TAX NEWSLETTER

Summary 2016

KINGSTON ROSS PASNAK LLP

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DFK CANADA

Beware – New CRA Scams are Being Invented Daily

By Adrienne Barclay CPA, CA, CPA (New Hampshire)
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The latest scam that the Canada Revenue Agency ("CRA") is warning the public against involves the use of iTunes gift cards to pay a fictitious tax balance.

There have been many victims of fraudsters convincing them that they owe back taxes and advising them that in order to avoid RCMP officers arresting them, they should purchase iTunes gift cards. They claim that the victim owes "back taxes" as a result of an audit and that an arrest warrant can be avoided if payment is made promptly. The victim is instructed to purchase and activate iTunes gift cards and provide the codes to the fraudsters, allowing them to drain the gift cards of their balances.

The fraudsters in this scam are very convincing by calling or texting your personal phone and identifying themselves as CRA employees and providing the victim with their employee number.

There is little recourse for these victims to get their money back. Credit card companies have said they cannot help as the original purchase was from a legitimate business. Apple has advised that the iTunes gift cards are drained of their funds immediately. The police have been able to track the iTunes gift card redemptions to accounts in China.

Police are actively investigating this current scam and say it has become so widespread that all across Canada they are receiving thousands of calls about similar scams. In addition, the Canadian Anti-Fraud Centre reports that to date they have received 46 complaints involving the iTunes gift cards with total losses of $85,041.

It is important to keep in mind that the CRA will never ask a taxpayer to give personal information of any kind by email, text message, or by clicking on a link. Nor will they ever ask for a tax balance to be paid through the use of any form of pre-paid credit card. In addition, the CRA will never threaten to lay criminal charges or have anyone put in jail if taxes are not paid.

If you receive an unexpected call from a "CRA representative" you should ask for the name and employee number plus a call back number. You can then call the CRA at their general line at 1-800-959-8281 to confirm whether you owe back taxes and to confirm the legitimacy of the CRA representative's request.

There are many known scams, pitches and fraud

Abating Penalties with the IRS

By Justin K. Hoffman, CPA, CA, CPA(Illinois), CFP, TEP, BComm
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The American tax system involves some of the most complex and onerous reporting in the world. It is of little surprise then that many taxpayers will eventually find themselves facing harsh penalties associated with failing to adequately comply with their reporting requirements.

When faced with a penalty, the Taxpayer has three main options to get the IRS to abate the penalty:

1) The First-Time Abatement (FTA)

The FTA gives the Taxpayer an opportunity to have the penalty waived without having to justify their conduct. It is a one-time option and can usually only be used against one year of penalties so the taxpayer should be tactical in its application. In selecting the appropriate year to apply the FTA, caution should be taken to ensure that the following requirements for its application are met:

- The Taxpayer is up-to-date on filing their returns
- The Taxpayer has arranged to pay or has paid any tax due
- The Taxpayer has had no penalties for the 3 years prior to the year being abated

2) The Reasonable Cause Abatement

The Reasonable Cause Abatement provides Taxpayers with an opportunity to argue why they should not be assessed the penalty. While the abatement can be requested over the phone, certain dollar limits exist where the IRS agent requires the request to be submitted in writing.

