***Canadian Tax Principles, 2022-2023* (Byrd/Chen)**

**Chapter 20 International Issues in Taxation**

20.1 Online Exercises

1) List two objectives that are served by income tax treaties.

Answer:

• Prevention of double taxation.

• Facilitating cross-border trade.

• Implementing a proper division of cross-border revenues.

• Provision of an information-sharing mechanism.

Type: ES

Topic: International - income tax treaties

2) Indicate the types of income on which non-residents are subject to Part I tax.

Answer: Non-residents are subject to Canadian Part I taxes on:

• employment income earned in Canada;

• income from a business carried on in Canada; and

• gains resulting from dispositions of Taxable Canadian Property.

Type: ES

Topic: International - non-resident liability for Part I tax

3) In general, employment income earned in Canada by a non-resident is subject to Part I tax. However, the Canada/U.S. income tax treaty provides exceptions to this general rule. Describe these exceptions.

Answer:

**$10,000 Rule -** Under this rule if, during a calendar year, a U.S. resident earns employment income in Canada that is $10,000 or less in Canadian dollars, then the income is taxable only in the U.S.

**183 Day Rule -** This rule exempts Canadian source employment income from Canadian taxation, provided it is earned by a U.S. resident who was physically present in Canada for no more than 183 days during any twelve month period commencing or ending in the calendar year. This exemption is conditional on employment income not being paid by an employer with a permanent establishment in Canada who would be able to deduct the amount paid from their Canadian income. Stated alternatively, if the employment income exceeds $10,000 and is deductible in Canada, it will be subject to Canadian income tax under Part I, even if the employee is present in Canada for less than 183 days during the year.

Type: ES

Topic: International - non-resident employment in Canada (Canada/U.S. treaty)

4) The Canada/U.S. income tax treaty does not interfere with Canada's right to subject to Canadian income tax on business income earned in Canada by a U.S. resident through a "permanent establishment (PE)". The treaty defines a PE in an expansive manner adding that, in some situations, an individual can be considered to be a PE for the purposes of this rule. Describe these situations.

Answer:

• An individual who acts on behalf of a non-resident business and who is authorized to conclude contracts in the name of that business is considered a PE.

• An individual who acts on behalf of a business and meets both a physical presence test (183 days or more in any 12 month period beginning or ending in the year) and a gross revenue test (that more than 50% of the gross active business revenues of the U.S. business are from services performed by that individual during the period the individual is in Canada), is considered a PE.

Type: ES

Topic: International - permanent establishments (PE)

5) Provide two examples of the type of income earned by a non-resident which would be potentially subject to Part XIII tax.

Answer: Income from:

• interest

• royalties

• rents

• dividends

• pension benefits

Type: ES

Topic: International - Part XIII tax on non-residents

6) A non-resident individual owns a rental property in Canada. While the rental income would be subject to Part XIII tax, as an alternative, the non-resident can elect to pay taxes under Part I instead, rather than Part XIII. Why might a non-resident make that election?

Answer: If the non-resident pays income tax under Part XIII, the income tax will (subject to a treaty rate reduction) generally be charged at a flat rate of 25% on gross rents. Alternatively, if the non-resident elects to be subject to income tax under Part I the income tax will only be charged on a source basis meaning gross rents minus all relevant expenses. The election to apply Part I is a separate income tax return that applies graduated income tax rates, therefore in 2022 the first $50,197 of rental income will only be charged 15% plus 48% of that amount for a combined rate of 22.05% [(15%)(1.48)]. However the Part I election precludes the claiming of any taxable income deductions and the claiming of any personal tax credits in the determination of the ultimate Part I liability.

Type: ES

Topic: International - rental income to non-residents (ITA 216)

7) When an individual becomes a resident of Canada, there is a deemed disposition/reacquisition at FMV of most of their capital property. Briefly explain why this is an important provision for most individuals.

Answer: An individual who becomes a resident of Canada may own capital property on which there are accrued but unrealized capital gains. If there was no deemed disposition/reacquisition at the time the individual becomes a resident of Canada, a subsequent sale of property could result in income tax being charged on on gains that accrued prior to the individual becoming a resident of Canada. The result could be that that same gain would be potentially subject to income tax in Canada as well as the individual's former resident country.

