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TAX LETTER

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TAX CHANGES WE CAN EXPECT FROM THE LIBERALS

Because Justin Trudeau’s Liberals were elected with a clear majority in the House of Commons on October 19, 2015, they have the ability to pass any legislation they wish (subject to approval by the Senate).

In their election platform, the Liberals proposed a number of specific tax changes. We can expect to see at least some of these introduced in Parliament in the new government’s first Budget, likely early in 2016:

- Reducing the 22% “middle income” bracket (on taxable income from $44,702 to $89,401 in 2015, increased by inflation for 2016) to 20.5%, to give a break to the “middle class”.

- Adding a new tax bracket of 33% federal tax (increased from 29%) on taxable income over $200,000, to force the “wealthy” to pay top tax rates well over 50% in most provinces.

- Rolling back the Tax-Free Savings Account (TFSA) annual cumulative contribution limit from $10,000 to $5,500. It is not known whether taxpayers who have contributed the additional $4,500 for 2015 will have to count that towards their 2016 contribution room or whether the $10,000 limit for

2015 will remain. It is also not known whether the indexing of the credit to inflation (rounded to the nearest $500), which was eliminated by the Conservatives with the increase to $10,000 in 2015, will be reinstated.

- Repealing the "Family Tax Cut" income splitting for families with children, introduced by the Harper government in 2014. (Pension income splitting will not be cancelled.)

- Replacing the Universal Child Care Benefit, as well as the Canada Child Tax Benefit and the National Child Benefit Supplement, with a new "Canada Child Benefit" that is income-tested, and thus not available to high-income taxpayers.

- Some form of cap on use of the $500,000 annual small business deduction by corporations owned by high-income earners. Perhaps this will take the form of the rule Quebec recently introduced, requiring a company to have more than 3 full-time employees to qualify for the credit. (The scheduled reduction in the small business corporate rate from 11% to 9% by applying the small business deduction will not be changed.)

- Limiting the stock option deduction to $100,000 in annual stock option gains, to reduce the tax savings available to very high income employees.

- Limiting the Canadian Exploration Expense deduction so that it can be used "only in cases of unsuccessful exploration".

- Increasing the Northern Canada deduction from $16.50 per day to $22 per day, and indexing it to inflation for future years.

- Repealing the education tax credit and the textbook tax credit for university and college students. The savings will be used to provide more grants to students who need support for education. (The tuition credit, for tuition actually paid, will not be affected.)

- Reinstatement of the labour-sponsored funds tax credit, which was being phased out from 2015-2017.

- A new Teacher School Supplies Credit, of 15% of up to $1,000 spent by teachers from their own funds on supplies for their students.

- The Home Buyer's Plan, which permits first-time buyers to withdraw RRSP fund to buy a home (and repay the funds to the RRSP over 15 years) will be extended "to allow Canadians impacted by sudden and significant life changes to buy a house without tax penalty. This will ease the burden on Canadians facing job relocation, the death of a spouse, marital breakdown, or a decision to accommodate an elderly family member."

- Bill C-377 (section 149.01 of the *Income Tax Act*), which requires labour unions to disclose extensive financial information to the CRA beginning in 2017 and requires the CRA to make that information public, will be repealed.

- The rules restricting charities from engaging in "political" activities will be relaxed.

- The CRA will

  — "offer to complete returns for some clients, particularly lower-income

Canadians and those on fixed incomes whose financial situation is unchanged year-to-year;
— support more Canadians who wish to file taxes using no paper forms; and
— deliver correspondence that is straightforward and easy to read."

- An additional $80 million will be invested to help the CRA "crack down on tax evaders".

- The government "will enhance existing tax measures to generate more clean technology investments, and work with the provinces and territories to make Canada the world's most competitive tax jurisdiction for investments in the research, development, and manufacturing of clean technology."

As well, it would not be surprising to see the Liberals cancel some of the Harper government's tax credits, such as the children's fitness tax credit and children's arts tax credit. The Liberals are definitely focused on tax measures that will benefit the "middle class" rather than the "wealthy".

BUSINESSES CLAIMING GST — HOW TO GUARANTEE AN AUDIT

If you start a new business (whether personally or in a corporation), you might be claiming GST/HST **input tax credits** (ITCs) to recover GST or HST that the business pays on purchases.

If you are not collecting and remitting GST or HST that exceeds these ITCs, then you will be claiming a "**net tax refund**" — in other words, asking the CRA (or Revenu Québec, in Quebec) to write your business a cheque.

There is nothing wrong with claiming a net tax refund, provided the business is entitled to one. Be aware, however, that claiming a refund that exceeds a basic threshold (rumoured to be $2,500, but it may vary) will trigger a CRA audit. You will get a letter from a "GST/HST Refund Integrity Officer" seeking invoices documenting the GST or HST that you have paid, as well as an explanation as to why you have not collected GST or HST on sales.

There can be good reasons for a business to get net tax refunds every year or even every month. These include:

- The business's sales are primarily exports of goods to outside Canada.

