	29.43%	18.95%
95,260	to 147,667	22,155	43.41%	25.38%	35.76%	21.70%
147,668	to 150,000	44,905	46.41%	29.52%	39.21%	23.20%
150,001	to 210,371	45,988	47.97%	31.67%	41.00%	23.98%
210,372	to 220,000	74,947	51.97%	37.19%	45.60%	25.98%
220,001	and up	79,952	53.53%	39.34%	47.40%	26.76%

- The tax rates include the provincial surtaxes and reflect budget proposals and news releases up to 15 June 2019. The rates do not include the Ontario Health Premium (see note 5 below). Where the tax is determined under the alternative minimum tax provisions (AMT), the table is not applicable. AMT may be applicable where the tax otherwise payable is less than the tax determined by applying the relevant AMT rate to the individual's taxable income adjusted for certain preference items. Effective for 2017 and subsequent taxation years, provincial surtax and the Ontario tax reduction are pro-rated if the individual is a multijurisdictional filer.
- The tax determined by the table should be reduced by the applicable federal and provincial tax credits, other than the basic personal tax credits, which have been reflected in the calculations.
- The rates apply to the actual amount of taxable dividends received from taxable Canadian corporations. Eligible dividends are those paid by public corporations and private companies out of earnings that have been taxed at the general corporate tax rate (the dividend must be designated by the payor corporation as an eligible dividend). Where the dividend tax credit exceeds the federal and provincial tax otherwise payable on the dividends, the rates do not reflect the value of the excess credit that may be used to offset taxes payable from other sources of income. This assumption is consistent with prior year rates. Where applicable, the provincial surtax has been applied prior to deducting the dividend tax credit.
- The rates apply to the actual amount of the capital gain. The capital gains exemption on qualified farm or fishing property and small business corporation shares may apply to eliminate the tax on those specific properties.
- Individuals resident in Ontario on 31 December 2019 with taxable income in excess of \$20,000 must pay the Ontario Health Premium. The premium ranges from \$nil to \$900 depending on the individual's taxable income, with the top premium being payable by individuals with taxable income in excess of \$200,599.
- Individuals resident in Ontario on 31 December 2019 with taxable income up to \$15,414 pay no provincial income tax as a result of a low-income tax reduction. The low-income tax reduction (\$244 of Ontario tax) is clawed back for income in excess of \$15,414 until the reduction is eliminated, resulting in an additional 5.05% of provincial tax on income between \$15,415 and \$20,245.

Prince Edward Island

Combined federal and provincial personal income tax rates - 2019¹

Taxable income		Prince Edward Island				
Lower limit	Upper limit	Basic tax ²	Rate on excess	Marginal rate on		
				Eligible dividend income ³	Other dividend income ³	Capital gains ⁴
\$ -	to \$ 12,069	\$ -	0.00%	0.00%	0.00%	0.00%
12,070	to 12,731	-	15.00%	0.00%	6.87%	7.50%
12,732	to 17,000	99	24.80%	0.00%	14.99%	12.40%
17,001	to 24,000 ⁵	1,158	29.80%	5.93%	20.74%	14.90%
24,001	to 31,984	3,244	24.80%	0.00%	14.99%	12.40%
31,985	to 47,630	5,224	28.80%	4.55%	19.59%	14.40%
47,631	to 63,969	9,730	34.30%	12.12%	25.91%	17.15%
63,970	to 95,259	15,334	37.20%	16.12%	29.25%	18.60%
95,260	to 98,995	26,974	42.70%	23.71%	35.57%	21.35%
98,996	to 147,667	28,569	44.37%	24.56%	37.18%	22.19%
147,668	to 210,371	50,165	47.37%	28.70%	40.63%	23.69%
210,372	and up	79,868	51.37%	34.22%	45.23%	25.69%

- The tax rates include the provincial surtax and reflect budget proposals and news releases to 15 June 2019. Where the tax is determined under the alternative minimum tax provisions (AMT), the table is not applicable. AMT may be applicable where the tax otherwise payable is less than the tax determined by applying the relevant AMT rate to the individual's taxable income adjusted for certain preference items.
- The tax determined by the table should be reduced by the applicable federal and provincial tax credits, other than the basic personal tax credits, which have been reflected in the calculations.
- The rates apply to the actual amount of taxable dividends received from taxable Canadian corporations. Eligible dividends are those paid by public corporations and private companies out of earnings that have been taxed at the general corporate tax rate (the dividend must be designated by the payor corporation as an eligible dividend). Where the dividend tax credit exceeds the federal and provincial tax otherwise payable on the dividends, the rates do not reflect the value of the excess credit that may be used to offset taxes payable from other sources of income. This assumption is consistent with prior year rates. Where applicable, the provincial surtax has been applied after deducting the dividend tax credit.
- The rates apply to the actual amount of the capital gain. The capital gains exemption on qualified farm and fishing property and small business corporation shares may apply to eliminate the tax on those specific properties.
- Individuals resident in Prince Edward Island on 31 December 2019 with taxable income up to \$12,731 pay no provincial income tax as a result of a low-income tax reduction. The low-income tax reduction is clawed back for income in excess of \$17,000 until the reduction is eliminated, resulting in an additional 5% of provincial tax on income between \$17,001 and \$24,000.

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Quebec

Combined federal and provincial personal income tax rates - 2019¹

Taxable income ²		Federal tax ³		Quebec Taxable income ²		Provincial tax	
Lower limit	Upper limit	Basic tax ⁴	Rate on excess	Lower limit	Upper limit	Basic tax ⁴	Rate on excess
\$ -	to \$ 12,069	\$ -	0.00%	\$ -	to \$ 15,269	\$ -	0.00%
12,070	to 47,630	-	12.53%	15,270	to 43,790	-	15.00%
47,631	to 95,259	4,454	17.12%	43,791	to 87,575	4,278	20.00%
95,260	to 147,667	12,607	21.71%	87,576	to 106,555	13,035	24.00%
147,668	to 210,371	23,985	24.22%	106,556	and up	17,590	25.75%
210,372	and up	39,168	27.56%				

Combined tax rates on dividend income - 2019⁵

Taxable income ⁶		Eligible dividends	Other dividends
\$ -	to \$ 12,069	0.00%	0.00%
12,070	to 15,269	0.00%	5.73%
15,270	to 43,790	4.44%	16.60%
43,791	to 47,630	11.34%	22.35%
47,631	to 87,575	17.66%	27.63%
87,576	to 95,259	23.18%	32.23%
95,260	to 106,555	29.52%	37.51%
106,556	to 147,667	31.93%	39.53%
147,668	to 210,371	35.39%	42.41%
210,372	and up	40.00%	46.25%

