CHAPTER 3:
Liability for Tax, Income Determination, and Administration

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Electronic Presentations in Microsoft® PowerPoint®

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TOPICS FOR CHAPTER 3

II.Liability for Tax

III.Determination of Income

IV.Administration of the Income Tax System

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II. Liability for Tax

ITA 2(1) - Federal and provincial income taxes are imposed on:

1. **Individuals**
2. **Corporations**
3. **Trusts**

Individuals	Corporations	Trusts
•Employment Income •Business Income •Property Income •Capital Gains •Other i.e. pension	•Business Income •Property Income •Capital Gains	•Employment Income •Business Income •Property Income •Capital Gains •Other i.e. pension

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Resident Individuals and Corporations

- Residency is the primary factor in determining how an entity is taxed in Canada.
- Subject to tax if considered resident in Canada.
- Residents subject to tax on worldwide income.
- Non-resident entities are only taxable on income earned in Canada.

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Individuals - Residency

- Residence is based on the legal or economic link an individual has with Canada.
    - question of fact whether one is resident or not, and
    - each case is judged on its own special circumstances.
- Residency is determined on a year to year basis.

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Individuals - Residency

- **Factors to consider in determining residency:**

  - Amount of time spent in Canada on a regular basis;
  - Motives for being present or absent;
  - Maintenance of a dwelling place in Canada

  - Origin and background of the individual;
  - General mode and routine of one's life; and
  - Existence of social and financial connections with Canada.

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Individuals - Residency

ITA 250(1) - “Sojourner”

- Individuals who do not exhibit a continuing state of relationship, but
- Spend more than 182 days in Canada are deemed residents.

- Once the criteria are met, one is considered a resident throughout the entire year.

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Individuals - Residency

ITA 114 - "Part-time Resident"

- Subject to tax in Canada on worldwide income earned while resident.
- Once residency ceases only subject to tax on Canadian source income.

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Corporations

- **ITA 250(1) - Corporations incorporated in Canada are residents of Canada**
  - subject to tax on world income.
- Foreign corporation may be Canadian resident if
  - "central management and control" is exercised from within Canada.

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Dual Jurisdictions

- May be subject to tax in a foreign jurisdiction if they carry on business outside of Canada.
- The treaty may limit Canada’s right to tax.
- May be subject to taxation in both jurisdictions; if so the Act generally allows a foreign tax credit.

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Non-Resident Individuals and Corporations

- Non-residents of Canada are taxable on specific activities.
- **Taxed in Canada on net income arising while non-resident if:**
  - carries on business in Canada (through a Permanent Establishment);
  - disposes of Taxable Canadian property; or,
  - is employed in Canada.

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III. Determination of Income

- **Each entity is required to pay tax on its taxable income in each taxation year.**
- What is taxable income?
  - The *Act* does not specifically provide a single definition of income.
  - The Act provides a framework to help determine:
    - Income from each category of income, and
    - Deduction from income in each category.

Taxable Income = Net Income – Special reductions

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Types of Income

- **An entity's world income is derived from five basic sources:**
    1. Employment income
    2. Business income
    3. Property income
    4. Capital gains and losses
    5. Other specific sources
- Income is determined by applying basic principles specific to the particular category.

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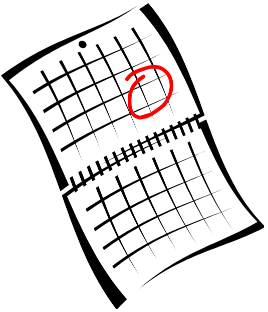
The Taxation Year

- **ITA 249.1** - Corporate taxpayers can choose the taxation year.



  - Once chosen, it cannot change it without concurrence is given by CRA.
  - A taxation year cannot exceed 53 weeks.
  - May be less than 12 months.
  - Exception is Professional Corps – fiscal year must coincide with calendar year.

- **ITA 249(1)** – Individual tax year = calendar year.

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Net Income for Tax Purposes

- **Next step:**

  - Aggregating the five types of income eligible for inclusion.

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Formula for Determining Net Income for Tax Purposes

Segment A – includes income net of deductions only positive net income

Employment	+
Business Income	+
Property Income	+
Other items	$\underline{\pm}$
Subtotal 1 (must be positive or Zero)	+ or 0

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IV. Administration of the Income Tax System

Filing Returns:

- Every taxpayer must file an income tax return.
- Filing deadline is different for each of these entities.
  - **ITA 150(1)(a)** - Corporations – due 6 months after taxation year.
  - **ITA 150(1)(d)** - Individuals:
    - April 30 – for most recent calendar year, or
    - June 15 – if individual (or spouse) carries on a business.
  - **ITA 150(1)(b)** - Deceased Individuals due the later of:
    - 6 months from date of death, or
    - Normal filing deadline (April 30 or June 15)
  - **ITA 150(1)(d)** Trusts – 90 days after fiscal year-end.

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Assessments

CRA has the right to reassess returns at a later time, subject to limitations:

- individuals, trusts and CCPCs - reassessed within three years of original assessment.
- For public corporations extended to four years.

Unless:

- taxpayer has made any:
  - misrepresentation that is attributable to neglect, carelessness, or wilful default, or
  - has committed any fraud in filing the return or supplying information.

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Pre-Payment of Tax Individuals (Instalments)

- **ITA 156.1(2)** - Instalment are required whenever federal tax owing exceeds $3,000 for both:
  – the current year and
  – either of the past two taxation years.
- Instalments are due quarterly, beginning on March 15.
- The balance of taxes payable is due on April 30.

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Pre-Payment of Tax Corporations (Instalments)

- Instalment payments are the primary method of remitting corporate tax.
- **ITA 157(2.1)** - A corporation must make 12 instalments per year = 1/12 of prior years tax owing
- Balance owing is due two months after taxation year-end (extended to 3 months for CCPC)

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Interest Charges

- CRA charges interest on any tax that is due and payable but not paid.
- Interest is charged on late or deficient tax instalments.
- Not deductible for tax purposes.

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Penalties and Offences

- **ITA 162(1)** - Failure to file an annual return:
  - 5% of the tax unpaid for the year, plus 1% for each month after the due date, to a maximum of 12 months.
- **ITA 162(2)** - Repeated failures to file an annual return:
  - 10% on a second or further late filing.
  - increased by 2% for each month after the due date, for a maximum of 20 months.

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Penalties and Offences

- **ITA 163(1)** - Failure to report an item of income:
  - 10% of the unreported income if the failure to report occurs more than once in a three-year period.
- **ITA 163(2)** - Knowingly making a false statement or omission:
  - 50% of the tax owing on the excluded or understated amount.

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Objection and Appeal

- **Taxpayers can appeal an assessment they do not agree with:**
  - The first step is to file a formal **notice of objection**.
- Unsatisfactory results of this first appeal may be appealed to the Tax Court of Canada.
- **Still not satisfied then appeal to:**
  - the Federal Court of Canada, and
  - perhaps to the Supreme Court of Canada.

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