Type: ES

Topic: International - immigration & emigration

8) When a person ceases to be a resident of Canada, there is no deemed disposition/reacquisition of their Canadian real estate. However, ITA 128.1(4)(d) allows a taxpayer to elect to have a deemed disposition/reacquisition of real estate at the time of their departure. Why would an individual wish to make this election? Briefly explain your conclusion.

Answer: The most common reason for making this election would be a situation in which the individual has capital losses. This could be either net capital loss balances, or current year losses including those resulting from the deemed dispositions on ceasing to be a resident of Canada. In this situation, the taxpayer may wish to realize a capital gain on the real estate that can be used to offset these other losses.

Alternatively, if the FMV of the real estate is less than its cost, the individual could make the election in order to use the capital loss on the required deemed disposition against capital gains on other property dispositions.

Type: ES

Topic: International - immigration & emigration

9) An individual ceases to be a resident of Canada (e.g. emigrates ) at a time when the individual owns shares in a private corporation with a FMV of $500,000 and an ACB of $300,000. Two years later, the individual returns to Canada and becomes a resident once again. The individual still owns the shares. What are the income tax consequences of the emigration (ceasing to be resident) from Canada and the immigration (becoming a resident) back to Canada.

Answer: There would be a deemed disposition of the shares at the time of emigration, resulting in a taxable capital gain of $100,000 [(1/2)($500,000 - $300,000)]. On immigration, if no election is made, the shares will have an ACB of $500,000.

There is however an election available to reverse the original deemed disposition that resulted from ceasing to be a resident of Canada. If the individual makes the election, the taxable capital gain would be reversed and any income taxes paid would be refunded. The ACB would be changed to the original $300,000.

Type: ES

Topic: International - immigration & emigration

10) John Barth has $20,000 of foreign business income, from which the foreign country has withheld $2,000 in income tax. Briefly describe the treatment of the withholding amount in determining John Barth's Canadian income tax payable.

Answer: John would include the $20,000 in foreign business income in his net income and taxable income. The $2,000 foreign income tax that was withheld is eligible for a foreign business tax credit to be applied to reduce his Canadian income tax liability.

Type: ES

Topic: International - foreign business income [of Canadian residents]

11) Explain why dividends received by individuals from non-resident corporations do not usually receive the same gross up and tax credit treatment that applies to taxable dividends received from taxable Canadian corporations.

Answer: The answer lies in the integration system for corporate income tax in Canada. Integration requires that there be Canadian income tax paid by the corporation when income is earned by the corporation and that there also be income tax paid by Canadian resident individual shareholders of that corporation when taxable dividends are paid to them by the corporation. The individuals receive credit for the Canadian corporate income taxes paid which requires the workings of the integration system which function on the basis of a gross-up and dividend tax credit. These Canadian integration features are generally absent with respect to foreign corporations.

Type: ES

Topic: International - foreign dividends received by a Canadian resident individual

12) Summarize the taxation of the income of controlled foreign affiliates (CFA) and non-controlled foreign affiliates (FA).

Answer:

**Controlled Foreign Affiliates (CFA) -** Whether the resident Canadian shareholder is an individual or a corporation, certain investment income referred to as Foreign Accrual Property Income (FAPI) that is earned by a CFA of the resident Canadian shareholder must be included in income on an accrual basis rather than a received basis. When these FAPI amounts are subsequently paid out as dividends they will be included in the income of the Canadian shareholder but will be eligible for an offsetting deduction to recognize that the amounts have already been included in the income of the shareholder in a previous year.

If the dividend is paid from non-FAPI sources of income, it will be included in income when received as a dividend, but, in the case of Canadian corporate shareholders, may be completely or partially offset by the ITA 113(1) taxable income deduction depending upon whether Canada has entered into an income tax treaty or Tax Exchange Information Agreement (TEIA) with the foreign country. Canadian individual shareholders would obtain partial relief through the foreign tax credit system only, since they are not entitled to the ITA 113(1) deduction. This generally encourages individuals to hold shares in foreign corporations through a resident Canadian corporation.

**Foreign Affiliates (FA) -** The income of FAs that are not CFAs will not be accrued. Rather, it is included in income when dividends are received from the FA. If the dividend is paid from active business income earned in a country with which Canada has an income tax treaty or TEIA, it will be offset by the ITA 113(1) taxable income deduction. In addition, dividends paid out of the non-taxable portion of some types of capital gains, or the full amount of capital gains resulting from dispositions of property used in an active business in a country with which Canada has an income tax treaty or TEIA, are also deductible under ITA 113(1). When the ITA 113(1) deduction is available, no foreign tax credit can be claimed.

