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Special points of interest:

- **Personal tax instalments:**
 - ▶ March 15, 2014
 - ▶ June 15, 2014
 - ▶ September 15, 2014
 - ▶ December 15, 2014
- **Personal income tax filing deadline is April 30th**
- **2013 RRSP contribution deadline is March 3rd**
- **TFSA contribution room for 2014 remains at \$5,500**

Taxation of Disaster Relief

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You may have had the misfortune of experiencing a natural disaster such as the Alberta Floods in June, or the ice storm in Eastern Canada in December. If you did, you or your business may be receiving compensation as a result and may be questioning the income tax consequences of this compensation.

Payments made to individuals by a public authority or insurance company with respect to personal losses or expenses are not taxable. Compensation received by a business, however, will generally result in income tax consequences.

In determining how the receipt should be characterized for income tax purposes, the “surrogatum principle” applies, meaning the tax consequences of a receipt for damages depends on the tax treatment of the item for which the payment is intended to substitute. Consequently, a receipt for damages will be considered income for tax purposes if it is compensation for loss of income. A receipt for loss of, or damage to, a capital asset will be a capital receipt or an income receipt.

The income tax consequences of receipts related to a capital asset depend on several factors, including the source of the funds, when the funds are received, and when the funds are expended.

Proceeds of insurance policies for damages to depreciable property such as a building or equipment are included in income if the proceeds are used to repair the property within a reasonable time after the damage occurred. If so, the amount to be included in income for a particular year will be the amount of the insurance proceeds expended in that year on

repairing the damage, thereby offsetting the amount deducted as an expense in the year for repairing the property.

The time at which the insurance proceeds are collected is not relevant so long as they are payable by the insurance company. If the proceeds of an insurance policy are not expended on repairing the property within a reasonable time after damage, the unexpended portion is treated as the proceeds of disposition of the depreciable property. Should the damage be so extensive that the property will have to be replaced, the insurance proceeds are treated as proceeds of disposition. Any resulting recapture of capital cost allowance or capital gain can be deferred if replacement property is acquired within a specified time period.

Amounts received from a public authority are included in taxable income. If the receipt relates to a capital asset acquired within a specified time period, the income inclusion can be avoided by electing to reduce the capital cost or adjusted cost base of the capital asset. As such, future capital cost allowance claimed on the property will be reduced, or the capital gain on the ultimate disposal of the property will be increased.

The issues of income tax consequences resulting from funds received due to a natural disaster are complex. Consult with your tax advisor to determine the appropriate tax treatment for your specific situation.

Gift Tax Shelters - Taxpayer Beware!

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Reducing one's tax bill is as much a passion for Canadians this time of year as hockey or weekends at the cottage. Since 2000, hundreds of thousands of taxpayers have turned to the use of gifting tax shelters to minimize their tax burden.

There have been multiple gifting tax shelter arrangements in Canada. While these arrangements are complicated and difficult to follow for even the most seasoned tax practitioners, generally, a gifting tax shelter is an arrangement whereby a taxpayer makes a cash investment (donation) and in return is issued a charitable donation receipt for an amount that is often significantly greater than the amount donated. In one such arrangement, for every \$10,000 a taxpayer invested in the gifting tax shelter, a donation receipt of \$30,000 was issued, resulting in a tax savings in excess of the initial donation.

The basic statutory framework for donations requires that, first of all, the donor make a gift and the donation tax credit claimed be based on the fair market value of that gift. There have been numerous court cases focused on these statutory requirements that have resulted in the elimination of the benefit of such arrangements.

For obvious reasons, the Canada Revenue Agency (CRA) takes issue with gifting tax shelters that provide receipts in excess of the donation and, over the years, has issued several alerts to taxpayers warning that all gifting tax shelters will be audited and that all audits to date have resulted in reassessments.

The resulting audits have seen CRA reassess over 182,000 taxpayers, deny \$5.9 billion in donation claims, and revoke the charity status of 47 organizations. It has also assessed \$137 million in third-party penalties against promoters and tax preparers.

In the fall of 2012, CRA announced it will hold the assessment of returns for individual taxpayers

claiming a donation credit by participating in a gifting tax shelter until an audit of the tax shelter is completed, which according to the CRA can take up to two years.

CRA has announced this procedure will continue despite a court ruling that found that, in doing so, the Minister of National Revenue has failed to examine a tax return "with all due dispatch." The CRA has stated, however, that if a taxpayer agrees to remove the claim from their return, the return can be assessed prior to completion of the tax shelter audit.