1. The tax rates reflect budget proposals and news releases to 15 June 2019. Where the tax is determined under the minimum tax provisions, the table is not applicable. Alternative minimum tax (AMT) and Quebec minimum tax (QMT) may be applicable where the tax otherwise payable is less than the tax determined by applying the relevant AMT and QMT rates to the individual's taxable income adjusted for certain preference items. The rates do not reflect the health services fund contribution that may be required on non-employment income.
2. Taxable income for Quebec purposes is likely to differ from that determined for federal purposes.
3. Federal tax payable has been reduced by the 16.5% abatement for Quebec taxpayers whose taxes payable are the aggregate of federal and provincial taxes.
4. The federal tax and provincial tax determined by the table should be reduced by all applicable credits other than the basic personal tax credits, which have been reflected in the calculations.
5. The rates shown are the combined federal and provincial rates (based on budget proposals and news releases to 15 June 2019), and apply to the actual amount of taxable dividends received from taxable Canadian corporations. Eligible dividends are those paid from public corporations and private companies out of earnings that have been taxed at the general corporate tax rate (the dividend must be designated by the payor corporation as an eligible dividend). Where the dividend tax credit exceeds the federal and provincial tax otherwise payable on the dividends, the rates do not reflect the value of the excess credit that may be used to offset taxes payable from other sources of income. This assumption is consistent with prior year rates.
6. Taxable income for Quebec purposes is likely to differ from that determined for federal purposes. The tax rates do not reflect the health services fund contribution that may be required on non-employment income.

Saskatchewan

Combined federal and provincial personal income tax rates - 2019¹

Taxable income		Saskatchewan				
Lower limit	Upper limit	Basic tax ²	Rate on excess	Eligible dividend income ³	Other dividend income ³	Capital gains ⁴
\$ -	to \$ 12,069	\$ -	0.00%	0.00%	0.00%	0.00%
12,070	to 16,065	-	15.00%	0.00%	6.87%	7.50%
16,066	to 45,225	599	25.50%	0.00%	15.07%	12.75%
45,226	to 47,630	8,035	27.50%	2.07%	17.37%	13.75%
47,631	to 95,259	8,697	33.00%	9.63%	23.70%	16.50%
95,260	to 129,214	24,414	38.50%	17.22%	30.02%	19.25%
129,215	to 147,667	37,487	40.50%	19.98%	32.32%	20.25%
147,668	to 210,371	44,960	43.50%	24.12%	35.77%	21.75%
210,372	and up	72,237	47.50%	29.64%	40.37%	23.75%

1. The tax rates reflect budget proposals and news releases to 15 June 2019. Where the tax is determined under the alternative minimum tax provisions (AMT), the table is not applicable. AMT may be applicable where the tax otherwise payable is less than the tax determined by applying the relevant AMT rate to the individual's taxable income adjusted for certain preference items.
2. The tax determined by the table should be reduced by the applicable federal and provincial tax credits, other than the basic personal tax credits, which have been reflected in the calculations.
3. The rates apply to the actual amount of taxable dividends received from taxable Canadian corporations. Eligible dividends are those paid by public corporations and private companies out of earnings that have been taxed at the general corporate tax rate (the dividend must be designated by the payor corporation as an eligible dividend). Where the dividend tax credit exceeds the federal and provincial tax otherwise payable on the dividends, the rates do not reflect the value of the excess credit that may be used to offset taxes payable from other sources of income. This assumption is consistent with prior year rates.
4. The rates apply to the actual amount of the capital gain. The capital gains exemption on qualified farm and fishing property and small business corporation shares may apply to eliminate the tax on those specific properties. Individuals resident in Saskatchewan on 31 December 2019 who reported a capital gain from the disposition of qualified farm property or small business corporation shares may be eligible for an additional capital gains credit of up to 2%.



Yukon

Combined federal and territorial personal income tax rates - 2019¹

Taxable income		Yukon				
Lower limit	Upper limit	Basic tax ²	Rate on excess	Marginal rate on		Capital gains ⁴
				Eligible dividend income ³	Other dividend income ³	
\$ -	to \$ 12,069	\$ -	0.00%	0.00%	0.00%	0.00%
12,070	to 47,630	-	21.40%	0.00%	11.58%	10.70%
47,631	to 95,259	7,610	29.50%	7.56%	20.90%	14.75%
95,260	to 147,667	21,661	36.90%	15.15%	29.41%	18.45%
147,668	to 210,371	40,999	41.80%	20.37%	35.04%	20.90%
210,372	to 500,000	67,209	45.80%	25.89%	39.64%	22.90%
500,001	and up	199,860	48.00%	28.92%	42.17%	24.00%

- The tax rates reflect budget proposals and news releases to 15 June 2019. Where the tax is determined under the alternative minimum tax provisions (AMT), the table is not applicable. AMT may be applicable where the tax otherwise payable is less than the tax determined by applying the relevant AMT rate to the individual's taxable income adjusted for certain preference items.
- The tax determined by the table should be reduced by the applicable federal and territorial tax credits, other than the basic personal tax credits, which have been reflected in the calculations.
- The rates apply to the actual amount of taxable dividends received from taxable Canadian corporations. Eligible dividends are those paid by public corporations and private companies out of earnings that have been taxed at the general corporate tax rate (the dividend must be designated by the payor corporation as an eligible dividend). Where the dividend tax credit exceeds the federal and territorial tax otherwise payable on the dividends, the rates do not reflect the value of the excess credit that may be used to offset taxes payable from other sources of income. This assumption is consistent with prior year rates.
- The rates apply to the actual amount of the capital gain. The capital gains exemption on qualified farm and fishing property and small business corporation shares may apply to eliminate the tax on those specific properties.

Nonresidents

Federal personal income tax rates - 2019¹

Taxable income		Nonresident rate of 48%	
Lower limit	Upper limit	Basic tax	Rate on excess
47,631	to 95,259	10,574	30.34%
95,260	to 147,667	25,024	38.48%
147,668	to 210,371	45,191	42.92%
210,372	and up	72,104	48.84%

- The tax rates reflect budget proposals and news releases to 15 June 2019.

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Non-refundable tax credits by jurisdiction