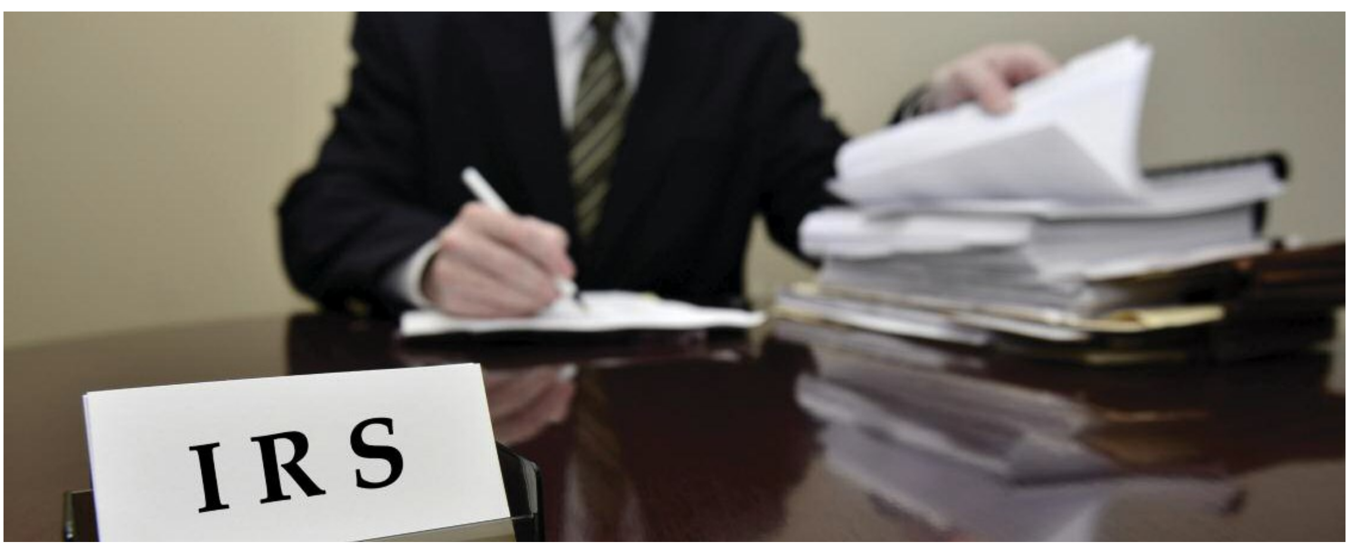
In order to achieve consistent results, the IRS has mandated that its agents employ the use of the "Reasonable Cause Assistant" (RCA), an artificial intelligence system, in assessing whether the penalties are eligible for abatement. Because the process is automated, the tax professional must carefully frame the abatement request within the parameters of the system to prevent the request from being disallowed. Arguing the abatement on grounds not cited in the Internal Revenue Manual (IRM) will often require that the request for penalty abatement advance to the appeals stage.

Acceptable reasons for the abatement of penalties as set out in the IRM include (but are not limited to) ordinary business care and prudence, death, illness, disaster, and errors.

3) Appealing the Denial of Your Abatement

If your argument for the abatement of penalties didn't fall within the basic "yes or no" logic utilized by the RCA, you will need to request an appeal of the denial. It is at this stage that you will have the opportunity to present your argument outside of the constraints of the RCA and to draw specific attention to the facts that may not have been considered by the agents at earlier stages of the abatement process.

This discussion aims to provide a general understanding of the process for abating penalties and is not intended to be an exhaustive list of the Taxpayer's options. In the case of large penalties it is recommended that



Corporate Owned Life Insurance and the Impact of 2017 Tax Changes

By Enzo Morini, CPA, CA, TEP
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Corporate owned life insurance on the life of an owner-manager can be an effective planning tool for Canadian- Controlled Private Corporations. The receipt of life insurance proceeds by a corporation can be used to: fund the buy out of a deceased shareholder's interest; fund the tax liability owed by a deceased shareholder's estate; or, offset the economic loss as a result of the death of a key employee. In addition, corporate owned life insurance may assist in securing bank financing.

As corporate income tax rates are significantly lower than personal tax rates, using corporate after tax dollars to pay for life insurance premiums is more favourable. Where the life insurance policy and coverage is a requirement imposed by a bank for financing, the premiums may also be deductible for income tax purposes to the extent of the amount borrowed relative to the amount of insurance coverage.

Changes to various tax rules with respect to life insurance have been under review for several years. In the 2012 Federal Budget, the Department of Finance indicated it would introduce legislation to modernize life insurance rules and these proposed rules were modified in Bill C-43 which received Royal Assent on December 16, 2014.

These new rules will be in effect on January 1, 2017 and for the most part will only apply to new policies issued. Policies issued prior to January 1, 2017 will be grandfathered provided no medical underwriting is added to the policies on or after January 1, 2017 or the policy is not converted into another type of policy.