In June 2013, the Department of Finance enacted amendments to the Income Tax Act which essentially shuts down the "buy low, donate high" arrangements involving taxpayers purchasing property at a significant discount and then donating the property for the higher fair market value by limiting the donation amount to the cost of the property. New laws also allow the CRA to collect 50% of the amount in dispute, or to withhold 50% of a refund due, where a taxpayer has objected to an assessment or appealed to the Tax Court of Canada when these amounts relate to a gifting tax shelter.

Despite the legislative changes and outcome of the court cases and CRA audits, there are still promoters of gifting tax shelter arrangements asking for your hard-earned money. It is recommended you consult with a professional tax advisor before entering into any gifting tax shelter arrangement or planning any course of action to resolve the delay of an assessment of your tax return.

Remember, if it sounds too good to be true, it likely is.

CRA takes issue with gifting tax shelters that provide receipts in excess of the donation.

Canada and US Reach an Agreement on the Foreign Account Tax Compliance Act (FATCA)

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New US FATCA requirements could result in the Internal Revenue Service locating US citizens who are not meeting their US income tax compliance obligations.

FATCA requires non-US financial institutions to enter into an agreement with the US Internal Revenue Service to report to the IRS accounts held by US residents (including corporations, trusts and partnerships) and US citizens who are also residents or citizens of Canada. Obligations for Canadian financial institutions to comply with FATCA are effective July 1, 2014.

On February 5, 2014, Canada and the United States signed a Tax Information Exchange Agreement related to FATCA.

With the agreement:

- ◆ Canadian financial institutions will report accountholder information on US residents and US citizens to the Canada Revenue Agency, who will then transfer the information to the IRS. Depending on the type of account, this information could include US identification numbers, account balances, values, and amounts paid or credited to the account.
- ◆ A 30 percent FATCA withholding tax on certain US-source payments can apply to a Canadian financial institution if the financial institution is in significant and long-term non-compliance with its

obligations under the agreement. Presumably this will result in compliance by the Canadian institutions.

- ◆ A number of accounts will be exempt from FATCA reporting, including Registered Retirement Savings Plans, Registered Retirement Income Funds, Registered Disability Savings Plans, and Tax-Free Savings Accounts.
- ◆ Smaller deposit-taking institutions, such as credit unions, with assets of less than \$175 million will be exempt from reporting.
- ◆ The IRS will provide the CRA with enhanced and increased information on certain accounts of Canadian residents held at US financial institutions.

Without the agreement:

- ◆ Obligations under FATCA would force Canadian financial institutions to choose between:
 - ◇ entering into an agreement with the IRS that would require them to report directly to the IRS on accounts held by US residents and US citizens; or
 - ◇ being subject to a 30 percent FATCA withholding tax on certain US-source payments for not complying with FATCA.
- ◆ Clients at Canadian financial institutions could also be subject to the 30 percent FATCA withholding tax or could have their accounts closed by their financial institution for failing to comply with FATCA requirements.

DFK affiliate firms encourage all of their clients and contacts that are US citizens to make sure their US tax and other filing obligations are up to date.

2014 Federal Budget—A Few Key Highlights

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On February 11, Finance Minister Jim Flaherty presented Canada's Economic Action Plan 2014 to the House of Commons. Below are three key highlights.

Remittance Thresholds for Employer Source Deductions

The threshold level of average monthly withholdings at which employers are required to remit up to two times per month will be increased to \$25,000 from \$15,000. As well, the threshold level of average monthly withholdings at which employers are required to remit up to four times per month will increase to \$100,000 from \$50,000.

Graduated Rate Taxation of Trusts and Estates

The measures described in the consultation paper released June 3, 2013 will generally proceed as planned. In addition, graduated rates will continue to be provided in respect of such trusts having individuals who are eligible for the federal Disability Tax Credit as their beneficiaries.

Testamentary trusts (other than estates for their first 36 months) and grandfathered inter vivos trusts will no longer benefit from special treatment under a number of related tax rules.

Estate Donations

More flexibility in the tax treatment of charitable donations made in the context of a death that occurs after 2015 was proposed. Donations made by will and designation donations will no longer be deemed to be made by an individual immediately before the individual's death. Instead, these donations will be deemed to have been made by the estate, at the time at which the property that is the subject of the donation is transferred to a qualified donee.

Donations will be eligible to be claimed by the estate for the year the donation is made, or an earlier year, or on the individual's tax returns for the last two taxation years.

For more detailed highlights of Canada's Economic Action Plan 2014, contact your DFK affiliate firm.