Maximum combined federal and provincial/territorial value - 2019¹

	BC	AB	SK	MB	ON	QC ⁶	NB	NS	PEI	NL	NT	NU	YT
Amount of credit	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$
Basic personal credit ¹¹	2,351	3,747	3,497	2,850	2,644	3,802	2,804	2,556 ¹⁴	2,798	2,629	2,684	2,450	2,583
Spousal and equivalent-to-spouse credit ^{2, 11}	2,273	3,747	3,497	2,797	2,518	3,802 ⁷	2,654	2,556 ¹⁴	2,649	2,480	2,684	2,450	2,583
Infirm dependant aged 18 or over ²	-	1,121	994	389	-	- ⁸	469	246	264	260	290	196	-
Caregiver credit ²	1,308	2,192	2,065	1,460	1,464	894 ⁹	1,540	1,502	1,335	1,331	1,361	1,267	1,528
Age credit (65 and over) ²	1,367	1,664	1,638	1,527	1,385	1,420 ¹⁰	1,609	1,488 ¹⁵	1,493	1,647	1,552	1,533	1,604
Disability credit	1,668	2,756	2,256	1,930	1,936	1,563	2,067	1,908	2,005	1,815	1,971	1,807	1,801
Pension income (maximum)	351	449	405	408	415	678 ¹⁰	397	403	408	387	359	380	428
Education and textbook - per month (full-time)	-	75	-	43	-	-	-	18	43	17	24	19	-
Canada employment credit	183	183	183	183	183	153	183	183	183	183	183	183	262
Child tax credit (per child under 18) ¹¹	-	-	640	-	-	-	-	-	-	-	-	-	-
Child fitness and arts credits ¹²	-	-	-	108	-	100	-	-	-	-	-	-	32
Credits as a percentage of ...	%	%	%	%	%	%	%	%	%	%	%	%	%
Tuition fees	20.06	25.00	15.00	25.80	15.00	20.53	24.68	23.79	25.78	23.70	20.90	19.00	21.40
Medical expenses ³	20.06	25.00	25.50	25.80	22.88	32.53	24.68	23.79	25.78	23.70	20.90	19.00	21.40
Charitable donations ⁴													
- first \$200	20.06	25.00	25.50	25.80	22.88	32.53	24.68	23.79	25.78	23.70	20.90	19.00	21.40
- excess (to the extent of taxable income below \$210,372)	45.80	50.00	43.50	46.40	46.41	48.22/ 49.97 ¹³	46.95	50.00	47.37	47.30	43.05	40.50	44.00
- excess (to the extent of taxable income above \$210,371)	49.80	54.00	47.50	50.40	50.41	53.31	50.95	54.00	51.37	51.30	47.05	44.50	48.00
CPP and QPP contributions ⁵	20.06	25.00	25.50	25.80	22.88	12.53	24.68	23.79	25.78	23.70	20.90	19.00	21.40
El premiums	20.06	25.00	25.50	25.80	22.88	12.53	24.68	23.79	25.78	23.70	20.90	19.00	21.40

- This chart summarizes the more significant non-refundable tax credits. Additional federal non-refundable tax credits are available. The tax value of each tax credit is the sum of the federal tax credit and the provincial/territorial tax credit and the reduction in provincial surtax (if applicable) as they would apply to taxpayers in the highest tax brackets, with the exception of the age credit. These values are based on known rates and credit amounts as at 15 June 2019.
- The value of these credits is reduced when the dependant's (taxpayer's, in the case of the age credit) income exceeds specified threshold amounts. The federal thresholds are: \$0 for the spouse and equivalent-to-spouse credits; \$16,766 for the caregiver credit; and \$37,790 for the age credit. The thresholds may be different for provincial purposes.
- The credit applies to eligible medical expenses that exceed the lesser of \$2,352 (federal threshold) and 3% of net income (family income for Quebec purposes). Provinces/territories may have different dollar thresholds.
- Charitable donations eligible for credit are limited to 75% of net income (except in Quebec).
- One-half of CPP/QPP paid by self-employed individuals is deductible for tax purposes.
- Additional Quebec personal credits include persons living alone or with a person covered by the tax credit for dependant children - \$263 (reduced when the parent's income exceeds \$34,610); single-parent families with one or more adult children enrolled in full-time studies - \$324 (reduced when the parent's income exceeds \$34,610); a credit of \$641 is available for related dependants (other than a spouse) aged 18 or over (reduced by 15% of dependant's income). Where minor dependant children are studying full time (vocational training or post-secondary studies), an additional credit of \$440 per term is available (maximum two terms), reduced by 15% of the children's income.
- Quebec permits the transfer of personal credits from one spouse to the other. The Quebec credit is reduced by 15% of the spouse's taxable income up to \$15,269. Quebec does not provide an equivalent-to-spouse credit.
- Quebec does not have a specific infirm dependant credit.
- A refundable Quebec tax credit of \$1,205 is also available. A portion of this refundable credit is reduced by 16% of the dependant's income over \$24,105. The credit is rather \$1,032 for caring for an elderly spouse unable to live alone. For 2018 and later years, a refundable Quebec tax credit of up to \$542 may be available for an individual who supports an eligible relative without housing or co-residing with the relative.
- The Quebec credits are reduced when net family income exceeds \$34,610.
- A federal caregiver tax credit of \$335 (\$280 in Quebec) may be available in respect of a spouse, dependant or child who is dependent on the individual by reason of mental or physical infirmity.
- The Manitoba tax credit may be available for an individual up to 24 years of age. Quebec provides a refundable children's activities tax credit of \$100 for a child between 5 and 15 years old (family income must not exceed \$138,525).
- The tax credit rate of 49.97% applies to charitable donations in excess of \$200 to the extent the individual has Quebec taxable income in excess of \$106,555; otherwise, a tax credit rate of 48.22% applies.
- An enhanced provincial basic personal credit, spousal credit and equivalent-to-spouse credit may be available for individuals with taxable income under \$25,000, resulting in a tax credit of \$264. The enhanced tax credits are gradually reduced and eliminated when taxable income reaches \$75,000.
- An enhanced provincial age credit is available for individuals with taxable income under \$25,000, resulting in a tax credit of \$129. The enhanced tax credit is gradually reduced and eliminated when taxable income reaches \$75,000.

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C Probate fees by province and territory



