GALLOWAY
BOTTESELLE
& COMPANY

Professional Services Group

The Abacus

ISSUE 63

PROFESSIONAL **STRENGTH** PERSONAL **SERVICE** PRACTICAL **SOLUTIONS**

# Dangers of filing a corporate return overly late

Some small business owners get busy running their business, and do not get around to filing their company's corporate income tax returns until long after they are due.

Of course, in practice the owner usually hires an accountant for this process; what the owner fails to do is get the business's records in enough order to provide them to the accountant in time.

There are penalties for filing returns late: usually 17% of the unpaid tax once a return is 12 months late.

Some business owners prepay their company's instalments in amounts they think are "about right", so that they are not in debt to the CRA even though they have not gotten around to filing.

## THERE IS A SERIOUS DANGER IN DOING THIS.

If a corporate return is filed **more than three years after the year-end** (more than two and a half years after its due date) then the CRA **cannot refund any overpaid instalments**. Subsection 164(1) of the Income Tax Act prohibits it.

It may be possible to get the CRA to transfer the unrefundable balance to a later year for which tax is owing, using Income Tax Act section 221.2. The CRA used to permit this. However, in 2014 the CRA created a new procedure and form for this procedure. New Form RC431 requires the corporation to show why it was "unable" to file its return within the three years. This stringent condition will be almost impossible to meet in most cases. *(Representations are being made to the CRA to change this administrative requirement.)*

Even if you do not pay instalments, the same problem arises if the **CRA issues an "arbitrary assessment"** of the corporation because it has not filed, and then seizes funds from the corporation to pay that assessment. If the corporation then files its return more than three years after year-end, it will not be able to get a refund of the "overpaid" amount. *(It might be able to argue in Federal Court that funds seized have not been "paid" by the corporation and so are not subject to the three-year rule, but this is uncertain.)*

So it's important to get your corporation's income tax return filed on time — or at least not overly late.

**INSIDE** THIS ISSUE

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# HST Quiz

## Is your business charging HST properly?

Whether or not you're in a Harmonized Sales Tax (HST) province, if you carry on business you need to know the rules for when to charge HST – or Goods & Services Tax (GST). You might be surprised!

| RATE | PROVINCE/TERRITORY |
|---|---|
| **15**% HST | Nova Scotia |
| **14**% HST | Prince Edward Island |
| **13**% HST | Ontario, New Brunswick, Newfoundland & Labrador |
| **5**% GST | All other provinces/territories |

*Note that there is a also a provincial retail sales tax in British Columbia, Saskatchewan and Manitoba, and a GST-like Quebec Sales Tax in Quebec. Alberta and the territories have only the 5% GST.*

## What rate of tax should you charge for each of these situations?

**1** You sell widgets in **Calgary.**
A customer in **Halifax** orders a widget which you ship to your customer in **Halifax**.

**2** You sell widgets in **Calgary.**
A customer in **Halifax** orders a widget. In order to get the widget to your customer in **Halifax**, you also arrange *(as your customer's agent)* for a courier company to deliver the widget to her.

**3** You sell widgets in **Calgary.**
A customer in **Halifax** orders a widget which you deliver to your warehouse in **Calgary**. In order to get it, your **Halifax** customer calls a courier company to have the widget picked up at your warehouse.

**4** You're an engineer in **Charlottetown.**
A client in **Winnipeg** thinks he's invented a new device, and wants you to review his design plans to tell him if they'll work. You remain at your office in **Charlottetown**, review the plans, write a report, and bill your **Winnipeg** client.

**5** You're an engineer in **Charlottetown.**
A client in **Winnipeg** thinks he's invented a new device, and wants you to review his design plans to tell him if they'll work. You travel to **Winnipeg**, review the plans, write a report, and bill your client.

**6** You're an engineer in **Charlottetown.**
A client in **Winnipeg** thinks he's invented a new device, but he's being sued by a competitor in Ontario who says your client stole the plans, and they're in litigation in the **Ontario** courts. You remain at your office in **Charlottetown**, review the plans, write an expert report for your client to use in litigation, and bill your **Winnipeg** client.

**7** You're an engineer in **Charlottetown.**
A client in **Winnipeg** thinks he's invented a new device, but he's being sued by a competitor in Ontario who says your client stole the plans, and they're in litigation in the **Ontario** courts. You travel to **Toronto** to testify as an expert witness in the trial on behalf of your **Winnipeg** client.

