

## TAX LETTER

September 2019

### TAX QUIZ BARE TRUST AND NOMINEE AGREEMENTS AROUND THE COURTS TAX QUIZ — THE ANSWERS ERRATUM AUGUST 2019 TAX LETTER

#### TAX QUIZ

This month we offer you a quiz to test your tax knowledge in various areas relating to your personal tax planning. You might find some useful ideas here!

We've put the answers separately, on page 5, so you can try the questions on your own (without peeking at the answers) and see how well you score. Try to explain your answers to yourself, along with any related planning points that must be considered.

1. You sell some shares on the stock market for \$12,000 *more* than you paid several years ago. What portion of the \$12,000 gain is included in your income and subject to tax?
2. You sell some shares on the market this month for \$12,000 *less* than you paid several years ago. Your only income this year is \$65,000 of employment income. Can you deduct the capital loss?
3. You and your spouse both work full-time. You earn \$80,000 and your spouse earns \$40,000. You have a two-year-old child. You pay \$11,000 a year to a nanny who takes care of your child while you work. Can you deduct the child-care expenses?
4. You started working for the first time in 2018. Your employment income was \$50,000 in 2018, and will be \$60,000 for 2019. You are not a member of a pension plan and you haven't contributed to an RRSP before. How much can you contribute to an RRSP, to claim a deduction on your 2019 return? Until when can you make that contribution? And what happens if you don't make a contribution for 2019?
5. You are employed full-time as a social worker, but also live on, and operate, a small farm growing crops. This year your farm will have a \$40,000 loss, as it has for each of the past five years. Can you deduct this \$40,000 against your \$60,000 of employment income?

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6. In addition to having \$60,000 of employment income, you receive US\$6,000 (C\$8,000) in dividends on U.S. stocks held in your Canadian brokerage account. Of this amount, 15% (US\$900) is withheld for U.S. tax, so you receive only the balance of US\$5,100 (C\$6,800). Do you have to report all the dividends and pay Canadian tax on the full C\$8,000, or can you report just the C\$6,800 you received?
7. You have been working in Canada in the computer field. You accept an offer to move to France to work on an 18-month project, during which your spouse and children will remain at home. You will be in France for all of 2020, and your income there will have French tax withheld at source. Will you have to report the income for Canadian tax purposes?
8. Your aunt gave you some shares in January 2019 as a wedding gift. These shares cost her \$5,000 (including commission) many years ago, and at the time of the gift they were worth \$20,000. You sell them now, in September 2019, for \$26,000. How much is added to your income for tax purposes from the gift and the sale combined?
9. You wish to donate \$5,000 to a charity. You can choose among three options:
  - (a) writing a cheque for \$5,000;
  - (b) donating a painting that you bought last year for \$3,000, and which an art appraiser has told you is now worth \$5,000;
  - (c) donating some shares in Apple that you own, which cost you \$3,000 a few years ago and are now worth \$5,000.

Which is the best and which is the worst option to choose, and why?

10. You have spent money this year on the following items for yourself and your spouse and children:

- (a) crutches due to a broken ankle;
- (b) Tylenol as prescribed by your physician;
- (c) vitamins as ordered by your physician;
- (d) medical marijuana as per a “medical document” you obtained under the *Cannabis Regulations*;
- (e) prescription sunglasses;
- (f) a travel health plan for your vacation in the U.S.;
- (g) a dental care plan;
- (h) a 30km taxi ride to the hospital when you broke your ankle; and
- (i) tutoring for your son, who has a learning disability, as certified by your physician.

Which of these are expenses for which you should save the receipts and make a claim on your tax return, and what will the claim be worth?

## **BARE TRUST AND NOMINEE AGREEMENTS**

A “bare trust” is an interesting concept that can be useful for tax purposes. Unlike a real trust, a “bare trust” is one where person T (the bare trustee) holds legal title to property for person O (the owner), but does not have any discretion as to what to do with it. T must simply transfer or deal with the property as O directs, and has no independent powers or responsibilities. A bare trust arrangement can be set up with a simple one-page agreement specifying these conditions.

A bare trust is often used for holding real property. For example, a numbered company might be used as the registered owner of land, to hide the name of the real owner from public view. The term “nominee” is also used for a bare trustee. T may also be called the “agent” of O, again just acting on O’s instructions. (Technically a bare trust and an agency are different legal concepts, but in practice they may be the same thing.)

In Quebec, where the *Civil Code* applies (unlike the common law in all other provinces and territories), a nominee may be called a “prête-nom” (literally, a “borrowed name”), and is subject to the rules in the *Civil Code*.

For tax purposes, a **bare trustee or nominee is almost always ignored**, and the real owner of the property (O) is considered to own it and deal with it. Thus, O’s original transfer of legal title to T is ignored for tax purposes; and when T transfers the property to a purchaser, O is considered to have sold it and must pay the tax on any profit or gain.

