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TAX LETTER

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TRANSFERRING SHARES TO YOUR RRSP

Should you transfer shares that you already own to your RRSP?

The prospect can be attractive. The shares you transfer are considered a **contribution to your RRSP**. If you have unused RRSP contribution room, you can thus get a substantial **tax deduction** for shares that you already own. If you have not been making maximum RRSP contributions, you may have substantial accumulated contribution room. (Unused contribution room can be carried forward indefinitely since 1991.)
However, there are a number of problems and pitfalls that you should be aware of (most of these concerns also apply to a RRIF, TFSA, RESP or RDSP):

1. Contribute — don't swap!

You can *contribute* shares to your RRSP, subject to the further points made below. But **do not swap** shares for other shares, securities or money that is in your RRSP!

Some taxpayers were finding ways to manipulate their income for tax purposes by swapping volatile securities in and out of their RRSPs (such as by picking the day's low price for the transfer, so that gains accrued tax-free in the RRSP). The Department of Finance cracked down on this in 2011, and introduced rules that severely penalize taxpayers for swapping assets into their RRSPs for cash or other assets. Any income or gain earned in the RRSP on such assets will be 100% confiscated.

So make sure you are *contributing* to the RRSP, not exchanging the shares for something the RRSP already owns.

2. Do the shares qualify?

Shares in corporations listed on Canadian stock exchanges are no problem. For shares in private companies or foreign corporations, however, you must ensure that they qualify as RRSP "qualified investments". Some do, but the rules are complex and must be checked carefully by a professional.

The rules for private corporations generally require that you and your family members not own 10% or more of the shares of any class of the corporation, and that it uses substantially all of its assets in an active business carried on in Canada. The rules for foreign corporations generally require them to be listed on specific stock exchanges (including all the major U.S. exchanges, as well as specific exchanges in 29 other countries).

3. Capital gain on transfer

When you transfer shares to your RRSP, you are considered to have sold them at their fair market value for tax purposes. If the market value is higher than your cost base, you will have a **capital gain.**

One-half of the capital gain will be included in your income and subject to tax (except to the extent you have unused capital losses from the same year or carried over from other years). You will have to consider this cost when measuring the value of the RRSP contribution.

EXAMPLE

You have shares in a public company that you purchased in 2013 for $2,000. They are now worth $10,000. You have $10,000 of unused RRSP contribution room. Your income is high enough that you are in a 50% tax bracket (combined federal/ provincial tax).

If you transfer the shares to your RRSP, you will have a $10,000 deduction, worth **$5,000** on your 2021 tax return.

However, you will also have an $8,000 capital gain, since you will be deemed to have sold the shares for $10,000. One-half of this gain, or $4,000, will be included in your income. In your 50% bracket, that will cost you **$2,000**.

The result is that you still benefit from the transfer, but your net tax saving will be $3,000 rather than $5,000. (If you donate the shares to charity instead, you will not pay tax on the capital gain so your tax savings will be about $5,000, though they will vary by province.)

4. No capital loss on transfer

As noted above, when you transfer shares to your RRSP, you are considered to have sold them at their fair market value for tax

purposes. However, if this value is less than the cost of the shares to you, you **cannot claim a capital loss**. Clause 40(2)(g)(iv)(B) of the *Income Tax Act* specifically prohibits claiming a capital loss on shares that you transfer to your (or your spouse's) RRSP.

It is hard to quantify the cost to you of not being able to claim the capital loss, because it depends on various other factors. Capital losses normally can be used only against capital gains (including in future years, or from the past 3 years). If you have other capital gains to use up, the capital loss can be quite valuable. In such a case, you should definitely consider *selling* the shares on the market for a capital loss, and then transferring the cash to your RRSP. (Don't have the RRSP buy back the same shares within 30 days, or your capital loss will be denied as a "superficial loss".)