Current as of 15 June 2019

Province/Territory	Fee/Tax ¹	Statute/Regulations
Alberta	<ul style="list-style-type: none"> ▸ \$35, where property's net value does not exceed \$10,000 ▸ \$135, where property's net value exceeds \$10,000 but not \$25,000 ▸ \$275, where property's net value exceeds \$25,000 but not \$125,000 ▸ \$400, where property's net value exceeds \$125,000 but not \$250,000 ▸ \$525, where property's net value exceeds \$250,000 	Surrogate Rules, Schedule 2 - under the <i>Judicature Act</i>
British Columbia	<ul style="list-style-type: none"> ▸ \$6 for every \$1,000 or portion thereof by which estate's value exceeds \$25,000, where value exceeds \$25,000 but not \$50,000 ▸ \$150 + \$14 for every \$1,000 or portion thereof by which estate's value exceeds \$50,000 ▸ There is an additional \$200 flat fee for estates exceeding \$25,000. 	<i>Probate Fee Act</i> s. 2, Supreme Court Civil Rules (Appendix C) under the <i>Court Rules Act</i>
Manitoba	<ul style="list-style-type: none"> ▸ \$70, where property's value does not exceed \$10,000 ▸ \$70 + \$7 for every additional \$1,000 or portion thereof by which value exceeds \$10,000 	<i>The Law Fees and Probate Charge Act</i> s. 1.1, Schedule; <i>Law Fees and Probate Charge Regulation</i>
New Brunswick	<ul style="list-style-type: none"> ▸ \$25, where estate's value does not exceed \$5,000 ▸ \$50, where estate's value exceeds \$5,000 but not \$10,000 ▸ \$75, where estate's value exceeds \$10,000 but not \$15,000 ▸ \$100, where estate's value exceeds \$15,000 but not \$20,000 ▸ \$5 per \$1,000 or portion thereof where value exceeds \$20,000 	<i>Probate Court Act</i> s. 75.1, Schedule A
Newfoundland and Labrador	<ul style="list-style-type: none"> ▸ \$60, where estate's value does not exceed \$1,000 ▸ \$60 + \$0.60 for every additional \$100 of estate's value over \$1,000 	<i>Services Charges Act</i> s. 4
Northwest Territories	<ul style="list-style-type: none"> ▸ \$30, where net property value does not exceed \$10,000 ▸ \$110, where net property value exceeds \$10,000 but not \$25,000 ▸ \$215, where net property value exceeds \$25,000 but not \$125,000 ▸ \$325, where net property value exceeds \$125,000 but not \$250,000 ▸ \$435, where net property value exceeds \$250,000 	Court Services Fees Regulations, Schedule A, Part 2 - under the <i>Judicature Act</i>
Nova Scotia	<ul style="list-style-type: none"> ▸ \$85.60, where estate's assets do not exceed \$10,000 ▸ \$215.20, where estate's assets exceed \$10,000 but not \$25,000 ▸ \$358.15, where estate's assets exceed \$25,000 but not \$50,000 ▸ \$1,002.65, where estate's assets exceed \$50,000 but not \$100,000 ▸ \$1,002.65 + \$16.95 for every \$1,000 or portion thereof by which estate's assets exceed \$100,000 	<i>Probate Act</i> s. 87(2), Fees and Allowances under Part I of the <i>Costs and Fees Act</i>
Nunavut	<ul style="list-style-type: none"> ▸ \$25, where net property value does not exceed \$10,000 ▸ \$100, where net property value exceeds \$10,000 but not \$25,000 ▸ \$200, where net property value exceeds \$25,000 but not \$125,000 ▸ \$300, where net property value exceeds \$125,000 but not \$250,000 ▸ \$400, where net property value exceeds \$250,000 	Court Fees Regulations s. 4, Schedule C - under the <i>Judicature Act</i>
Ontario ²	<ul style="list-style-type: none"> ▸ nil, where estate's value is \$1,000 or less ▸ \$5 per \$1,000 or portion thereof of the first \$50,000 of an estate's value ▸ \$250 + \$15 per \$1,000 or portion thereof by which estate's value exceeds \$50,000 	<i>Estate Administration Tax Act</i> s. 2
Prince Edward Island	<ul style="list-style-type: none"> ▸ \$50, where estate's value does not exceed \$10,000 ▸ \$100, where estate's value exceeds \$10,000 but not \$25,000 ▸ \$200, where estate's value exceeds \$25,000 but not \$50,000 ▸ \$400, where estate's value exceeds \$50,000 but not \$100,000 ▸ \$400 + \$4 per \$1,000 or portion thereof by which estate's value exceeds \$100,000 	<i>Probate Act</i> s. 119.1(4)
Quebec	▸ No probate fee or tax ³	Tariff of judicial fees in civil matters s. 15(8)
Saskatchewan	▸ \$7 per \$1,000 of the estate's value or portion thereof	<i>The Administration of Estates Act</i> s. 51(2)
Yukon	<ul style="list-style-type: none"> ▸ nil, where estate's value is \$25,000 or less ▸ \$140, where estate's value exceeds \$25,000 	Rules of Court for the Supreme Court of Yukon, Appendix C - under the <i>Judicature Act</i>

1. Additional flat fees (e.g., filing fees) may apply.

2. In accordance with Ontario's 2019-20 budget implementation legislation, the *Estate Administration Tax Act* is amended with respect to estates for which an application for an estate certificate is made on or after 1 January 2020. The probate tax exemption will apply to the first \$50,000 of the value of an estate, thereby eliminating the current lower rate of \$5 for every \$1,000, or part thereof, applicable on the first \$50,000 of the estate's value. Therefore, the probate tax will be \$15 for every \$1,000, or part thereof, of the value of the estate exceeding \$50,000.

3. Quebec charges a flat fee of \$205, irrespective of whether a natural person or legal person files a request for a will verification with the Superior Court.

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D Land transfer taxes



Current as of 15 June 2019

Province or territory	Tax or duty ¹	Statute and other sources
Alberta	No land transfer tax; however, registration fees may apply.	See the Tariff of Fees Regulation, Alta. Reg. 120/2000 for the application of registration fees.
British Columbia	Total of <ul style="list-style-type: none"> 1% of the first \$200,000 of the taxable transaction's fair market value (FMV); 2% of the land's FMV over \$200,000; 3% of the land's FMV over \$2 million, but not over \$3 million; and If property is residential, an additional 2% of the land's FMV over \$3 million.² An additional 20% tax on transfers to foreign entities of residential property located in Greater Vancouver Regional District and prescribed areas.³ 	<i>Property Transfer Tax Act</i> ss. 2.02(4), 3(1), 3.01(4); <i>Property Transfer Tax Regulation</i> 74/88 ss. 17.01, 17.02. See <i>Land Title Act</i> , Schedule 2 for the application of registration fees.
Manitoba	<ul style="list-style-type: none"> 0% on the first \$30,000 of FMV; 0.5% on the FMV over \$30,000 to \$90,000; 1.0% on the FMV over \$90,000 to \$150,000; 1.5% on the FMV over \$150,000 to \$200,000; and 2.0% on the FMV over \$200,000. 	<i>The Tax Administration and Miscellaneous Taxes Act</i> s. 112(1) (under Part III, Land Transfer Tax). See the Manitoba Land Titles Fees Regulation 71/2014 for the application of registration fees.
New Brunswick	1.0% of the greater of: <ul style="list-style-type: none"> Consideration for the transfer; and Real property's assessed value. 	<i>Real Property Transfer Tax Act</i> s. 2(1.03). See New Brunswick Regulation 83-130, Schedule B for the application of registration fees.
Newfoundland and Labrador	No land transfer tax; however, registration fees may apply.	See the Schedule of Fees Prescribed by the Minister of Government Services - Registry of Deeds at http://www.servicel.gov.nl.ca/forms/files/fees_deed.pdf and the <i>Registration of Deeds Act</i> , 2009 s. 39 for the application of registration fees.
Northwest Territories ⁴	No land transfer tax; however, registration fees may apply.	See the <i>Land Titles Act</i> s. 156(2) and the Land Titles Tariff of Fees Regulations, Schedule for the application of registration fees.
Nova Scotia	Determined by each municipality and applied to the sale price of every property that is transferred by deed. Maximum being 1.5% of the value of the property transferred.	<i>Municipal Government Act</i> s. 102(1) (under Part V, Deed Transfers). A list of municipality rates is available at http://www.novascotia.ca/snsmr/pdf/ans-property-dtt-rates.pdf .
Nunavut	No land transfer tax; however, registration fees may apply.	See <i>Land Titles Act</i> s. 156(1) and the Land Titles Tariff of Fees Regulations, Schedule for the application of registration fees.
Ontario ⁵	Total of <ul style="list-style-type: none"> 0.5% of the value of the conveyance's consideration up to and including \$55,000; 1.0% of the value of the conveyance's consideration exceeding \$55,000 up to and including \$250,000; 1.5% of the value of the conveyance's consideration exceeding \$250,000; 2.0% of the value of the conveyance's consideration exceeding \$400,000; and 2.5% of the value of the conveyance's consideration exceeding \$2 million (only where the conveyance of land contains at least one and not more than two single family residences). An additional 15% tax on transfers to foreign entities of residential property located in Greater Golden Horseshoe region.⁶ 	<i>Land Transfer Tax Act</i> ss. 2(1), 2(2.1). See <i>Land Titles Act</i> s. 163.1(1)19 for the application of registration fees.
Prince Edward Island	1% of the greater of: <ul style="list-style-type: none"> Consideration for the transfer; and Real property's assessed value. No land transfer tax is applied where neither the greater of the consideration or assessed value exceeds \$30,000. 	<i>Real Property Transfer Tax Act</i> ss. 3(1), 4(2). See <i>Registry Act</i> s. 50.1 for the application of registration fees.
Quebec ⁷	Total of <ul style="list-style-type: none"> 0.5% of the basis of imposition up to and including \$50,900; 1% of the basis of imposition exceeding \$50,900 up to and including \$254,400; and 1.5% of the value of the basis of imposition exceeding \$254,400. The basis of imposition being the greater of <ul style="list-style-type: none"> Consideration furnished for the transfer; Consideration stipulated for the transfer; and Immovable's market value at the time of the transfer. 	<i>An Act Respecting Duties on Transfers of Immovables</i> ss. 2, 2.1. See <i>An Act Respecting Registry Offices</i> , Schedule I for the application of registration fees.
Saskatchewan	No land transfer tax; however, registration fees may apply.	See the <i>Land Titles Act</i> , 2000 s. 118, and the Information Services Corporation website for the application of registration fees at https://www.isc.ca/LandTitles/Pages/LandTitlesFees.aspx .
Yukon	No land transfer tax; however, registration fees may apply.	See the Land Titles Tariff of Fees Regulation, YOIC 2016/110 for the application of registration fees.