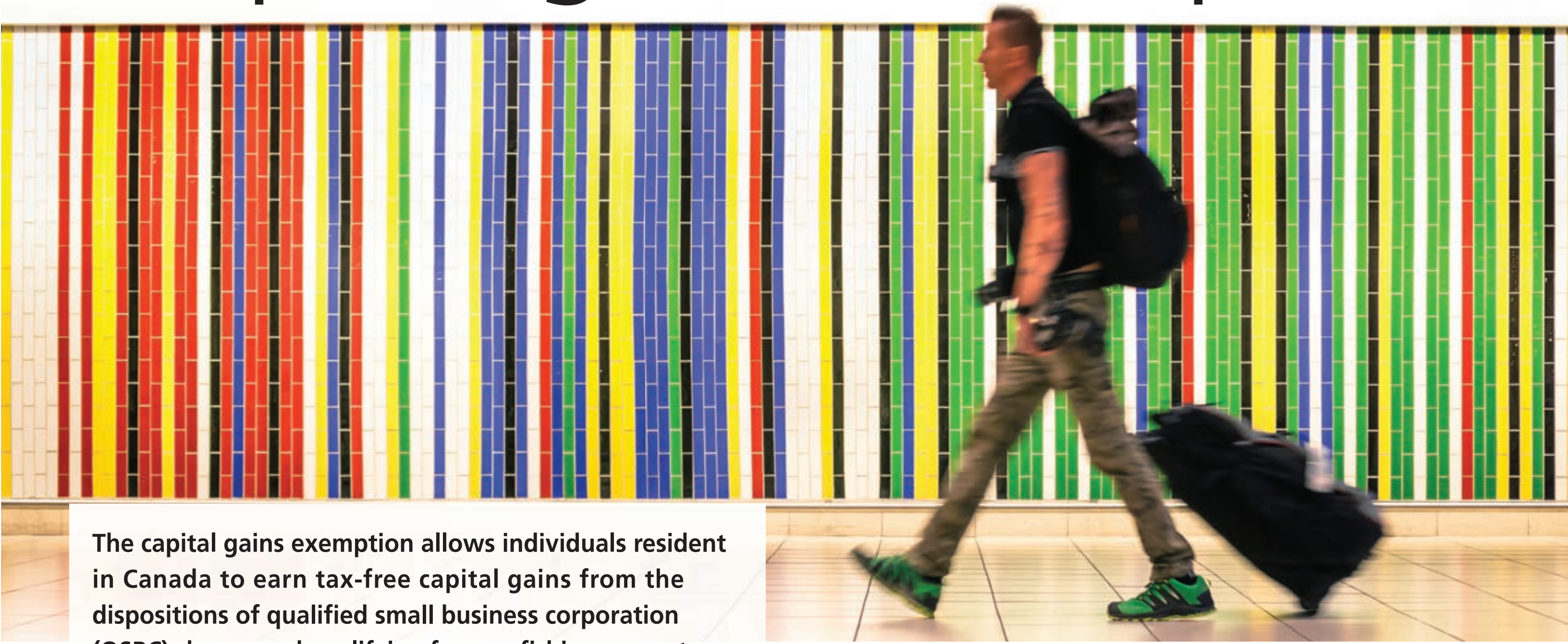
**8** You're a hair stylist in **Edmonton.**
You style the hair of a **Toronto** client who's visiting **Edmonton**.

**9** You're a plastic surgeon in **Edmonton.**
You're doing facelifts *(which are taxable when done solely for cosmetic reasons).* You do a facelift for a **Toronto** patient who's visiting **Edmonton**.

**10** You're a computer expert in **New Brunswick.** A customer from a nearby town in **Quebec** sends you a computer to repair. You fix the customer's computer and return it to him in **Quebec**.

*Turn to page 4 to see how you scored!*

# Capital gains exemption



**The capital gains exemption allows individuals resident in Canada to earn tax-free capital gains from the dispositions of qualified small business corporation (QSBC) shares, and qualifying farm or fishing property.**

The exemption is actually a deduction in computing taxable income: you report the capital gain as part of "total income" and "net income" *(so your "net income", which affects other calculations, may be quite high)*, and then claim the deduction at the last stage of the "taxable income" calculation on your return.

For several years, the exemption limit was $750,000 of capital gains from these properties, but the limit was raised to $800,000 in 2014 *($400,000 of taxable capital gains, since only half of capital gains are included in income)*. For later years, the limit is indexed for inflation: for 2015, it is $813,600.

