FALL 2019

THE Quarterly Dividend

Vol. 28 No. 4

Your guide to income tax & financial planning

FAST TRACK

Foreign Income Verification Statement

For the past twenty years has required Canadians to disclose their holdings of foreign assets if their collective cost was at least $100000 at any time during the year.

Let's look at what involved:

Who: Canadian individ-

In this Issue:

Self-Supply Rules

A few years ago, when housing prices seemed to be going up almost on a daily basis, many individuals attempted to take advantage of the market and purchase a residential property, "fix it up" and re-sell it.

In the course of the renovations, the "builder" would undoubtedly purchase materials and hire labourers to do rhe work. This would require him to keep track of the Harmonized Sales Tax that he was paying during the construction so that he could recoup it at the end of the project. Or so he thought.

Contrast the above "builder" with an "investor" who purchases an already renovated residence and endeavours to re-sell it during a rising market.

Since he has not paid for the cost of renovations there is no HST to recoup. In fact, he pays HST on the purchase price of the residence and cannot "get it back".

In order to put the "builder" and the "investor" on an equal footing, the government devised "self-supply rules" to apply to the "builder".

Here is an example of how it works:

At the outset, it is important to note that these rules apply if the "builder" constructs or substantially renovates a residential complex that he intends to sell or lease to a third party upon completion. If his intention is to live in the premises after construction, he is precluded from claiming back the HST, no matter what.

The determination of the HST is based upon a "deemed" taxable supply rather than an actual one. This means that no matter what the "builder" actually paid for materials and labour, the tax is calculated with reference to the "fair market value" of the property once construction has been completed.

This is defined as the "highest price, expressed in monetary terms, that a seller can reasonably be expected to obtain from a knowledgeable, informed and prudent party, acting at arm's length and under no compulsion to transact".

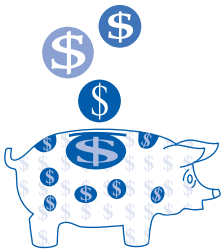
Think about this for a minute. The HST demanded of the "builder" is based upon the fair market value of the renovated property after it has been re-constructed or refurbished. Not on the actual expenditures incurred but on "everything" - the costs of land, material, labour and profit.

If the fair market value of the property, as determined by the agreed upon selling price to the buyer is $2500000, the "self-supply" of HST liable to the government by the "builder" at the time of closing is based on the full $2500000. This works out to $325000 (and no input tax credits are allowed).

Compliments of

Neamtan & Associates
CPA Professional Corporation
Accounting, Tax and Financial Planning
Audrey L. Neamtan, B.Comm., C.A. CFP

361 Willowdale Avenue
Toronto, Ontario M2N 5A5
Phone: (416) 590-9382
Fax: (416) 590-9636
Email: audrey@neamtan.ca



uals, corporation, trusts and partnerships;

What: Termed "specified foreign property" these include (i) money deposited in or outside Canada in foreign currency denominated bank accounts, (ii) shares or debt of non-Canadian corporations; (iii) tangible property located outside Canada when it is not being used to earn active business income or exclusively for personal use;

Where: the country where the foreign assets are being held and/or in what currency they are denominated;

When: The "tax values" of the assets exceed $100000, in Canadian funds at any time during the taxation year.

How: The Act requires the "tax values" of the assets involved. In most cases this is the actual cost paid for the

Loan Covenants

In the world of corporate finance, companies who have traditionally relied upon the Chartered Banks for their loans must now renew their borrowings on an annual basis. This allows the bank to keep a closer eye on their customers while "making sure" that the borrower is showing sufficient strength from operations to meet its commitments.