Alternatively, i f the dividend is paid out of passive income, or earned in a non-treaty/non-TEIA country, it will be included in income and only be eligible for deductions under ITA 113 to the extent income taxes or dividend withholding taxes have been paid on the amounts distributed. In this latter case ITA 113(1) acts as a substitute for the foreign tax credit rules of ITA 126.

Type: ES

Topic: International - foreign affiliates (FA) & controlled foreign affiliates (CFA)

13) Clarkson Equipment Ltd. (the "Canadian company") is a manufacturer of construction equipment that is used throughout the world. The factory is located in Windsor, Ontario and the majority of its manufacturing operations take place at that location. In the current year, the Company negotiated a very significant contract with an African country with which Canada has an income tax treaty. The contract requires not only the provision of the Company's equipment, but instruction and training of the operators as well. Given the magnitude of this contract, Clarkson is considering establishing a subsidiary in the African country to carry out the terms of the agreement. Compare the Canadian income tax treatment of income earned if the contract was with the Canadian company or with a non-resident subsidiary of the Canadian company.

Answer: If the Canadian company undertakes to deliver the goods and provide the services required in the contract, the business profits will be included in the income of the Canadian company subject to full Canadian corporate income tax rates. However, tax credits for any foreign income taxes paid on that income would be available to the Canadian company.

If a separate subsidiary is incorporated in the African country, the subsidiary can purchase the required manufactured items from Clarkson and potentially resell them at a profit. Additional profits could arise as a result of providing training services. Any profits will be active business income and will not be deemed Foreign Accrual Property Income (FAPI). This means that there will be no Canadian taxation until such time as the earnings are repatriated into Canada (paid as dividends). If the corporate income tax rates in the African country are lower than Canadian rates, forming the subsidiary may be advantageous.

Type: ES

Topic: International - carrying on business through a foreign subsidiary (tax planning)

14) If there is a conflict between the ITAand the Canada/U.S. income tax treaty, the provisions of the income tax treaty must be used.

Answer: TRUE

Type: TF

Topic: International - income tax treaties

15) If a non-resident individual has Part I income tax payable and is required to file a Canadian income tax return, the individual will not be eligible for any of the personal tax credits.

Answer: FALSE

Explanation: Regardless of the amount of Canadian income reported, some credits will be available to non-residents filing a Canadian income tax return. Examples include EI and CPP tax credits, and the charitable donations tax credit.

Type: TF

Topic: International - non-resident individuals & personal tax credits

16) The Canada/U.S. income tax treaty permits Canada to tax the business income of U.S. residents, provided that the business is operated in Canada through a permanent establishment (PE).

Answer: TRUE

Type: TF

Topic: International - income tax treaties

17) If a U.S. resident earns less than $10,000 in Canadian employment income, the employment income will not be subject to Part I income tax even if the income is paid by a Canadian business that deducts the amounts.

Answer: TRUE

Type: TF

Topic: International - income tax treaties

18) If a non-resident is required to pay Part XIII tax in Canada, they will have to file a Canadian income tax return.

Answer: FALSE

Explanation: Non-residents are not required to file a Canadian tax return for income that is subject to Part XIII tax. If excess amounts have been withheld form NR7-R will be filed to recover the excess. Form NR7-R is not an income tax return.

Type: TF

Topic: International - Canadian filing requirements for non-residents

19) If a U.S. resident individual receives Canadian interest on participating debt, the individual will be required to pay Part XIII tax on the amounts received.

Answer: FALSE

Explanation: The Canada/U.S. income tax treaty states that interest arising in a contracting state (Canada) and beneficially owned by a resident of the other contracting state (U.S.) may be taxed only in that other state (U.S.). Technically Part XIII would apply however the income tax treaty with the U.S. would override this result.

Type: TF

Topic: International - interest payments to non-residents

20) If a Canadian resident individual emigrates to the U.S. (ceases to be a resident of Canada), there will be a deemed disposition at FMV of any property in the individual's brokerage accounts and their RRSP.

Answer: FALSE

Explanation: While there will be a deemed disposition of the properties in brokerage accounts, as an "excluded right", RRSPs are exempt from the deemed disposition rule.