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1. Exemptions or refunds may be available in certain circumstances.
2. The additional 2% tax on the portion of a residential property's FMV that exceeds \$3 million (resulting in an effective top rate of 5%) applies effective 21 February 2018.
3. The additional tax has increased from 15% to 20% of the residential property's FMV. In addition, the tax has been extended to apply to prescribed areas outside the Greater Vancouver Regional District. Both measures apply effective 21 February 2018.
4. In its 2018-19 budget tabled on 8 February 2018, Northwest Territories announced it will develop proposals to implement a land transfer tax similar to other jurisdictions.
5. For commercial properties, land transfer tax rates are
 - 0.5% on consideration up to \$55,000; plus
 - 1.0% on consideration exceeding \$55,000 but not exceeding \$250,000; plus
 - 1.5% on consideration exceeding \$250,000 but not exceeding \$400,000; plus
 - 2.0% on any consideration in excess of \$400,000.

Note that the city of Toronto levies a municipal land transfer tax (MLTT) that applies in addition to the provincial land transfer tax. For transfers occurring on or after 1 March 2017, MLTT rates for both residential and commercial properties are identical to the provincial rates.

6. The 15% Ontario non-resident speculation tax (NRST) applies where a foreign entity (i.e., a foreign national – an individual who is not a Canadian citizen or permanent resident of Canada – or foreign corporation, or taxable trustee), on or after 21 April 2017, purchases or acquires residential property located in the Greater Golden Horseshoe region of Southern Ontario. The NRST applies to transfers of land that contain at least one and not more than six family residences. It does not apply to multi-residential apartment buildings with more than six units, or to agricultural, commercial, or industrial lands.
7. Quebec has amended *An Act Respecting Duties on Transfers of Immovables* to index land transfer tax brackets, applicable to 2018 and subsequent fiscal years. In addition, municipalities are now allowed to set a rate higher than 1.5% for the portion of the basis of imposition exceeding \$500,000, subject to a maximum rate of 3.0% (except for the city of Montreal).
Montreal has adopted by-laws setting higher rates for any part of the basis of imposition exceeding \$500,000 in relation to the transfer of a property situated entirely within the territory of the city. As well, for 2018 and subsequent years, Montreal tax brackets are modified annually according to parameters established by the Ministry of Municipal Affairs, Regions and Land Occupancy. For consistency, Montreal indexes the two last brackets. For the 2019 fiscal year, Montreal levies tax at the rate of:
 - 0.5% on a basis of imposition that does not exceed \$50,900; plus
 - 1.0% on a basis of imposition that exceeds \$50,900 but does not exceed \$254,400; plus
 - 1.5% on a basis of imposition that exceeds \$254,400 but does not exceed \$508,700; plus
 - 2.0% on a basis of imposition that exceeds \$508,700 but does not exceed \$1,017,400; plus
 - 2.5% on any basis of imposition in excess of \$1,017,400.

Source: Ernst & Young Electronic Publishing Services Inc.

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The revised tax on split income rules

Background

On 18 July 2017, the federal government issued a consultation paper and draft legislative proposals designed to limit income-splitting arrangements that use private corporations to benefit from the lower personal tax rates of certain family members age 18 or over who are direct or indirect shareholders of the corporation, or are related family members of direct or indirect shareholders.

The proposals targeted “income sprinkling,” an income-splitting technique that shifts income received from an incorporated family business from someone in a high income tax bracket to individuals in a low income tax bracket (usually family members) to produce income tax savings.

For example, assume you’re a shareholder-manager of a private corporation and that you are taxed at the highest marginal personal income tax rate (33% federal rate in 2019). Your spouse and adult children (e.g., post-secondary students) have no sources of income, but then subscribe for other classes of shares of the corporation. Instead of having the corporation’s after-tax earnings paid to you as dividends and taxed in your hands at the highest marginal tax rate, the earnings can be paid as dividends to your spouse and adult children and taxed in their hands at lower rates.¹ The tax savings are progressively reduced if your spouse or adult children have other sources of income.

In response to concerns expressed during the consultation period (which ended on 2 October 2017) that the 18 July 2017 proposals were very broad-based and complex, the government released revised proposals on 13 December 2017. These proposals were included in the first 2018 federal budget bill and were enacted in June 2018.

The former legislation already limited income-splitting arrangements with minor children who were resident in Canada throughout the year and had a parent who was resident in Canada at any time in the year. The tax imposed under these rules was the tax on split income (TOSI), which was often referred to as the “kiddie tax.” The TOSI was (and still is) equal to the highest federal marginal personal income tax rate multiplied by an individual’s split income (see below) for the year.²

The new TOSI rules

Effective on and after 1 January 2018, the revised rules limit the ability to share income within a family by expanding the base of individuals subject to the TOSI to include children age 18 and over and other related adult individuals (including spouses or common-law partners, grandparents and grandchildren, but not aunts, uncles, nephews, nieces, or cousins) who are residents of Canada at the end of the year and who receive split income. Split income arises when a stream of income is connected, either directly or indirectly, to a related business. A related business generally exists when a related person is active in the business on a regular basis or owns at least 10% of the fair market value of the shares in a corporation that carries on the business.³

In addition, the types of income that are subject to the TOSI have been expanded under the revised rules to include:

- ▶ Interest income earned on a debt obligation of a private corporation, partnership or trust (subject to some exceptions)
- ▶ Gains from the disposition of property if income from the property would otherwise be split income.