5. Cost of withdrawing the funds

Don't forget that any funds in your RRSP are taxed when you take them out (such as after you turn 71 and the RRSP is converted to a RRIF, which requires a certain percentage to be withdrawn each year). The transfer of shares gives you a *deferral* of tax which can be very valuable, especially because of tax-free compounding within the RRSP. However, when you want access to the funds, you will have to pay the tax. The financial institution will withhold a percentage of the amount you withdraw, as prepayment against the tax you will owe on it.

If you are transferring shares to your RRSP, be sure you are aware of these costs if you may need the funds back soon. As well, if you do take them out soon, you will have effectively wasted the contribution room for future years.

6. No dividend tax credit or advantageous capital gains treatment

Both dividends and capital gains are given special tax relief when you get them personally. For dividends from Canadian corporations, you get the dividend tax credit, which approximately offsets the tax paid by the corporation on the income that it had to earn to pay you the dividend. The result is that the top tax rate on dividends is typically in the range of 30-45% rather than about 50% (the details depend on your province of residence as well as your level of taxable income and the kind of dividend). Capital gains, as noted above, are only half taxed, so the top rate is typically about 25-27%.

If you put shares into your RRSP, both of these advantages are lost. Any dividends or capital gains simply result in the RRSP having more cash. The RRSP pays no tax. However, when you withdraw the funds from the RRSP (or later from your RRIF), you will be fully taxed on the withdrawal, with no credit for the fact that part of the funds withdrawn were received as dividends or capital gains.

As long as you leave the funds in your RRSP for many years, these disadvantages can be outweighed by other advantages, such as the up-front tax deduction and the tax-free compounding within the RRSP, as well as the fact that you may be in a lower tax bracket when you eventually withdraw the funds on retirement. However, you may wish to calculate the tradeoff, based on how long you expect to leave the shares in the RRSP and the expected rate of return.

Conclusion

Transferring shares to your RRSP can be an excellent way of obtaining a current tax deduction if you have unused contribution room. However, it is not always beneficial. Do not overlook the pitfalls and costs that may apply.

REQUEST A DETERMINATION IF YOU HAVE A LOSS

If you have a business or property loss that wipes out all of your income for the year, you report taxable income on your income tax return as zero.

What happens if the CRA audits you some years later and decides that you claimed too much loss?

For a regular assessment of tax, there is a "three-year clock" that starts running as soon as the CRA issues your original assessment for the year.

For example, suppose you filed your 2017 return on April 4, 2018 and you received a Notice of Assessment dated April 19, 2018. The CRA cannot reassess you to change your 2017 taxable income after April 19, 2021. (This limitation does not apply in cases of fraud, carelessness, neglect or wilful default, or if you sign a waiver before the deadline.)

But what if you had a business loss in 2017, reported zero taxable income and zero tax, but also had a $50,000 loss carryforward to claim in a later year? And suppose the CRA decides, many years later, that the $50,000 loss in 2017 shouldn't be allowed?

The three-year clock will not start running for a loss, since your "assessment" — i.e., zero tax for 2017 — does not need to be changed if the CRA disallows the loss carryforward claim for a later year. Thus, for example, if you claim the $50,000 loss from 2017 on your 2021 return filed in April 2022, the CRA can reassess you to deny the claim, any time up to the reassessment deadline for your 2021 return (normally sometime in 2025), rather than only until April 2021, as would be the case for your 2017 return.

There is a way to prevent this, however, and to start the clock running. Once you receive your "nil assessment" for a year in which you pay no tax, write to the CRA and request a **determination of loss** under *Income Tax Act* subsection 152(1.1). The CRA will usually comply and issue the determination fairly quickly. Once it is issued, the date on the Notice of Determination starts a three-year clock running for any redetermination. If the three years run out, then your loss is guaranteed and (subject to exceptions for fraud etc. as mentioned above) you can be sure of being able to carry it forward and claim it in a future year. Business losses can be carried forward up to 20 years.