- The business's sales are primarily services provided to non-residents of Canada.

- The business's sales are primarily zero-rated goods, such as basic groceries, medical devices, certain drugs or certain farm equipment.

- The business's sales are primarily to a provincial or territorial government that has not agreed to pay GST/HST on its purchases, so no GST is being charged (Alberta, Saskatchewan, Manitoba, Yukon or NWT).

- The business is a startup with high capital purchases, such as equipment.

However, to obtain your net tax refunds you will have to prove the entitlement to the CRA auditor. This means showing invoices that meet all the documentary requirements for the GST/HST (such as showing the supplier's GST number, and in most cases being addressed to your business). This also

means explaining why your business has not collected more GST or HST than it has paid out, and how this complies with the law.
Very often what happens is that a business claims ITCs without realizing that it is not entitled to them, and filing the net tax refund claim results in the business being assessed for GST or HST that it should have collected and remitted.

For example, businesses that make "exempt" supplies (not zero-rated supplies) are not entitled to input tax credits. This includes residential landlords, certain health care providers, certain education providers, child-care services, and businesses supplying financial services, among others.

So, don't blindly assume that, because you're running a business and have been given a GST number, you can claim back all the GST or HST your business pays. Make sure you obtain professional advice about the GST and that you understand the rules. Getting this wrong will usually lead to a very expensive assessment!

You may also wish to review CRA Guide RC4022, "General Information for GST/HST Registrants".

THE LEAP YEAR BITES — WATCH THOSE DEADLINES!

Because 2016 is a leap year, some deadlines fall earlier this coming year than normal.

If you will be filing a T3 **trust tax return**, the deadline (assuming a calendar year-end for the trust) is 90 days after the end of the year. Normally that is March 31. This year, because February has 29 days, the 90-day period expires on **Wednesday March 30**.

A T3 return filed on March 31 will be late. If the return contains any election or designation that has to be filed by the return's due date, and the return is not filed by March 30, the election or designation will not have been properly made!

If you are making **RRSP contributions**, any investment that gives you a **labour-sponsored funds tax credit**, or various other investments that can be completed up to 60 days after the end of the year and still be claimed on your 2015 return, your deadline is **Monday February 29**, not March 1 as usual!

Make sure to keep these deadlines in mind in the new year.

"RECTIFICATION" — FIXING TAX MISTAKES

Tax planning sometimes goes wrong.

Transactions executed for tax purposes often involve corporate reorganizations, contracts, issuing new classes of shares, mergers, transfers, etc. What happens if someone forgets to sign the right document, or the lawyers do not draft the right documents to make the transaction work?

Or worse yet, what happens if you or your corporation engage in some transaction, such as a real estate deal, setting up a trust, or a transfer of property within a family group, and aren't properly advised about the tax consequences, and a huge tax problem results?

Surprisingly, it *may* be possible to fix the problem by going to Court. Not the Tax Court of Canada, which is the only Court that can hear your tax appeal, but the **superior court of the province** whose law governs the corporation or the transaction. In Ontario, this is the Ontario

Superior Court of Justice; in BC, Nova Scotia, PEI and Newfoundland/Labrador, it is the province's Supreme Court; in Alberta, Saskatchewan, Manitoba, and New Brunswick, it is the Court of Queen's Bench; in Quebec it is the Superior Court.

The reason this works is that the province's superior court has the sole right under the *Constitution Act, 1867* to determine matters of "property and civil rights in the province". The Tax Court of Canada, on a tax appeal, is required to apply provincial law to determine the status and meaning of such things as contracts and corporate documents. and if the province's superior court has issued a formal Order deeming a contract to have included a particular provision or deeming a corporation to have issued a particular class of shares, the Tax Court is required to accept that ruling as determining those matters.

One can apply to the superior court for a *retroactive* order "**rectifying**" a contract or document. The Court may be quite sympathetic, as long as you are simply trying to fix a mistake and get the effect you intended, or would have intended if you had known about the problem.

Sometimes a court will apply **rescission** instead of rectification, so as to cancel a contract completely.

If such a Court order can be obtained (whether rectification, rescission or a "declaratory order"), it will effectively be binding on the Canada Revenue Agency and the Tax Court for tax purposes.

The limits of rectification are still being tested in the Courts. Note that rectification in the provincial superior courts cannot be used to remedy a failure to file a document with the CRA on time, since that is a matter of federal jurisdiction. The provincial superior courts can make findings of fact that the CRA must accept for purposes of determining what transaction took place, but these courts cannot intrude directly on CRA administration.

The CRA's *Income Tax Technical News* No. 22 acknowledges that rectification is valid and that the CRA will generally accept a Court order rectifying past transactions. However, if you are seeking a rectification order your lawyer should notify the CRA's lawyers, the Department of Justice, ahead of time and seek their agreement not to oppose your application.

DOES GST OR HST APPLY TO CHARITY EVENT TICKETS?

Most charities rely primarily on donations for their revenues. However, charities increasingly run events for fund-raising purposes — everything from dinners to golf tournaments to bike races to flea markets.