		Current Year $	Last Year $
	Information from balance sheet:		
	Current portion long-term debt	100000	100000
	Remainder of long-term debt	900000	1000000
		1000000	1100000
	Information from income statement:		
	Revenue	875000	800000
	Expenses		
	Operating costs	665000	615000
	Interest expense	60000	66000
	Amortization	25000	25000
		750000	706000
	Income for the year	125000	94000
	Financial Covenant Debt Service Ratio must be at least 1.25 Interest rate 6% per annum		
Step One:	Determine Adjusted Earnings		
	Income for the year	125000	94000
	Add: Interest expense (Debt charges)	60000	66000
	Amortization (Depreciation)	25000	25000
	Earnings before income taxes, debt charges and Depreciation (EBITDA)	210000	185000
Step Two:	Determine Obligations		
	Current portion of long-term debt	100000	100000
	Debt charges	60000	66000
		160000	166000
Step Three:	Apply Formula		
	Results of Step One/Results of Step Two	1.3125	1.11446

In many cases, the bank wants to see that the borrower is maintaining a "debt service ratio" of at least 1.25:1.00 based upon reported figures in the company's annual financial statements.

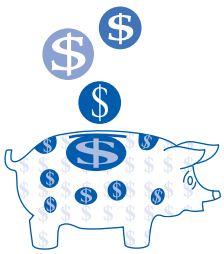
The information needed from the financial statements is as follows:

Last year's debt service ratio was slightly below the percentage required under the company's loan agreement with the bank.

If this is the "first time" that the convenant has not been met, it is unlikely the bank will "call the loan" and force the company to seek financing elsewhere. They will want explanations about current results and some indication about how the company plans to meet its target in the future.

If this situation goes beyond a second year they will probably want to keep a closer eye on the company, perhaps requiring semi-annual reviews rather than conducting them only once per year.

If the situation does not improve (and show results similar to "current year" above, the company may be asked to pay off their indebtedness and seek financing elsewhere.



assets, in Canadian dollars, when purchased. However the "value" of these assets often fluctuate over time. Shares, for example, whose cost was, say $105000 but are currently trading at a valuation of $95000 are still to be reported at the figure of $105000.

Why: In addition ro the disclosure of the assets themselves, the government requires disclosure of the earnings they generated. These are presumably "tied in" with the foreign income reported elsewhere on the return. Conversely, if the return shows sufficient foreign earnings and the required form has not been produced, they they may ask for one upon penalty for non-compliance with the Act.

Are there any exceptions? Yes!! When a taxpayer holds shares or debt with a

The Accelerated Investment Incentive

The 2019 budget confirmed changes in the way capital assets are to be amortized when companies invest in the purchase of property, plant and equipment for their businesses.

The full cost of assets bought for companies claiming the manufacturing and processing deduction and "specified clean energy equipment" will now be allowed a full write-off when acquired.

For all other asset purchases, the change entails an accelerated capital cost claim in the year when they are first put into use. The entire cost will still be "written off" but following a different schedule than before.

Also, the acquired assets must not have been "purchased" from someone who is not dealing at arm's length with the business.

For example, an asset with an allowable CCA rate of twenty percent and costing $1000 was previously claiming depreciation for income tax purposes at one-half of the allowable rate or ten percent in the year of acquisition and twenty percent thereafter.

From now on, the business can claim CCA at twenty percent right away and it will be calculated on one hundred and fifty percent of the acquisition cost. After that, the regular rate is applied.

	Before Econ Stmt $	After Econ Stmt $	Difference $
Original cost	1000	1000	
CCA year asset acquired	100	300	200
	900	700	
CCA following year	180	140	-40
	720	560	
CCA following year	144	112	-32
UCC balance at end of third year	576	448	128

The business can claim CCA of $552 ($300+140+112) under the new regime compared to $424 ($100+180+144) before. It does not seem like much but this is for an asset costing $1000. When the acquisition is of a greater value, the amounts can increase significantly.

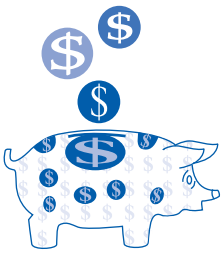
Should You Hold Dividend Paying Investments in Your RRSP?