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¹ Depending on the amount of dividends paid, portions may be subject to the highest marginal tax rate.

² The amount of the individual’s tax payable on split income can be reduced by any claim made for the federal disability tax credit (after 2017), any federal dividend tax credit and federal foreign tax credit available on that income.

³ *Income Tax Act*, Canada 120.4(1) definition of “split income.” For example, dividends received from a private corporation by family members of the owner either directly or through a family trust or partnership would be split income unless a specific exception is met. According to the CRA, split income does not include salary.



Exceptions to the application of the TOSI

Under the rules, all individuals resident in Canada are a “specified individual” for purposes of being subject to the TOSI⁴ unless a specific exclusion to the rules applies.

Income received or gains realized from a related business by certain adult family members are excluded from the TOSI if a number of conditions are met. These family members are as follows:

- ▶ Adult family members who are 18 or older and actively engaged in the family business on a regular, continuous and substantial basis in either the current year or any five previous (but not necessarily consecutive) years. It's generally a question of fact whether an individual satisfies this test; however, an individual will be deemed to be actively engaged on a regular, continuous and substantial basis in a year if the individual meets a “bright line” test by working an average of at least 20 hours per week during the year (or in the case of a seasonal business, during the portion of the year in which the business operates). If these conditions are met, the business is referred to as an “excluded business” under the revised rules.⁵

- ▶ Adult family members who are 25 or older and directly own at least 10% of the shares of the private corporation (in terms of the votes and value of the corporation)⁶ so long as the corporation earns less than 90% of its business income from the provision of services and is not a professional corporation, and at least 90% of the corporation's income⁷ for the year is not derived directly or indirectly from one or more related businesses, other than the business(es) carried on by the corporation itself. If these conditions are met, the shares are referred to as “excluded shares” under the revised rules.⁸
- ▶ Family members who are 24 or younger (including minors) on property inherited from a parent or from anyone else if the individual is either a full-time student enrolled during the year at a post-secondary educational institution or qualifies for the disability tax credit.⁹
- ▶ Spouses (or common-law partners), if the other spouse (or partner) is 65 or older and the TOSI would not have applied had the other spouse (or partner) received the income or gain.
- ▶ Spouses (or common-law partners), if the other spouse (or partner) died before the end of the year, and the TOSI would not have applied had the other spouse (or partner) received the income or gain in their last taxation year.
- ▶ Adult family members receiving income or taxable capital gains from the disposition of inherited property where the deceased would have met the active engagement threshold under the excluded business test, or where the deceased would have met either the excluded shares test or the reasonable return test (see below), provided the deceased had attained the age of 24 before the year of their death,¹⁰ had the amount been received by the deceased.
- ▶ Adult family members realizing taxable capital gains on the arm's-length disposition of QSBC shares or qualified farm or fishing property (even if the lifetime capital gains exemption is not claimed),¹¹ or realizing taxable capital gains on the deemed disposition of property on their death (these exclusions also apply to minor children with the exception of actual dispositions to non-arm's-length parties).¹²

⁴ The definition is very broad, excluding only those individuals over the age of 17 who are nonresidents of Canada and minors with parents who are nonresidents of Canada.

⁵ The CRA has stated that if a corporation operates more than one business (e.g., a construction business and a property management business), the excluded business exception is determined on a business-by-business basis. Therefore, a separate accounting for each business and a tracing of funds would be required for purposes of the business-by-business determination. See CRA document 2018-0761601E5.

⁶ Individuals seeking to rely on this exclusion in 2018 had until the end of 2018 to meet the minimum 10% votes-and-value condition.

⁷ The CRA's view is that the references to “income” and “business income” in the definition of excluded shares refer to gross income, not net income. See the May 2018 STEP Conference CRA roundtable question 5 (CRA document 2018-0743961C6) and the CRA's July 2019 guidance, “Tax on split income – excluded shares”. The CRA's view, in document 2019-0802331E5, is that taxable capital gains from the disposition of property (without any offsetting allowable capital losses for the year) are included in the determination of income for purposes of the related businesses component of the excluded shares definition.

⁸ The CRA has stated that if a corporation derives its business income from the provision of both services and non-services (e.g., a business carried on by plumbers, mechanics or other contractors that also includes the sale of replacement parts or materials), the income from the provision of non-services will generally be taken into account for purposes of the less than 90% test re: income from the provision of services unless that income can reasonably be considered to be necessary but incidental to the provision of the services. See CRA document 2018-0761601E5 and the July 2019 guidance, “Tax on split income – excluded shares”.

⁹ Family members who are 25 or older may qualify for an exception to the TOSI with respect to income or gains on inherited property provided certain other conditions are met.

¹⁰ This last exception may apply even if the adult family member was under the age of 25 and, therefore, not otherwise eligible to meet the excluded shares test or the reasonable return exception by virtue of their age had the income or gain not been derived from inherited property.

¹¹ This exception also applies to trust beneficiaries if these types of taxable capital gains are realized by a personal trust and are allocated to beneficiaries of the trust in the year of disposition. If all required conditions are met, the beneficiaries could claim the lifetime capital gains exemption with respect to those gains.

¹² Capital gains realized by minors on the disposition of private company shares to a non-arm's-length party are treated as non-eligible dividends and taxed at top marginal rates.

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- ▶ Adult family members receiving income derived from property acquired as a result of a breakdown of a marriage or common-law partnership, if the spouses or partners are separated and living apart as a result of the relationship breakdown.

In July 2019, the CRA released a guidance document on the excluded shares exception noted above. The document focuses primarily on the test requiring a corporation to earn less than 90% of its gross business income (e.g., sales revenue) from the provision of services. The guidance confirms that the test refers to gross business income earned in the previous taxation year, unless the business is in its first year of operation, in which case the test would be based on the current taxation year for that first year only. The guidance also states that if incidental goods or materials are used in the provision of services, their cost would not be subtracted in calculating the percentage of gross business income attributable to services. If goods are provided with a service and the goods are not incidental to the service because they are sold separately for use by the customer, the sale price allocated to the goods is not included as service income in applying the gross business income test. See the “Clean Home Inc.” example below.

Adult family members who are 25 or older and receive split income after 2017 are subject to a reasonable return test if they do not meet any of the above-noted exclusions. The test is based on the extent of their contribution of labour and capital to the business, risks taken and other payments already received from the business. The TOSI will apply to split income received by these adult family members to the extent it is unreasonable under this test.