In some cases, a charity needs to charge GST or HST on its fees (or "tickets") to such events.

This article provides a summary as to when charity events or tickets are likely to be taxable. It is only a general summary. A charity that has any uncertainty about this issue should consult a tax professional with GST/HST expertise.

In the summary below, "charity" refers to an entity that is a registered charity for income tax purposes (with an "RR" Business Number, entitled to issue receipts for

donations that entitle the donor to a tax credit for income tax purposes).

Unregistered small supplier

Any person or entity that is a "**small supplier**" is permitted to remain outside the GST/HST system. They do not register for GST/HST, and they do not need to charge GST/HST on their sales. (They also cannot claim input tax credits to recover the GST or HST they pay on purchases. Effectively they are like a consumer.)

For businesses generally, a person with no more than $30,000 in annual revenues is normally a small supplier that can choose to remain unregistered. For a charity, the threshold is $50,000. If total *GST-taxable* revenues in any four consecutive calendar quarters total more then $50,000, the charity is not a "small supplier".

As an alternative test, any charity whose total revenues (including donations and government support) do not exceed $250,000 is a "small supplier".

(Note that any "associated" persons are included in the test for a small supplier. This includes persons under common control. If the charity controls a business corporation, for example, that corporation's sales may cause the charity to not be a small supplier.)

A "small supplier" can choose not to register for GST/HST. **If it remains unregistered**, it does not charge GST/HST on its taxable sales.

Note that a charity can have a GST/HST number without being registered! Charities generally qualify for a "Public Service Body Rebate" of part of the GST/HST they pay on purchases (the percentage varies by province and by the type of charity). The CRA will give the charity an "RT" Business Number (e.g. 12345 6789 **RT**0001) for purposes of this rebate. That does not mean the charity is "registered" for GST/HST. A charity that is "registered" will normally be asked by the CRA to file a GST/HST return (not a rebate application) at least once a year. If you are not sure whether a charity is registered, call the CRA or check at www.cra.gc.ca/gsthstregistry.

If a charity is a small supplier, *and* it is not registered, then it does not need to charge GST or HST, even on fees that are normally taxable under the GST/HST.

Fund-raising event exemption

A **fund-raising event** is exempt if it meets both of the following conditions:

- It is an **admission** to a **fund-raising dinner, ball, concert, show or like fund-raising event**.
- **Part of the fee** may reasonably be regarded as an amount that is **donated to the charity**, and a donation tax receipt can be issued for that portion (or could be issued if the donor were an individual).

If the above conditions are met, then the charity does not need to charge GST or HST on the admission, even if the charity is GST-registered.

It may not always be clear what constitutes a "like fund-raising event". A golf tournament or other competitive event is probably not "like" a dinner, ball, concert or show, but this is uncertain. If you are unsure, get professional advice from a tax professional with GST/HST expertise.

Other exemptions

If neither of the above two exemptions applies, there are several other possible exemptions that can apply, depending on the kind of charity and the type of event the charity is running. A "public institution" (university, hospital, school, public college or entity determined by the CRA to be a municipality for GST/HST purposes) has rules that are different from other charities.

If you conclude that neither of the two exemptions in above applies, get professional advice from a tax lawyer or accountant with GST/HST expertise as to whether a charity is required to collect GST or HST on fees being charged, and if so, how to determine what rate of GST or HST to charge to each participant.

You may also wish to review CRA Info Sheet GI-067, "Basic GST/HST Guidelines for Charities".

AROUND THE COURTS

Inflated receipts for charitable donations — no donation allowed at all

Canada's charitable donation credits for individuals are generous. In many provinces the total of federal and provincial credits approaches or equals 50% of the amount of the donation. While this promotes philanthropy, it has also led to abuse.

The recent *Castro* decision of the Federal Court of Appeal is an appeal of several Tax Court of Canada decisions on such fraudulent donations. In a typical case, the taxpayer would donate $1,000 and received a tax receipt showing he had donated $10,000. The Tax Court disallowed the $10,000 as a donation, but did allow a credit on $1,000, the actual cash donated to the charity.

The Federal Court of Appeal overruled the Tax Court and disallowed the donation entirely. The Court of Appeal agreed with the Tax Court that receiving an inflated receipt was not a "benefit" that reduced the amount of the donation. However, the $10,000 receipt did not show the correct amount of the donation. The Income Tax Regulations (section 3501) are very clear that detailed information must be provided on a receipt. and that if the amount of the donation is not correctly shown, the receipt is deemed to be "spoiled" and unusable. (We discussed the requirements for donation receipts in our September 2015 letter.)

Taxpayers be warned: the CRA has gotten more and more sophisticated in its ability to track false donations. If you make a fraudulent claim for a donation credit — or one made with carelessness or negligence as to its validity — there is no limit as to when the CRA may reassess you to recover the tax you should not have saved. Assessments to reverse donation credits, plus interest and penalty, are often issued many years after the fact, after the CRA has completed a detailed audit of the charity.

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