Tax Newsletter

Spring 2014

An Independent Member Firm of DFK Canada Inc. and DFK International

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Special points of interest:

- ***Personal tax instalments:***
  - ► ***June 15, 2014***
  - ► ***September 15, 2014***
  - ► ***December 15, 2014***
- ***June 15th is personal tax filing deadline for self-employed individuals and their spouse or common-law partner.***
- ***CRA is late posting T1 payments. Many are receiving Notices of Assessment showing a balance owing. CRA is updating their system and will be reversing interest charges.***

Moving Your US Pension to Canada

Justin K. Hoffman, CPA, CA, CFP, Tax Manager, Davis Martindale LLP, London, ON, DFK Affiliate Firm

Brad Taylor, CA, Tax Manager, Kingston Ross Pasnak LLP, Edmonton, AB, DFK Member Firm

Many individuals moving to Canada after years of working in the United States will have accumulated a substantial balance in their US pension account. The decision as to what to do with these accounts is a crucial part of forming a complete retirement plan.

The Rollover

Under 60(j)(i) and 60(j)(ii) of the Income Tax Act, individuals can, on the collapse of a US plan, transfer the balance to an RRSP on a tax-deferred basis. The transfer operates by including the full amount of the collapsed pension in income, and then allowing an offsetting deduction for the amount transferred into the RRSP. The individual should be aware that despite the Canadian tax deferral, the collapse of the pension will still attract US withholding tax of 15 to 30%. For the gross pension to be eligible for the rollover, several conditions must be met:

1) The individual must have an RRSP account (the rollover doesn't work with RRIFs);
2) The individual must deposit the amount into the RRSP within 60 days of the end of the year in which the US pension account was collapsed; and
3) The amount transferred must represent the employee's contributions to the plan. Employer contributions cannot be rolled on a tax-deferred basis.

Planning for the Transfer

To ensure that the transfer occurs on a tax efficient basis, the individual's circumstances should be reviewed. A few questions to consider are as follows:

1) Is the individual over age 59 and a half? If not, an additional 10% withholding applies.
2) Has the pension fund been informed that the taxpayer is a Canadian citizen? Failure to inform the promoter can result in an additional 5% withholding tax.
3) Does the individual have sufficient cash to transfer the entire pension into the RRSP? After withholding taxes, the individual will have only 70 - 85% of the original withdrawal available to transfer into their RRSP. The remaining 15 – 30% will be taxable income.
4) What percentage of the transfer should be rolled into the RRSP to ensure the maximum usage of the foreign tax credit? Will the unused foreign tax credit be utilized within the next 7 years?
5) Will the promoter allow the individual to retain their US pension plan while resident in Canada or must they collapse it immediately? Is there another promoter who would be willing to operate the plan in the US?

In many cases, individuals will find that the rollover of the foreign pension will result in an unacceptable result. OAS will often be fully clawed-back in the year of withdrawal, and since the eventual withdrawal of the transferred funds from the RRSP will be considered Canadian income, the foreign tax credits carried forward from the initial transfer will not be able to be utilized, resulting in a double-tax scenario. Consequently, each individual's situation should be reviewed carefully and all options considered before opting to make the tax-deferred transfer.

T1135—Foreign Income Verification Statement

Mathew Desilets, BCom, CA, Tax Manager, Kingston Ross Pasnak, LLP, Chartered Accountants, Edmonton, AB, DFK Affiliate Firm

CRA has recently introduced changes greatly increasing the complexity of the T1135 filing and as a result, transitional relief has been announced **for the 2013 tax year.**

As a reminder, Canadian resident taxpayers are required to file a T1135 form if at any time in the year the cost amount of specified foreign property to the taxpayer was more than $100,000 Canadian dollars. Some common examples of specified foreign property include funds held outside of Canada (e.g., a bank account in the United States), securities of non-resident corporations (including those held in Canadian brokerage accounts, or traded on a Canadian stock exchange), and debts receivable from non-residents. There are many other examples of specified foreign property, so please see the T1135 form under the heading "what property do you have to report?" for additional information.

There are significant penalties for not complying. Additional information relating to penalties for the T1135 can be found here: http://www.cra-arc.gc.ca/tx/nnrsdnts/cmmn/frgn/1135-eng.html. If you have prior years' filings, consider making a voluntary disclosure, under which CRA will waive many penalties. Your local DFK accounting office can provide you with more information on this program.

If you have not yet filed your 2013 T1135 form, the 2013 deadline has been extended to **July 31, 2014.**

Canada Revenue Agency (CRA) permits a transitional method of reporting that can **greatly reduce the complexity** for the 2013 tax year only.

The first step in determining whether you qualify for the transitional method of reporting is ensuring the investment is held with a "**Canadian registered securities dealer.**" It is important to confirm with the investment advisor as the results are often surprising. We have been told by investment advisors that even some accounts held by major investment brokers do not qualify for the exception.