Type: TF

Topic: International - immigration & emigration

21) In general, if a non-resident individual earns employment income in Canada, the individual will be subject to Canadian income tax on that income.

Answer: TRUE

Explanation: However, the Canada/U.S. income tax treaty does provide two exceptions to that rule.

Type: TF

Topic: International - non-resident employment in Canada (Canada/U.S. treaty)

22) In general, if a non-resident earns business income from mining in Canada, the profits are not subject to Canadian income tax.

Answer: FALSE

Explanation: The income from a mine in Canada owned by a non-resident would be considered the carrying on of a business in Canada through a permanent establishment by that non-resident and, as a result, Part I income tax would apply.

Type: TF

Topic: International - non-resident carrying on business in Canada

23) Under the Canada/U.S. income tax treaty, if a Canadian resident earns employment income in the U.S. that is $10,000 or less in U.S. dollars, then the income is taxable only in Canada.

Answer: TRUE

Type: TF

Topic: International - income tax treaties

24) If a U.S. corporation owns a storage facility in Canada, this will be considered a permanent establishment (PE) for purposes of determining which country has the right to subject the business income attributable to that PE to Canadian income tax.

Answer: FALSE

Explanation: Such facilities are not considered to be PEs under the Canada/U.S. income tax treaty.

Type: TF

Topic: International - permanent establishments (PE)

25) Under ITA 2(3), gains resulting from the disposition of any capital property in Canada by a non-resident will be subject to Part I income tax.

Answer: FALSE

Explanation: Only gains on dispositions of "Taxable Canadian Property" fall under ITA 2(3).

Type: TF

Topic: International - non-resident liability for Part I tax

26) A non-resident earning rental income on property in Canada can either pay Part XIII tax or, alternatively, elect to be subject to Part I instead.

Answer: TRUE

Type: TF

Topic: International - rental income to non-residents (ITA 216)

27) All Canadian interest that is earned by non-residents is subject to Part XIII tax.

Answer: FALSE

Explanation: Only interest on participating debt and exempt interest paid to non-arms' length non-residents is subject to Part XIII tax subject to any relevant income tax treaty.

Type: TF

Topic: International - interest payments to non-residents

28) While Canadian dividends paid to U.S. residents are subject to Part XIII tax, the Canada/U.S. income tax treaty serves to reduce this rate from the statutory rate of 25%.

Answer: TRUE

Explanation: The rate applicable to U.S. corporate residents is reduced to 5% when the U.S. corporations owns 10% or more of the voting shares, or to 15% in other situations.

Type: TF

Topic: International - dividends paid to non-residents (U.S. income tax treaty)

29) An entity would be a controlled foreign affiliate (CFA) of a Canadian taxpayer if it is a foreign affiliate (FA) of the Canadian taxpayer that would, at that time, be controlled by the taxpayer if the taxpayer owned all of the shares of the capital stock of the FA that are owned at that time by persons who do not deal at arm's length with the taxpayer.

Answer: TRUE

Type: TF

Topic: International - foreign affiliates (FA) & controlled foreign affiliates (CFA)

30) Which of the following businesses will be subject to Part I tax in Canada?

A) A U.S. company that receives dividends from its Canadian subsidiary.

B) A U.S. company that stores its inventory in a Canadian warehouse.

C) A multinational manufacturing business that has a factory in Canada.

D) A U.S. company that has a temporary office in Canada while searching for a site for its planned Canadian manufacturing plant.

Answer: C

Explanation: C) A multinational manufacturing business that has a factory in Canada.

Type: MC

Topic: International - non-resident liability for Part I tax

31) Kenichi Takahawa is a resident of the United States, living in Detroit, Michigan. He works and earns income for the year as follows:

Employment income in Canada (Windsor, Ontario) $50,000

Business income in Canada 35,000

Interest income on bank account in Canada 3,000

Capital gain from disposition of vacant land in Detroit 7,000

What is his net income for Part I purposes?

A) $50,000

B) $85,000

C) $88,000

D) $91,500

Answer: B

Explanation: A) $50,000 [employment income only]

B) $85,000 [$50,000 + $35,000]

C) $88,000 [$50,000 + $35,000 + $3,000]

D) $91,500 [$50,000 + $35,000 + $3,000 + (1/2)($7,000)]

Type: MC

Topic: International - non-resident liability for Part I tax

32) Fahad Lodhi is a resident of the United States, living in Port Huron, Michigan. He works and earns income in Canada all year as follows:

Employment income in Canada (Sarnia, Ontario) $ 9,500

Business income in Canada 30,000

Interest income on bank account in Canada 500

Capital gain from disposition of vacant land in Canada 10,000

What is his Canadian net income under Part I?