So, if you have nil taxable income for the year and a loss carryforward, request a "determination of loss".

GST/HST ON SETTLING A BUSINESS DISPUTE

If you own or manage a business, you occasionally end up in disputes with customers or suppliers over the terms of a contract or payment. Sometimes these disputes have to be referred to lawyers, and sometimes they end up in court.

Regardless of how far the dispute goes until it's settled, do you know about the GST or HST consequences of any settlement or

damage award? Your lawyer might not be aware of this issue.

A settlement or award for breach of contract will normally **be considered tax-included** if the following conditions are met:

- The payment is made by the "recipient" to the "supplier" rather than the other way round. That is, it is the purchaser, lessee or customer who is making the payment, and the vendor, lessor or supplier who is receiving it. (In other words, money is flowing in the same direction as it would have flowed under the contract.)

- The payment is for breach, termination or modification of a **contract or agreement**. (It need not be a *written* contract; an oral agreement is still a contract.)

- GST or HST was payable, or would have been payable, under the contract, if it had been fulfilled as planned.

In these circumstances, any settlement amount is normally deemed by the *Excise Tax Act* to be a total that **already includes GST or HST**.

The supplier (vendor, lessor) must carve out a fraction of the total and remit it to the Canada Revenue Agency as GST or HST. The fraction depends on the province. If your customer is in Ontario, for example, where the HST rate is 13%, the fraction is 13/113ths, or just over 11.5%. In the western provinces and the territories, where the GST rate is 5%, the fraction is 5/105ths.

The recipient (purchaser, lessee) can claim an input tax credit and *recover* the same amount from the CRA, provided the recipient would have been able to claim the credit if the moneys had been paid under the contract.

> *EXAMPLE 1*
>
> *Landlord leases office space in Ontario to Tenant for $5,000 per month plus 13% HST, under a one-year lease. Six months into the lease, Tenant wishes to cancel. After some discussions, Landlord agrees to accept a one-time payment of $10,000 to release Tenant from the lease.*
>
> Landlord must treat the amount received as HST-included. If Landlord accepts $10,000, it must calculate 13/113ths of this amount or $1,150 and remit this amount to the government as HST collected. In other words, Landlord has really settled for $8,850 plus 13% HST of $1,150. (The $8,850 will also be income for income tax purposes, but this article is not about income tax.)
>
> Similarly, Tenant is paying $8,850 plus HST of $1,150. If Tenant is a normal business that can claim input tax credits for HST that it pays, Tenant can recover the $1,150 as a refund when filing its next HST return — which may be something of a windfall if Tenant made the deal without expecting this. This is so even if the settlement agreement does not mention the HST.
>
> If Landlord really wants to settle for $10,000, Landlord should add 13% for HST and settle for $11,300. Then Landlord keeps $10,000 and sends $1,300 (13/113ths of the $11,300) to the government as HST, and Tenant (if a business) can claim the same $1,300 as an input tax credit.

Note that in Quebec, the Quebec Sales Tax (QST) is treated the same way, in addition to the GST.

The same rule applies to an amount that is kept as a **forfeited deposit**.

> *Example 2*
>
> *B (a builder) builds a new home for sale in Edmonton. P (the purchaser) offers $300,000 for the home, putting down a $10,000 deposit. P then changes his mind and walks away from the deal, forfeiting the deposit. B decides not to sue and just keeps the $10,000.*
>
> B does not really get to keep $10,000. The $10,000 is considered to be GST-included. The GST is calculated as 5/105 of this amount, or $476. Thus, B really gets $9,524 plus 5% GST of $476, and must remit the GST to the government. (Again, the $9,524 is also income for income tax purposes.)
>
> This may come as a shock to B. B should not have accepted the $10,000 deposit unless B was aware that it was really only a deposit of $9,524 plus GST.