(One exception to this rule is the GST new housing rebate. Based on the 2018 *Cheema* decision of the Federal Court of Appeal, if T co-purchases a new home with O, going onto the purchase agreement just to help O get financing for O’s new home, then even if T is only a bare trustee, O cannot get the new housing rebate. See our September 2018 Tax Letter.)

**Quebec** introduced a very important rule in May 2019. Any nominee agreement **must be disclosed to Revenu Québec within 90 days of signing if it was signed after May 16, 2019 (or by September 16, 2019 if it was signed before May 17, 2019 and the**

**tax consequences continue after that date), with possible penalties** for non-compliance.

## AROUND THE COURTS

*CRA controls its audit process, and the Courts won’t intervene*

It’s been well established, in Court cases over many years (e.g., *Main Rehabilitation Co.*, 2004 FCA 403), that if you’re appealing an income tax (or GST/HST) assessment, the *only* issue the Tax Court of Canada can address is whether the assessment is legal and correct. **How the CRA behaved during the audit process doesn’t matter.** Even if the auditor acted unreasonably, once you’ve been assessed you have to show the Tax Court why the assessment is wrong, and the auditor’s actions are irrelevant. (And if the assessment is for GST/HST or source deductions, CRA Collections will force you to pay the assessment even while you’re appealing, long before you can get to the Tax Court.)

So what do you do if a CRA auditor is acting unreasonably — say, by proposing an assessment that is clearly wrong?

You can’t go to the Tax Court during the audit. Unless there’s an assessment to appeal, the Tax Court doesn’t have any legal basis to consider your case.

You can approach the auditor’s Team Leader or more senior management for help, but often they will support the auditor, unless you can show a clear violation of CRA policy or clearly wrong interpretation of the law (and sometimes even in those cases).

If you’re still stuck, you can file a “Service Complaint” within the CRA.

If that still doesn't get you anywhere, you can ask the Taxpayer's Ombudsman for help, and the Ombudsman can make recommendations to the CRA. But those recommendations aren't binding, and it's the CRA's decision as to how it will audit, and whether or when it will reassess you.

So are there any other legal options?

Yes — in theory. The Federal Court has jurisdiction over the CRA. If the CRA has made a decision you disagree with (other than issuing an assessment that you can appeal to the Tax Court), you can apply to the Federal Court for "judicial review", and seek an order such as "*mandamus*" (Latin for "we order") or an injunction, to order the CRA what to do or not do.

The problem with this is that, as two recent cases show, the Federal Court in practice is very unlikely to intervene. The cases are *Safe Workforce Inc.* (2019 FC 645), and *Ghazi* (2019 FC 860).

In the first case, Safe Workforce (SW) was being audited by the CRA. The auditor issued a proposal letter, proposing to reassess. SW asked for all information in the auditor's file about SW (so it could better reply to the proposal), and while some information was disclosed, the CRA's response to further requests was that SW should file an *Access to Information Act* request. SW applied for disclosure, but the CRA's Access to Information department was slow in responding. After some months went by, the auditor indicated he would "close the file" and issue the assessment. SW complained to the auditor's superiors, and the Assistant Director Audit of that CRA office confirmed that the auditor could go ahead and issue the assessment.

SW then brought an application in Federal Court for judicial review, seeking an injunction to stop the CRA from issuing the assessment until the Access to Information disclosure had been provided, so that SW could make further submissions. Seems reasonable?

The government brought a motion to strike out the judicial-review application on the basis it could not possibly succeed. SW countered with a motion seeking an interim injunction to prevent the assessment from being issued until the judicial-review application had been heard.

The Federal Court dismissed both motions. The Court ruled that it was premature to dismiss the application, because it could conceivably succeed. But the Court also declined to issue an interlocutory injunction, as there was **no indication that SW would suffer "irreparable harm" by having the assessment issued**, since it could appeal to the Tax Court.

Thus, in effect, SW lost its case because the CRA can now proceed to issue the assessment. As the judge wrote, "there is no statutory or common law obligation to allow the Applicant to participate in the audit process". In other words, an auditor's proposal letter is an administrative courtesy with no legal status, and doesn't give you a legal right to stop the assessment from being issued.

*Ghazi* was a somewhat similar case. Ghazi was being audited by the CRA, which proposed to assess him for HST not collected on the sale of two real estate properties. His lawyer asked the auditor for the facts that the auditor was assuming to support the proposed assessment and penalties.



Ghazi sought to have the Assistant Director Audit of that CRA office change auditors, and move the file to a new audit team. When she refused, Ghazi applied to the Federal Court for judicial review. He sought an order requiring the CRA to take the auditor and team leader off the audit.