A) $30,000

B) $35,000

C) $45,000

D) $44,500

Answer: B

Explanation: A) $30,000 [business income only]

B) $35,000 [$30,000 + (1/2)($10,000)]. The employment income is exempt from taxation in Canada as it is less than $10,000.

C) $45,000 [ $9,500 + $30,000 + $500 + (1/2)($10,000)]

D) $44,500 [ $9,500 + $30,000 + (1/2)($10,000)]

Type: MC

Topic: International - non-resident liability for Part I tax

33) Under ITA 115(2) certain non-resident individuals will be deemed to be employed in Canada even when they are not working in Canada. Which of the following non-resident individuals would be deemed to be employed in Canada?

A) Marcel is employed by a Canadian resident company in a foreign country. The income tax treaty with the foreign country subjects his employment income to income tax in that country.

B) Anita was previously a Canadian resident. She is currently employed by a non-resident company in a foreign country, but receives pension income from a Canadian resident company.

C) Johann receives a signing bonus from a non-resident company. His services will be provided in Canada.

D) Helen is employed by a Canadian resident company in a foreign country. The income tax treaty with the foreign country exempts her employment income from income tax.

Answer: D

Explanation: D) Helen is employed by a Canadian resident company in a foreign country. The income tax treaty with the foreign country exempts her employment income from income tax.

Type: MC

Topic: International - non-resident liability for Part I tax

34) Merivale is a U.S. corporation with operations throughout the United States. In addition to its U.S. operations, it has a sales office in Calgary. Canadian employees who work out of this sales office take orders for the company's products. The orders are filled from a warehouse in Montana.

A) Merivale is not subject to Canadian income tax because it is not incorporated in Canada.

B) Merivale is not subject to Canadian income tax because the orders are not filled from a Canadian warehouse.

C) Merivale is not subject to Canadian income tax because the mind and management of the company is not in Canada.

D) Merivale is subject to Canadian income tax on the income that is attributable to the Calgary office.

Answer: D

Explanation: D) Merivale is subject to Canadian income tax on the income that is attributable to the Calgary office.

Type: MC

Topic: International - non-resident liability for Part I tax

35) In which of the following cases, where a U.S. resident disposes of a property, is the gain taxable in Canada?

A) Joelle Elfassy sells 100 shares in a widely held Canadian public company that has over 10 million shares issued.

B) Ku Jung owns a rental property in downtown Vancouver. Ku has owned the property for 3 years and has never lived in it. The property is sold for a substantial gain.

C) Danyal Sigindere incorporated a private company in Canada 10 years ago. The company rents space and operates a retail clothing store. Danyal sells the shares for a gain of $1,000.

D) Ariella Incorporated sells its list of Canadian customers to a Canadian business.

Answer: B

Explanation: B) Ku Jung owns a rental property in downtown Vancouver. Ku has owned the property for 3 years and has never lived in it. The property is sold for a substantial gain.

Type: MC

Topic: International - taxable canadian property

36) In the Canada/U.S. income tax treaty, the definition of a permanent establishment does not include:

A) an oil well.

B) a storage facility.

C) a factory.

D) a mine.

Answer: B

Explanation: B) a storage facility

Type: MC

Topic: International - permanent establishments (PE)

37) Darren Brock, a non-resident, borrows $422,000 and invests it in a Canadian rental property which generates gross annual rents of $72,000. The interest expense on the loan is $6,000, and other expenses of operating the property, including maximum CCA, total $20,000. Which of the following sets of numbers represents first, the net income and taxable income to Mr. Brock if he reports his rental income under Part I, and second, the base upon which Part XIII would be calculated?

A) $72,000; $46,000

B) $46,000; $52,000

C) $72,000; $66,000

D) $46,000; $72,000

Answer: D

Explanation: D) $46,000 ($72,000 - $6,000 - $20,000); $72,000

Type: MC

Topic: International - rental income to non-residents (ITA 216)

38) Mike O'Shea, a resident of Ireland, has owned a Canadian rental property for several years. The property is located in Alberta and, in the current year, it was sold for an amount that resulted in a significant capital gain. Which of the following statements is correct with respect to the capital gain?

