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Tax Newsletter

Topics for discussion:

- Carryover of tax losses
- Tuition tax credit
- Around the courts

Carryover of tax losses

Under the Income Tax Act, if you have a net loss for the year rather than positive net income, you might not have any other income against which to use that loss in that year. Fortunately, there are “carryover” provisions that allow you to carry the loss back or forward to other taxation years.

Non-capital losses

If you have a loss from employment, a business or property in a taxation year, the losses will reduce your other sources of income in the same year. However, your overall net income cannot be negative. Therefore, your losses from these sources in excess of your positive income from all sources cannot be used in that year. Such losses are called “non-capital losses”.

Non-capital losses can be carried back 3 years or forward 20 years, to offset all other sources of income for those years. If you carry back the losses, there is a special form T1A that is filed to amend the previous tax year’s tax return.

Net capital losses

One-half of your capital losses are called “allowable capital losses” (ACL) and one-half of your capital gains are “taxable capital gains” (TCG). ACLs in a taxation year reduce your TCGs for the year, but only down to zero net TCGs. Any excess ACLs cannot reduce other sources of income in that year.

The excess ACLs for the year, called “net capital losses”, can be carried back 3 years or forward indefinitely, to offset TCGs in those other years. Unfortunately, they normally cannot offset other sources of income. One exception is described immediately below.

Allowable business investment loss (“ABIL”)

An ABIL is a type of allowable capital loss that arises on the disposition of shares or debt in a small business corporation. (Various conditions apply.) Unlike regular ACLs, an ABIL can reduce all sources of income, not just TCGs.

Unused ABILs in a year can be carried back 3 years or forward 10 years to offset all sources of income in those years. After the 10-year carry-forward period, unused ABILs convert to regular ACLs and therefore can only offset TCGs in years beyond that.

Listed personal property losses

There is a general rule that says capital losses from the disposition of personal-use property are deemed to be nil and are therefore not recognized for income tax purposes.

However, if the loss is from the disposition of a “listed personal property” (LPP), the loss can offset gains from disposition of LPP in the same year. If there is a net gain, one-half is a TCG included in income in that year. If there is a net loss, the excess loss can be carried back 3 years or forward 7 years to offset gains from LPP in those years (but not gains from other properties). LPP includes works of art; rare books, folios, and manuscripts; jewelry; stamps; and coins.

TUITION TAX CREDIT

The federal tuition tax credit equals 15% of eligible tuition fees payable in respect of a taxation year. It applies to tuition payable by students to most universities and colleges in Canada, as well as to other educational institutions providing courses at a post-secondary school level.

Included in the tuition credit amount are mandatory ancillary fees, such as for lab work, materials or computer services. For fees that are not mandatory, up to $250 qualifies if the student chooses to pay the fees.

The credit is also available for students who are developing or improving skills in an occupation and the educational institution (other than at a university level) has been certified as providing such skills by the Minister of Employment and Social Development Canada. The CRA takes the position that the phrase “to improve the student’s skills in an occupation” means that the student already possesses sufficient skills to enable the student to work at an occupation and the course or program must be capable of improving those skills. An occupation is considered “a profession, vocation, trade, or other particular employment.”

Each province has a corresponding tuition credit, which varies depending on the province.

Students may claim the federal credit for tuition paid to universities outside of Canada. Generally, the credit is available only if the student is enrolled full-time in a program leading to a degree and the course is at least three weeks in length. The CRA provides the following guidelines in terms of what constitutes a university outside of Canada:

"We will accept that an educational institution is a university outside Canada for purposes of the tuition credit if it meets all of the following conditions:

- it has the authority to confer academic degrees of at least the bachelor level (bachelor's degree or equivalent) according to the education standards of the country it is located in
- it has an academic entrance requirement of at least secondary school matriculation standing
- it is organized for teaching, study and research in the higher branches of learning."

For universities in Commonwealth countries, the CRA will also accept an eligible educational institution "that is part of the Association of Commonwealth Canada if the institution can grant degrees of at least the bachelor level." For institutions in the United States, the CRA will accept "an accredited degree-granting institution currently recognized by the Institute of Education Sciences National Center for Education Statistics or Council for Higher Education Accreditation (CHEA) in a university outside Canada, provided that the institution can grant degrees of at least the bachelor level."

A list of foreign qualifying universities can be found on the CRA website at Recognized universities and higher educational institutions outside Canada - Canada.ca.

In addition, if the student lives near the Canada-United States border, tuition fees paid to an educational institution in the United States that is a university, college or other educational institution providing courses at a post-secondary school are eligible regardless of whether the courses lead to a degree.

In terms of filing requirements, the student must fill out and file Schedule 11 with their tax return. They also must receive a form from the educational institution: Form T2202 from an institution in Canada, Form TL11A from a foreign institution, or Form TL11C for students commuting to attend an institution in the United States.

The credit is often claimed by the student. However, if the student has no remaining tax payable in the taxation year, the student can transfer up to $5,000 of the tuition to their parent, grandparent, spouse or common-law partner, who can then claim the credit on that amount on their tax return.

Alternatively, the student can choose to carry forward the credit indefinitely to a future taxation year, where the student can claim the credit in that future year.

The credit cannot be carried forward to a future year to transfer to one of the individuals described above. In other words, the tuition in a taxation year can only be transferred in that year.

Example

Student has $9,000 tuition payable for year 1. Student has some tax payable (before the tuition tax credit) but uses $3,000 of the tuition for the credit in year 1 to reduce their tax to zero.

The remaining $6,000 can be carried forward for Student. Alternatively, up to $5,000 can be transferred to one of the above individuals in year 1, and any remaining amount can be carried forward to future years for Student.

AROUND THE COURTS

Foreign source tax deductions do not reduce Canadian tax instalment requirements

In the recent Bhachu case, the taxpayer was a resident of Canada who worked for a petroleum company in Egypt in the taxation year at issue. As a Canadian resident, he was liable to pay income tax on his worldwide employment income. He was also liable to pay tax to the government of Egypt for his employment income earned in Egypt.

The taxpayer was assessed by the CRA and charged interest for not making tax instalments in Canada. Generally, an individual must pay quarterly instalments in a taxation year if their non-withheld tax for the year and one of the two preceding years exceeds $3,000.

In the year in question, the Egyptian company withheld tax for Egyptian tax purposes but not for Canadian tax purposes, such that it seemed that Mr. Bhachu was liable to pay instalments in Canada. He did not, which is why the CRA charged instalment interest.

The taxpayer appealed the CRA assessment. The taxpayer argued that the withheld tax for Egyptian tax purposes should have relieved him from paying Canadian instalments. The Tax Court judge disagreed, and held that there the Canadian tax rules do not take into account foreign withholding taxes in determining whether instalments are to be made in Canada.

Upon further appeal to the Federal Court of Appeal, that Court agreed with the Tax Court judge and dismissed the taxpayer's appeal. The taxpayer had also argued that a provision in the Canada-Egypt income tax treaty absolved him from being required to pay the Canadian instalments. The Federal Court rejected this argument as being a misinterpretation of the Treaty provision.

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This letter summarizes recent tax developments and tax planning opportunities; however, we recommend that you consult with us before embarking on any of the suggestions contained in this letter, which are appropriate to your own specific requirements.