The moral of the story: whenever you settle a commercial dispute, whether by litigation or otherwise, make sure to "gross up" (increase) the settlement amount by the appropriate GST, HST and/or QST, so that the tax is available to be remitted to the government without eating into the amount of the settlement.

Note that these rules do not apply to payments *by* a supplier — e.g. payment by a landlord to cancel a tenant's lease early. They also do not apply to payments that are not related to a contract — for example, payments for damage caused by negligence, such as where someone with whom you have no contractual relationship damages your business's property.

If your dispute is being handled by a lawyer, **do not assume that your lawyer is taking care of this issue**. Civil litigation lawyers are usually not tax experts, and many of them are not aware of this rule, which is found in section 182 of the *Excise Tax Act*.

CHARITABLE DONATION RECEIPTS: STRINGENT REQUIREMENTS

The *Income Tax Regulations* (subsection 3501(1)) state that every receipt must contain the following:

> "(a) the name and address in Canada of the organization as recorded with the Minister;
> (b) the registration number assigned by the Minister to the organization;
> (c) the serial number of the receipt;
> (d) the place or locality where the receipt was issued;
> (e) where the gift is a cash gift, the date on which or the year during which the gift was received;
> (e.1) where the gift is of property other than cash
>
> > (i) the day on which the gift was received,
> > (ii) a brief description of the property, and
> > (iii) the name and address of the appraiser of the property if an appraisal is done;
>
> (f) the date on which the receipt was issued;
> (g) the name and address of the donor including, in the case of an individual, the individual's first name and initial;
> (h) the amount that is
>
> > (i) the amount of a cash gift, or
> > (ii) if the gift is of property other than cash, the amount that is the

fair market value of the property at the time that the gift is made;

(h.1) a description of the advantage, if any, in respect of the gift and the amount of that advantage;

(h.2) the eligible amount of the gift;

(i) the signature, as provided in subsection (2) or (3), of a responsible individual who has been authorized by the organization to acknowledge gifts; and

(j) the name and Internet website of the Canada Revenue Agency."

In the *Kueviakoe* case decided in March 2021, the Federal Court of Appeal confirmed that these requirements are absolute. If **any detail** is wrong or missing, the CRA can deny your tax credit for the donation, and you will not be able to succeed by appealing to the Tax Court of Canada, even though you genuinely made the donation.

What went wrong in the *Kueviakoe* case? Although it may seem absurd:

- The receipts were in the name "Thierry Kueviakoe", and the taxpayer's full name was actually "Ekue Arthur Thierry Kueviakoe", so the receipts did not show his "first name and initial", as required by paragraph (g) of the Regulations;

- One receipt showed the charity's address, but did not show "the place or locality where the receipt was issued", as required by paragraph (d) of the Regulations.

AROUND THE COURTS

NHL team manager's salary continuation taxed only on his days in Canada

Former Toronto Maple Leafs general manager Dave Nonis recently won a Tax Court appeal on an interesting issue.

Nonis was a non-resident of Canada for tax purposes while working for the Leafs, as under the Canada-US tax treaty his ties to the US were closer than to Canada. The Leafs fired Nonis in April 2015. Under his contract terms, the team paid him his salary for the next 12 months. However, he spent only 37 days in Canada in 2015 after being fired, and none in 2016.

For Canadian tax purposes, Nonis reported only 37/365ths of his income from the Leafs in 2015 after being fired, and none in 2016. After all, he wasn't in Canada any more.

The CRA disagreed, and assessed Nonis on the basis that a specific technical rule in the *Income Tax Act* required him to pay Canadian tax on all his income from the Leafs.

Nonis appealed to the Tax Court of Canada. In a decision on April 2021, the Tax Court judge ruled in Nonis's favour. He concluded that the salary continuation Nonis received under his contract was not like a "signing bonus". Indeed, it would be "absurd" for Nonis to have to pay Canadian tax on the income while he was no longer in Canada.

As a result, Nonis's appeal was allowed.

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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.