If the split income recipient is 18 to 24 years old and does not meet the applicable exclusions noted above, but has contributed capital to the related business, the amount of income subject to the TOSI is reduced by the



individual’s “safe harbour capital return,” an amount equal to the prescribed rate of return on the fair market value of the capital contributed. For purposes of this exclusion, the prescribed rate is based on the highest prescribed rate in effect for a quarter in the year. In 2019, the prescribed rate was 2% in Q1, Q2, Q3 and Q4. However, if the individual finances the contributed capital, a higher-than-prescribed rate of return can be earned without being subject to the TOSI if the amount of income received represents a reasonable return on the individual’s contribution of arm’s-length capital. It is anticipated that meeting the “arm’s-length capital” test will be difficult, as it excludes borrowed funds (regardless of whether it’s related party or external bank borrowings), direct or indirect transfers of property from a related person (other than as a consequence of the death of the related person), and income earned (or gains derived from the disposition of property) from a related business (other than as salary).

Some unexpected consequences

Common business structures such as family trusts, investment holding companies and partnerships¹³ are likely to be impacted by the TOSI. The results may be unexpected, partly because the definition of split income is broad, and the exclusions, in particular with the excluded shares test, are difficult to apply in practice. For instance, when applying the excluded shares test, a direct holding of the shares by the specified individual is required. Accordingly, the exclusion will not apply if private company shares are held not directly but, instead, indirectly through a family trust. Income earned from such shares that is otherwise split income where other exclusions are not available will be subject to the TOSI.

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¹³ For example, the CRA confirmed in document 2019-0813021E5 that generally, a corporation that is a member of a partnership is considered to be carrying on the business of the partnership for purposes of the TOSI rules.



It also appears that dividends paid to holding companies from a wholly owned operating company cannot be paid through to a 10%+ shareholder, who would otherwise meet the excluded shares test, without attracting the TOSI (unless another exception applies), because the dividend would be indirectly derived from a related business. The CRA has confirmed in recent interpretations that the excluded shares exception would generally not include shares of a holding corporation, as all or substantially all of the income would be derived from another related business (other than a business carried on by the holding corporation itself).¹⁴

The CRA issued a ruling¹⁵ in which it provided the following example: An individual who is at least 25 years old owns at least 10% of the shares of a holding company that, in turn, owns the shares of a manufacturing company. The individual's spouse is actively engaged on a regular and continuous basis in the activities of the manufacturing company. The manufacturing company pays a dividend to the holding company which, in turn, pays a dividend to the individual. The CRA confirmed that the dividend received by the individual does not meet the excluded shares test, because it does not meet the portion of the test that specifies that at least 90% of the holding company's income for the year must not be derived directly or indirectly from one or more other related businesses. Accordingly, the individual would be subject to the TOSI if the individual cannot meet the reasonable return test or qualify for any of the other exclusions.

There are more issues with investment holding companies. These issues can arise even when the investment holding company has passive investments.

For example, consider a situation where an investment holding company owns passive investments and shares in an operating company carrying on a related business. If the passive investments were funded from the related business, public company dividends paid to the investment holding company and then to the shareholders may, in certain circumstances, be considered split income. This is because, under the TOSI rules, at least part of the investment income may be considered to be derived directly or indirectly from a related business in respect of the shareholders, if, for instance, the investment holding company also received income in that year from the operating company.¹⁶

The CRA has stated that if the investment holding company in this situation 'carries on a business' the purpose of which is to derive income from property (e.g., earning interest and/or dividend income from passive investments), then the dividends paid to the shareholders could be derived from the investment holding company's own business instead of the related business carried on by the operating company. Therefore, if 90% or more of the investment holding company's income for the last taxation year that ends before the dividend is paid is income generated from the passive investments and the other conditions are met for the excluded shares test, then the income received by the shareholders would not be subject to the TOSI as the excluded shares exception would apply.¹⁷

(In contrast, if more than 10% of the investment holding company's income for the year was received from the operating company, then the 90% test would not be met and the excluded shares exception would not apply).

The CRA cautioned that "the question of whether or not a corporation is carrying on a business whose purpose is to earn income from interest and dividends is a question of fact that can only be resolved following an exhaustive analysis of all the present facts and circumstances in relation to a given situation".¹⁸

For the income to qualify as an "excluded amount," one of the above exclusions would need to be met, and it may be difficult to do so with respect to an investment holding company if the income is not derived from the company's own business. Generally, unless the shareholder was actively employed in the business that financed the investments owned by the holding company such that the income is from an "excluded business," then the shareholder would need to be able to meet the "reasonable return" test or one of the other exclusions. The reasonable return test may not be met if the shareholder contributed nominal capital to the holding company.

Contact your EY Tax advisor if you have any concerns about the possible application of the TOSI to your business structure.

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¹⁴ See CRA documents 2018-0745871C6 and 2018-0743971C6.

¹⁵ CRA document 2018-0761601E5. A similar scenario was outlined in CRA document 2018-0768801C6 (situation A).

¹⁶ Under paragraph 120.4(1.1) (d) of the Act. Also, see CRA documents 2019-0792011E5, 2018-0771861E5 and 2018-0779981C6.

¹⁷ CRA document 2018-0768801C6 (situation B).

¹⁸ See CRA documents 2018-0771861E5 and 2018-0765791C6. Investments that are passively managed with a buy and hold strategy would likely not be indicative of a business.



Examples

The following examples illustrate the application of the new rules:

Glassco

Réjean and Lucie are spouses, both over age 25, who own 100 voting Class A shares of Glassco and 100 voting Class B shares, respectively. Glassco manufactures windows that are sold to builders in the Montreal area. There are no other shareholders. Class A and B shares are of equal value. Réjean founded the business 25 years ago and works full time managing its operations. Lucie is not involved in any way in Glassco's business and has never contributed any capital to it.

In November 2019, Glassco pays a dividend of \$75,000 to Réjean on the Class A shares and \$50,000 to Lucie on the Class B shares.

Neither Réjean nor Lucie will be subject to the TOSI on the dividend income received. Réjean is actively engaged in the family business on a regular, continuous and substantial basis and, therefore, meets the excluded business test. Lucie meets the excluded shares test. She is at least 25 years old and owns at least 10% of the shares of Glassco (in terms of votes and value). Glassco is not a professional corporation and it earns less than 90% of its business income from the provision of services. In addition, at least 90% of Glassco's income is not derived from one or more related businesses. Réjean also meets the excluded shares test.

EngineerCo

Megan and her common-law partner Amir own, respectively, 64% and 35% of the shares of EngineerCo, which provides engineering consulting services in the lower BC mainland. Their son, Gary, who is 23, owns the remaining 1% of the shares.

Megan, age 66, worked full time in the management of the business for more than 20 years, but has been retired for the past three years. The business is now run by the company's employees, although Amir, age 62, still provides sales and marketing support services to the company on a part-time basis for about 40 hours a month. Amir's involvement with the company has been limited to this role. Gary will be graduating with an engineering degree next year and intends to join the family business at that time. For each of the past two summers, Gary worked at EngineerCo to finance his university tuition. He did not work at EngineerCo during the school year.