## QSBC shares

In general terms, a share of a private corporation qualifies as a QSBC share if it meets the following criteria:

- at the time of the disposition of the share, the corporation is a "small business corporation" *(see below)*; and
- throughout the 24 months before the disposition, the corporation was a Canadian-controlled private corporation (CCPC) and more than 50% of its assets on a fair market value basis were used principally in a business carried on primarily in Canada *(or were shares or debt in certain related CCPCs that met similar asset thresholds)*.

A **CCPC** is basically a private corporation resident in Canada that is not controlled by public corporations, non-residents, or a combination thereof.

A "**small business corporation**" is a CCPC where "all or substantially all" of the corporation's assets on a fair market value basis are used principally in a business carried on primarily in Canada *(or are shares or debt in certain related CCPCs that met similar asset thresholds)*. The CRA takes the position that "**substantially all**" normally means 90% or more, although that percentage is not in the Income Tax Act and the Courts are not bound by it.

Furthermore, you or a related person must normally own the shares for at least 24 months prior to the disposition. The 24-month hold period generally disqualifies "quick flips" of shares that might otherwise qualify as QSBC shares. There are some exceptions, including where you transferred substantially all the assets of your business to the corporation within the past two years in exchange for those shares.

• • •

**If you are thinking of selling your business** you should contact your accountant to ensure your corporation is structured properly to take advantage of the capital gain exemption. Because of the 24-month rule you should ensure the planning is done well in advance of selling the business.

# HST Quiz Answers

Here are the answers to our HST quiz on page 2.

**1 15%, the rate for Nova Scotia**: Goods sold and shipped anywhere in Canada bear GST or HST based on the rate of tax in the destination province.

**2 15%, the rate for Nova Scotia**: As long as you arranged the shipping – even as the customer's agent – the same rule applies as in situation 1, above: the GST or HST applies at the rate in the destination province to which you've shipped the goods.

**3 Only 5% GST, the rate for Alberta**: You completed delivery at your **Calgary** warehouse, and the customer made her own arrangements to pick up the goods.

**4 Only 5% GST**: Services are normally taxed based on the customer's address *(subject to some exceptions)*.

**5 Only 5% GST**: It doesn't matter where you performed the work. Services are normally taxed based on the customer's address *(subject to some exceptions)*.

**6 13% HST, the rate for Ontario**: A service "rendered in connection with litigation" in a province's courts is taxed at the rate for that province. The litigation is in an **Ontario** court. This rule is often thought to apply only to lawyers' services, but is actually much broader!

**7 13% HST, the rate for Ontario,** because this is a service in connection with litigation in an Ontario court. It doesn't matter where you perform the service.

**8 Only 5% GST, the rate for Alberta**: Even though services are normally taxed based on the customer's address, there's an exception for "personal services" performed in the presence of the individual to whom the services are rendered. Such services are taxed based on where they're performed. Since you performed the service in **Alberta**, the **Alberta** rate applies.

**9 13% HST, the rate for Ontario**: The exception for "personal services" in situation 8, above, doesn't apply to an "advisory, professional or consulting service". Instead, such a service is subject to the normal rule for services, based on the customer's address. *(A physician's service is a "professional" service.)*

**10 Only 5% GST, the rate for Quebec**: There's a special rule for goods that are sent for repair, alteration, cleaning or a similar physical service. The tax applies based on the address to which the goods are returned after being repaired, altered, cleaned, etc. *(If you have an office in Quebec, you would have to charge Quebec Sales Tax as well.)*

*If you didn't score too well on the quiz, don't be surprised! The rules are complex and confusing. What's important is that you ensure that your business applies the rules correctly. Otherwise you could be in for a very costly assessment if a CRA auditor shows up to audit your business for GST and HST.*




## Galloway Botteselle & Company

*Independent member firm of*

PORTER HÉTU *INTERNATIONAL*

Professional Services Group

**Brian M. Galloway**, CFP, CPA, FCGA
**E. Albert Botteselle**, CFP, CPA, CGA
**Brian R. Blamey**, BA, CPA, CGA
**David P. Van Gruen**, CPA, CGA
**Saskia N. Muller**, CPA, CGA, B.COM
**Selena G. Nisbet**, CPA, CGA, B.COM

Maple Place Professional Centre
300 – 2000 West 12th Avenue
Vancouver (BC) V6J 2G2
TEL (604) 736-6581
FAX (604) 736-0152
EMAIL info@gbco.ca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Please send your comments or questions to Flora Hugon at **fhugon@gbco.ca**