Once you have confirmed the investments are held with a "Canadian registered securities dealer," you can report the foreign investments under the transitional reporting method, in accordance with CRA's instructions attached to the T1135 form. This disclosure is limited to the value of the foreign property at the end of 2013, and the income and gains on such property held in the account during the year, in aggregate for each account.

After the 2013 reporting year, CRA has stated that it will require a detailed disclosure. This means that for every foreign property you hold (including each non-resident company's stock holdings), you will be required to report **on a separate line** the highest cost of the investment in the year, the cost of the investment at the year end, the income earned on the property, and any gains or losses from the disposition of the property. We recommend having a discussion with your investment broker to determine the extent to which they can assist in providing the information required to complete the above filing requirements.

Additional details of how to report under the transitional reporting method can be found on CRA's website at http://www.cra-arc.gc.ca/E/pbg/tf/t1135/README.html, or by consulting with your local DFK accounting office.

If you have not yet filed your 2013 T1135 form, the 2013 deadline has been extended to July 31, 2014.

Donating By Will

Linda Woo, CPA, CA, Principal, Segal LLP, Chartered Accountants, Toronto, ON, DFK Affiliate Firm

There are many reasons to give to a charity: a personal relationship with a particular charity, a sense of social responsibility, the need to help others less fortunate, or a desire to give back to the community. Studies have shown that in addition to benefiting the community, the act of giving could increase the wellbeing, self-esteem and reputation of the donors themselves.

Because charitable giving can affect the disposable income and savings of donors, donors may not be able to donate the amount they would like. For donors who would like to donate larger amounts but can't afford to do so during their lifetime, or who wish to leave a legacy after their death, a donation can be made through a declaration in a Will.

The advantages of making a donation in this manner, is that the general income limitation (i.e., the maximum amount of donations that may be claimed in a year is generally limited to 75% of the donor's net income) does not apply; 100% of the donations made in the year of the donor's death and the immediately preceding year can be claimed in those years. These donations are also deemed to occur in the donor's terminal year; therefore, a donation tax credit can be claimed on the donor's final tax return even though the actual donation occurs during the administration of the estate. Furthermore, any excess donations may be carried back to the year prior to death.

Making a donation through a Will, however, does have its drawbacks. For example, the donor will not be able to benefit from any tax savings during his/her lifetime or be able to witness the benefit his/her donation provides. Also, the executor may not be able to claim the full tax credit available if the donor has a low level of income because the death occurred early in the year (this also assumes the preceding year's income was low).

With respect to the last item, the 2014 federal budget, proposes to provide some relief by allowing more flexibility to executors to apply donation credits. If the proposals are accepted, donations made by Will (and designated donations) will be deemed to have been made by the estate at the time at which the property is transferred to a qualified donee. The executor will then have the flexibility of claiming the donation in the year in which the estate makes the donation, an earlier taxation year of the estate, or the last two taxation years of the deceased individual. To qualify, the donation must be made within the first 36 months following the individual's death. The changes are expected to apply to donations made by Will or designation donations for deaths that occur on or after January 1, 2016.

Thus, donations can now be used to reduce the taxable income of the deceased individual in a manner most advantageous to the estate. Hopefully, this encourages people to consider making a donation as part of their estate planning.

To further facilitate charitable giving, the trustee of an individual's estate will be allowed increased flexibility to apply charitable donation credits against the income tax liabilities of the individual or the estate." - 2014 Federal Budget

Mortgage Your Own Property — A Different Kind of RRSP Investment

Kody Wilson, CPA, CA, Supervisor, Ginsberg Gluzman Fage & Levitz, LLP, Chartered Accountants, Ottawa, ON, DFK Affiliate Firm

Have you ever considered lending yourself money in the form of a mortgage? If you were purchasing a $400,000 house and had a down payment of $150,000, you would still need to borrow $250,000 to pay the rest.

What if you had enough money in your Registered Retirement Savings Plan (RRSP) to cover the balance? Legally, an RRSP cannot own real estate; however, an RRSP can lend money for a mortgage.

You will need to have a self-directed RRSP, which means you are responsible for all of the investments that take place within the account.

There are strict guidelines you must follow if you decide to go this route. For instance:

- The mortgage must be administered by an approved lender;
- The interest rate must be in line with the standard rates; and
- The mortgage has to be insured by Canada Mortgage and Housing Corporation.

It is set up like any mortgage from a financial institution would be, with the exception of the fact you make the payments to yourself and you get to keep the interest.

Some of the pros include:

- You keep all the interest;
- Protection from rising rates;
- Guaranteed investment return; and
- Interest and principal payments don't count as RRSP contributions.

Some of the cons include:

- The fees associated with taking out a mortgage against your RRSP;
- The large RRSP holdings requirement; and
- The risk of losing out on other RRSP investment opportunities.

Speak with your advisor to discuss the advantages and disadvantages of RRSP mortgages as they pertain to your specific situation.