Changes to the Capital Dividend Account Balances

The death benefit received by a corporation on the death of an insured less the adjusted cost basis ("ACB") of the life insurance policy is added to a corporation's Capital Dividend Account ("CDA"). The balance of the CDA can be paid out to a shareholder as a capital dividend which is received on a tax free basis by the shareholder.

The ACB of a policy is equal to the total premiums paid with respect to that policy less the total Net Cost of Pure Insurance ("NCPI").

As a result of the increased life expectancy of Canadians, newly updated mortality tables will be used to calculate the NCPI resulting in lower NCPI rates and consequently higher ACB of policies going forward. As a result of the higher ACB of life insurance policies, the amount of life insurance proceeds received on the death of an insured that is added to the capital dividend account will be reduced. As always, in order for a shareholder to receive the proceeds of life insurance policies that are not added to the capital dividend account, the shareholder will have to receive a taxable dividend.

Life Exempt Test Rules

Life insurance provides protection but some policies also allow for the accumulation of savings on a tax deferred basis. This preferential treatment is available for certain "exempt" insurance policies. Under the exempt test, provided the investment income accumulation in the policy does not exceed a defined amount, the investment income is not subject to annual accrual taxation.

Several changes to the exempt test will become effective on January 1, 2017. The exempt test changes will materially reduce the maximum accumulation amounts which can remain tax exempt within a policy. The exempt test compares the savings component of the actual life insurance policy to the savings component of a theoretical benchmark policy.

The key changes to the exempt test include:

- A revised definition of the benchmark policy;
- New prescribed assumptions with respect to calculating the savings element;
- New prescribed assumptions with respect to reserves;
- revisions to the rate at which death benefits can be increased; and
- revisions to the amount of funding required for policies.

The new life insurance rules will diminish some of the tax advantages available with life insurance products. However, corporate owned life insurance remains an effective tax and estate planning tool. Individuals and corporations considering life insurance planning or

Don't Pay to Stay - U.S. Residency Rules

By *Krysta Adamski, CPA, CA*
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Canada's increasingly harsh winters and shorter summers have resulted in more Canadian citizens crossing the border to vacation with our neighbours to the south. But while you're packing your sunscreen and warm-weather clothing, are you also taking note of how this trip might affect your taxes?

A lot of people go by the '183-day rule' but it's actually a little more complicated than that. You could be in the U.S. for as little as four months and still get caught up in their residency rules.

Under current U.S. law, the rule is called the Substantial Presence Test. *So how do you know where you fall?*

Have you been in the U.S. for at least 31 (consecutive or non-consecutive) days in the current calendar year, either for business OR pleasure? If so, the IRS will calculate:

- All of your U.S.-based days in the current year,
- PLUS 1/3 of your U.S. based days in the preceding year,
- PLUS 1/6 of your days U.S. based in the second preceding year. (The IRS generally counts any part of a day spent in the U.S. as 1 day for this calculation)

If that totals up to fewer than 183 days, then you are not considered a U.S. resident, and at most, will only have to file a U.S. non-resident tax return for any U.S.-sourced income. Or, if you have U.S.-sourced income but have not visited the U.S. at all (such as with many freelancers or contract workers who work remotely), then you may not have to pay U.S. taxes at all.

If, however, your total time is 183 days or more, then you are considered a U.S. resident for taxation purposes, and will have to file tax returns with both the IRS and CRA.

Not all hope is lost, however. If every other aspect of your life is located in Canada, you may be able to file a 'closer connection' form, which is form 8840. This form is to claim that you're a Canadian resident with closer ties to Canada, and you should therefore be taxed as a Canadian resident, not a U.S. one.

The "closer connection" form isn't applicable if you've spent more than 183 days in the U.S. in the current year: however, there is still one last chance:

U.S./Canadian tax implications can be complicated, so here is the bottom-line takeaway:

First of all, if traveling to the U.S., for any reason, make sure you track how many days you spend there.

Secondly, if you have any travel to or financial dealings with the U.S., either for business or pleasure, it's always best to give your accountant a 'heads-up', so that we (as accountants) can make sure you're well-informed. It's better to be cautious and ask those questions in advance instead of assuming you're fine and getting a nasty surprise at tax time.

Please note that this article is not appropriate for US citizens or green card holders.