The Federal struck out Ghazi's application for judicial review without a hearing, as it had no legal chance of success. Any complaints Ghazi had about the audit team's conduct could be addressed by the CRA Ombudsman. Ghazi's real objective was to stop the assessment being issued, which was not something the Federal Court would do. Ghazi had an adequate remedy of appealing the assessment to the Tax Court of Canada.

As one can see from these two cases, in practice one cannot get any help from the Courts in trying to stop an audit assessment. If you have no luck with CRA management or the Ombudsman, the assessment will be issued, and all you can do is appeal to the Tax Court. And if the assessment is for GST/HST or source deductions, you'll be forced to pay even while you're appealing.

## TAX QUIZ — THE ANSWERS

Here are the answers to the quiz on page 1.

1. **One-half** of a capital gain is taxable. That is, half of the gain is your "taxable capital gain", which is included in income for tax purposes. Unless you do so much trading that you're considered to be carrying on a business of stock trading, the \$12,000 gain is a capital gain, and **\$6,000** will be included in your income and taxable.

However, all **commissions** you originally paid to buy the stock, as well as those you

pay to sell the stock, are deducted when you calculate the gain. So if you paid \$200 commission when buying the stock and \$400 when selling it, your capital gain is actually \$11,400, and the amount to be included in your income for tax purposes will be \$5,700.

2. **No.** You have an allowable capital loss of \$6,000 (one-half of the capital loss), or perhaps something like \$5,700 if you paid commissions on the purchase and sale as in #1 above. However, you cannot use an allowable capital loss against employment income, or against any other income other than taxable capital gains.

If you had taxable capital gains in any of the previous three years, you can carry *back* your allowable capital loss and use it against those gains. If not, you can **carry forward your allowable capital loss indefinitely**, and apply it in any future year, but only against taxable capital gains.

3. **No, but your spouse can deduct \$8,000.** Only the lower-income spouse can deduct child care expenses, and only to a limit of \$8,000 per child you have under age 7 at year-end (\$5,000 for each child aged 7-15 at year-end; \$11,000 per severely disabled child), and only up to 2/3 of the lower-income spouse's "earned income" (generally, income from employment or business). You yourself cannot deduct the expenses, because you earn more than your spouse.

Note that if you also had a 14-year old child needing no child care, your spouse would be able to deduct the full \$11,000 paid to the nanny even though the nanny is caring only for the baby. The limits of \$8,000, \$5,000 and \$11,000 per child apply based on the number of children

you have, not based on which child is being cared for by the person(s) you are paying.

4. You can contribute **\$9,000** for 2019. That's 18% of your 2018 "earned income" (if your 2018 earned income exceeded \$147,222, the 2019 maximum limit of \$26,500 would apply). You should find the contribution limit printed on your 2018 Notice of Assessment, which you should have received in spring 2019 after filing your 2018 return.

Note that if you are a member of a pension plan, this contribution limit is reduced by your "Pension Adjustment", which is an amount that reflects the future value of your pension based on your employer's current contributions. This appears on the 2018 T4 you received from your employer, and is also printed on your Notice of Assessment and available online from your CRA "My Account".

Your contribution deadline for deducting an RRSP contribution is 60 days after the end of the year. But if you guessed March 1, 2020, then you're not quite right. Since 2020 is a leap year, the 60th day is February 29, not March 1. But if you guessed February 29, you're still not right. Since February 29, 2020 is a Saturday, the deadline is extended to the next business day, **Monday, March 2, 2020**.

If you do not contribute for 2019, your contribution room accumulates, and you can contribute (and deduct) the \$9,000 in any later year, in addition to your contribution room for that year. So, for example, your \$60,000 of employment income in 2019 creates a further \$10,800 of contribution room for 2020 (18% of \$60,000); and in

2020 (or by March 1, 2021) you can contribute and deduct up to \$19,800 — the unused \$9,000 plus the new \$10,800.

5. No. You will be allowed to deduct only **\$17,500, or more likely nothing at all**. If the farm is not operated in a commercial manner, then the CRA will take the position that the farm is just a hobby and not a real "business" (especially since the ongoing losses suggest you are not really trying to make a profit), and no deduction will be allowed.

Even if the farm does qualify as a "business", the deduction is limited to \$2,500 plus half of the next \$30,000, total \$17,500, as a "**restricted farm loss**", unless you can show that farming, or farming plus your other job, is your "chief source of income". Since you have a full-time job unrelated to farming, it is very unlikely you will be able to show this unless the farm generates significant revenues. Many such cases have gone to the Tax Court of Canada, and the taxpayer usually loses (though not always).