In 2017, Amir provided Gary with \$50,000, which was invested in EngineerCo in return for a 1% interest in the company. In 2019, the prescribed rate of interest was 2% for the entire year. Megan, Amir and Gary all received dividend income from EngineerCo in December 2019. Two years later, in 2021, Amir sold his shares in EngineerCo to Gary for a fair market purchase price. The shares are QSBC shares.

Neither Megan nor Amir will be subject to the TOSI on the dividend income received in 2019. Although Megan has not been actively involved in the business of the company for three years, she was actively engaged in the family business on a regular, continuous and substantial basis for at least five years in the past and, therefore, is still able to meet the excluded business test. Neither Megan nor Amir can meet the excluded shares test, because EngineerCo derives all of its business income from the provision of services. Amir cannot meet the excluded business test because he does not meet the bright line test of working an average of at least 20 hours per week during the year in the business. The TOSI, however, still does not apply to the dividends received by Amir, because Megan is at least 65 years old and she would not have been subject to the TOSI had she received Amir's dividends.

Gary does not meet the excluded business test, as he does not meet the bright line test. The dividend income that he receives will be subject to the TOSI, with the exception of \$1,000 of the amount received. The \$1,000 represents Gary's safe harbour capital return, equal to 2% (the highest prescribed rate of interest in effect for a quarter in 2019) of the capital Gary contributed to the business. A higher amount cannot be excluded from the TOSI because Gary cannot meet the arm's-length capital test, as his capital contribution to EngineerCo was financed by his father.

In 2021, any taxable capital gains realized by Amir on the sale of the shares to Gary will not be subject to the TOSI, because the shares are QSBC shares. It doesn't matter whether or not Amir claims his lifetime capital gain exemption on the sale.

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TechCo

TechCo imports and distributes inventory management software to various businesses in the Toronto area. TechCo's shareholders are Claudio (75% interest) and a family trust (25% interest), a discretionary trust for the benefit of Claudio's wife Anna and their 22-year-old son Mark.

Claudio works full time in the operations of the business. When the business was in its startup phase, TechCo obtained an operating line of credit from a financial institution. Anna was required to act as guarantor of the line of credit, with the guarantee secured by a mortgage on the family residence. The line of credit is still required for TechCo's day-to-day operations. Anna provides occasional bookkeeping services to the company for approximately 300 hours a year. Mark is a full-time postsecondary student, but has worked during the summer at TechCo for each of the last three years.

During 2019, TechCo paid dividends to both Claudio and the family trust. The trust distributed all the dividends to Anna and Mark.

Claudio's dividend income is not subject to the TOSI, as he is actively involved in the business and meets the bright line test by working an average of at least 20 hours per week during the year at TechCo.

Anna, however, does not meet the bright line test. Also, although Anna is over 25 and TechCo does not earn any income from the provision of services, she does not meet the excluded shares test, as she does not have a direct interest in at least 10% of TechCo's shares (only Claudio and the family trust do). However, Anna's dividend income could possibly be excluded from the TOSI due to the risks she assumed by acting as guarantor on the line of credit, provided the amount of dividends received represents a reasonable return on the risks assumed.

All of Mark's dividend income will be subject to the TOSI, as he does not meet the bright line test and has not contributed any capital to the business.

Clean Home Inc.

Jordana and Leslie are spouses, both over age 25, who each own 50 common shares of Clean Home Inc. There are no other shareholders. Clean Home operates a residential cleaning business. Jordana is actively involved in the management of the company's operations on a full-time basis while Leslie works full-time in his legal practice. In addition to providing cleaning services to their customers, Clean Home also sells floor wax, mops and window cleaner separately to people who do not use Clean Home's cleaning services, as well as to customers when they are purchasing cleaning services. In 2018, Clean Home Inc.'s gross revenue was \$750,000 and was made up of the following sources:

- ▶ Sales of home cleaning services: \$600,000
- ▶ Sales of cleaning supplies to customers who purchase cleaning services: \$100,000
- ▶ Sales of cleaning supplies to other customers: \$ 50,000

In 2019, Clean Home paid dividends to both Jordana and Leslie.

Neither Jordana nor Leslie will be subject to the TOSI on the dividend income received in 2019 because they both meet the excluded shares exception. Both spouses are at least 25 years of age and own at least 10% of the company's shares on a votes and value basis. The company is not a professional corporation and none of the company's sales is derived from any related businesses. Less than 90% of Clean Home's sales is from the provision of services (since 80% is derived from cleaning services and the balance is earned from the sale of goods) and, therefore, that condition for the excluded shares exception is also met.

The sale of floor wax, mops and window cleaner is not incidental to the provision of services, since they were either sold separately or, if sold with a cleaning service, were distinct and separate from the cleaning service. Therefore, \$150,000 of total sales in 2018 is not included in the service part of gross business income. In contrast, cleaning products used by Clean Home in the course of providing the home cleaning service are considered incidental to the service provided and, therefore, the cost of these products would not be subtracted from the service part of gross sales. This would still be the case if an amount for the cleaning products was listed separately on the invoice for cleaning services or on a separate invoice.

In this example, Jordana also meets the excluded business exception from the TOSI, since she is actively engaged in the business on a regular, continuous and substantial basis.

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Tax tips

- ▶ Consider reorganizing the structure of your private corporation, if possible and as required, to minimize the impact of the revised TOSI rules on you and your family.
- ▶ Each year, a determination should be made whether any of the exceptions to the revised TOSI rules are applicable and the steps that may be taken, if any, to ensure that at least one of the exceptions is met to allow for income splitting.
- ▶ If the revised TOSI rules preclude income splitting with your spouse or partner and/or other family members, consider employing them to take advantage of remaining income-splitting opportunities. Their salaries must be reasonable for the work they perform.
- ▶ Multiplication of the lifetime capital gains exemption among family members who own shares directly in your private corporation (or indirectly through a trust) is still possible under the revised TOSI rules. Taxable capital gains realized on the arm's-length disposition of QSBC shares, or qualified farm or fishing property, are exempt from the TOSI (but see the comment on non-arm's-length dispositions above). The cumulative lifetime capital gains exemption as indexed for 2019 was \$866,912.
- ▶ Eligible pension income continues to be eligible for splitting among married or common-law couples as the revised TOSI rules do not address pension income splitting. See [Chapter 9: Families](#) for further details.
- ▶ Consult with your EY Tax advisor for assistance on these matters.

Conclusion

The revised TOSI rules include significant changes to the taxation of private corporations and their shareholders. These rules may entail certain unexpected consequences to taxpayers, particularly if a family business is carried on through a group of companies such as a holding company or a related investment company, or where shares of the company carrying on the family business are held by a family trust. They also continue to contain subjective elements such as the reasonableness test for exemption from the TOSI. In short, these rules pose a significant challenge to private businesses. For further details, see [EY Tax Alert 2017 Issue No. 52](#).

Contact your EY Tax advisor to determine to what extent, if any, your private corporation and family members are impacted by the revised TOSI rules and whether planning arrangements are available to mitigate the impact of any adverse tax implications.

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