Here is a question that sometimes comes up. Should a Canadian taxpayer "hold" shares of Canadian dividend paying corporations in their RRSP's or should they "hold" them personally under their own names? Let's look at two scenarios and see what conclusions can be drawn from them.

Scenario One:

Taxpayer is in the lowest "tax bracket"

In the Canadian income tax regime, dividend income is taxed as follows: Sandy has shares in Bell Canada that currently give her $5000 in dividends each year. When she prepares her income tax return she must



registered security-dealer or trust company, the amounts reported are not the actual costs of the shares/debt themselves but the fair market values of these investments. In these cases, two amounts are reported. The first is the fair market value of the investor's portfolio at the end of the year. The second is the "highest" value of this portfolio attained within the year. Although each is subject to a minimum valuation of $100000, it is possible that one disclosure may be greater than $100000 and the other less than $100000.

Thanks for Your Referrals

We very much appreciate your referrals. If you know of someone who can benefit from the services we provide or who would like to receive our publication, please let us know. We will send them a copy with your compliments.

"gross up" the dividend by thirty eight percent and show dividend income of $6900 for the year. However, she is entitled to claim a "dividend tax credit" determined as fifteen percent of the taxable amount or $1036 as a reduction in her Federal income taxes.

So if Sandy has other income of say $35000 her total Federal taxes for the year will be $4222 made up of $2978 on her other income and $1244 on her dividends. In other words, her $5000 dividend income became $3756 after taxes.

This means that the taxes on the "extra" $1900 were $1244 but her dividend tax credit was only $1036. She theoretically gave the government an extra $208 by investing in shares.

If Sandy had earned the same $5000 through an interest bearing Guaranteed Investment Certificate, for example, her taxable income would have been $40000, not $41900 as when she received dividends.

Her total Federal taxes for the year will be $3728 made up of $2978 on the other income and $750 on her interest income. In other words, her $5000 interest income became $4250 after taxes.

Under this scenario her total income for the year was $40000 but when the income from the investment was in the form of dividends she kept $35778 but when it was in the form of interest she kept $36272. Under this scenario it is preferable to hold shares of Canadian companies that pay dividends in an RRSP because the earnings are recognized in the plan and there are no dividend tax credits or income taxes.

Scenario Two:

If Sandy has other income of say $65000 her total Federal taxes for the year will be $8672 made up of $8294 on her other income and $378 on her dividends. In other words, her $5000 dividend income became $4622 after taxes.

This means that the taxes on the "extra" $1900 were $378 but her dividend tax credit was $1036. She was theoretically ahead of the taxman by $1522 when investing in shares.

If Sandy had earned the same $5000 through an interest bearing Guaranteed Investment Certificate, for example, her taxable income would have been $70000, not $71900 as when she received dividends.

Her total Federal taxes for the year will be $9319 made up of $8294 on the other income and $1025 on her interest income. In other words, her $5000 interest income became $3975 after taxes.

Under this scenario her total income for the year was $70000 but when the income from the investment was in the form of dividends she kept $61328 but when it was in the form of interest she kept $60681.

Under this scenario it is preferable to hold shares of Canadian companies that pay dividends outside an RRSP.

In the earlier example, the decision was easy because the dividend tax credit did not match the extra taxes that were owing upon receipt of the dividend. That is not the case here, and since the dividend tax credit exceeds the amount of taxes owing on the dividend, and holding the investment in the RRSP takes away the dividend tax credit from the shareholder, the advantage swings the other way.

Conclusion:

The simple answer, of course, is "it depends". That is always the answer, but if you have "other" income (employment, pensions, capital gains, rental income, etc) as well as investment income that provide you with taxable income of $50000 or more, holding Canadian dividend shares in your RRSP is "better" than holding them personally.

Printed on recycled paper with environmentally friendly inks