6. **You must report the full \$8,000** on your Canadian return and pay tax on it. However, you can claim a "**foreign tax credit**" for the U.S. tax. The foreign tax credit rules are complex, but most likely you can recover the full C\$1,200 of U.S. tax as a credit on your Canadian return, since your Canadian tax on the \$8,000 will be higher than \$1,200.
7. **Yes**. On these facts, you will remain "resident in Canada" for Canadian tax purposes while you are in France. (The Canada-France tax treaty, like all of Canada's 92 tax treaties, has rules to determine which of the two countries you

will be considered a resident of, for tax purposes.) As a Canadian resident, you must file and pay tax on your worldwide income from all sources. However, you will be able to claim a Canadian foreign tax credit to reduce the “double taxation” effect of being taxed by both countries. (Before 2016, you might also have been able to claim the “Overseas Employment Tax Credit” to reduce your Canadian tax, but that no longer exists.)

8. You will add **\$3,000** to your income for tax purposes. You do not pay any tax on the gift. (Your aunt, however, will have a \$15,000 capital gain, and thus a \$7,500 taxable capital gain included in her income, from making the gift to you. When she makes the gift, she is deemed to have sold the shares at their current fair market value.)

When you sell the shares, you have a capital gain. The “cost base” of the shares to you for tax purposes is their value on the date you received them as a gift, of \$20,000. So you have sold shares with a cost base of \$20,000 for \$26,000. This gives you a \$6,000 capital gain, and half of that, or \$3,000, is included in your income for tax purposes as the “taxable capital gain”. Of course, if you pay commission on selling the shares, that is deducted from the capital gain (as in #1 above) before you calculate the taxable capital gain.

9. **Option (c) is the best, and option (b) is the worst.**

Option (c) is the best because you effectively get to realize the capital gain on the Apple shares without paying any tax on it. Normally, if you give a gift of

property, you are deemed to have sold the property at fair market value (as applied to your aunt in #8 above). But if you donate publicly-traded shares to a charity — including shares listed on most foreign exchanges — you do not have to recognize the capital gain. You get the donation credit for the full \$5,000 value you have donated (likely worth about \$2,500, depending on the province), without paying tax on the capital gain.

Option (a) is second-best. You get the donation credit for \$5,000, but you still have the accrued capital gain on the Apple shares, and one day you will need to pay tax on it (or your estate will, if you pass away without ever selling or giving away those shares).

Option (b) is the worst option. Because you have owned the art for less than three years, its value for purposes of the charitable donation credit cannot exceed your cost (Income Tax Act subsection 248(35)). So you will get the donation credit for only \$3,000 instead of \$5,000, and the credit will be worth only about \$1,500.

10. You can claim the medical expense credit for items **(a), (d), (e), (f), (g) and (i)**. Crutches are an allowable expense. Marijuana is allowable, if you have a “medical document” for medical use of cannabis. Prescription glasses are allowable, even if they are sunglasses. Private health care plans, including travel plans and dental plans, qualify as well. And tutoring services for a person with a learning disability, where the need is certified by a medical practitioner, also qualify.

You cannot claim any amount for items (b), (c) and (h). Over-the-counter Tylenol and vitamins do not qualify even if prescribed or ordered by your doctor; drugs qualify only if they cannot legally be obtained without a prescription from a physician or dentist. And transportation qualifies only in limited circumstances—for example, if it is 40km or more where it is paid to a person carrying on a transportation business (such as a taxi) and equivalent medical treatment is not available locally.

The CRA's Income Tax Folio S1-F1-C1, available on the CRA's website, contains a detailed list of qualifying medical expenses.

For all expenses that exceed a threshold for the year, the medical expenses are worth about 22% of what you paid. (You get a 16% federal tax credit plus a separate provincial tax credit which varies by province.) The threshold for 2019 is \$2,352 or 3% of your "net income", whichever is less. ("Net income" is your total reported income minus most allowable expenses, though some deductions come later in calculating "taxable income".) So you need to have substantial medical expenses before you cross the threshold and can start claiming the credit for additional expenses beyond that point.

Note however that the claim applies to expenses paid in any 12-month period ending in the year. On your 2019 return, for example, you can if you wish claim expenses paid from, say, March 5, 2018 through March 4, 2019. Thus, if you do not have enough expenses in one year to make a claim, you may still be able to combine those expenses with some from the following year to get some tax relief.

## ERRATUM AUGUST 2019 TAX LETTER

In our August 2019 Tax Letter, in the example on page 6 under the subheading "Transfer of Dividend to Spouse or Common-law Partner", the number \$12,609 was used, although the number should have been **\$12,069**. In the example, based on \$12,069, Lisa spousal credit would have been **\$900** instead of \$981. She still saves federal tax, but the amount is **\$571** rather than \$652. We apologize for the error.

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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.