A) Mr. O'Shea is not a Canadian resident and, as a consequence, will not be taxed on the capital gain.

B) Mr.O'Shea will be assessed for a withholding tax under Part XIII.

C) Mr. O'Shea will be subject to Part I tax on the capital gain.

D) Mr. O'Shea will be subject to both Part I tax as well as Part XIII tax.

Answer: C

Explanation: C) Mr. O'Shea will be subject to Part I tax on capital gains on the disposition of taxable Canadian property which would include real property situated in Canada.

Type: MC

Topic: International - non-resident liability for Part I tax

39) Many types of income are subject to withholding tax under Part XIII*.* Which of the following would **NOT** be subject to Part XIII tax when paid to a non-resident individual? Ignore any income tax treaty provisions that might be applicable.

A) A withdrawal from a RRIF by a former resident of Canada.

B) A capital dividend from a CCPC.

C) Interest on Government of Canada bonds.

D) A taxable dividend from a CCPC.

Answer: C

Explanation: C) Interest on Government of Canada bonds.

Type: MC

Topic: International - Part XIII tax on non-residents

40) Certain types of Canadian income earned by non-residents are not subject to Part I tax. Which of the following types of income would **NOT** be subject to Part I tax? Ignore any income tax treaty implications that might be applicable.

A) Capital gains from the sale of Canadian real estate.

B) Interest on a GIC issued by a Canadian bank.

C) Income resulting from the exercise of employee stock options of a Canadian public company.

D) Recapture resulting from the sale of a Canadian business property.

Answer: B

Explanation: B) Interest on a GIC issued by a Canadian bank.

Type: MC

Topic: International - non-resident liability for Part I tax

41) A non-resident individual owns a rental property in Canada. Which of the following statements is correct?

A) The gross rents are subject to withholding under Part XIII however, the taxpayer can elect to file a Canadian income tax return and pay Part I income tax on the rental profits.

B) The rental income is subject to withholding under Part XIII. However, the taxpayer can elect to file a Canadian income tax return and pay Part I tax on the gross rents.

C) The taxpayer must file a Canadian income tax return which includes the rental profits.

D) The rental profits are subject to withholding under Part XIII.

Answer: A

Explanation: A) The gross rents are subject to withholding under Part XIII however, the taxpayer can elect to file a Canadian income tax return and pay Part I income tax on the rental profits.

Type: MC

Topic: International - rental income to non-residents (ITA 216)

42) Which type of income is **not** subject to Canadian income tax to a non-resident under either Part I or Part XIII?

A) Rental income from a property situated in Canada.

B) Pension benefits from a Canadian employer.

C) Dividend income from a Canadian corporation.

D) Interest paid on a savings account at a Canadian bank branch located in Canada.

Answer: D

Explanation: D) Interest paid on a savings account at a Canadian bank branch located in Canada

Type: MC

Topic: International - Part I & Part XIII tax on non-residents

43) In which of the following cases would the interest payment made to a non-resident be subject to Part XIII withholding tax?

A) Ling, a resident of a country that does not have an income tax treaty with Canada, earns interest of $5,000 from a Canadian term deposit.

B) Jin, a resident of a country that does not have an income tax treaty with Canada, earns interest of $15,000 on a Canadian government bond.

C) Dou, a U.S. resident, earns interest of $42,000 on a loan to Moon Limited, a CCPC. Dou owns 51% of the voting shares of the company.

D) Ying, a resident of a country that does not have an income tax treaty with Canada, earns $25,000 on a loan to Sun Enterprises Limited, a CCPC. The interest is dependent upon the profits of the CCPC. Ying owns 40% of the shares in the company.

Answer: D

Explanation: D) Ying, a resident of a country that does not have an income tax treaty with Canada, earns $25,000 on a loan to Sun Enterprises Limited, a CCPC. The interest is dependent upon the profits of the CCPC. Ying owns 40% of the shares in the company. Since the loan is arm's length Part XIII only applies if the interest is from participating debt which is the case.

Type: MC

Topic: International - Part XIII tax on non-residents

44) Which of the following types of payment is **NOT** subject to Part XIII tax when paid to a non-resident?

A) Dividends

B) Pension benefits

C) Interest paid under non-participating debt to an arm's length person

D) RRSP payments

Answer: C

Explanation: C) Interest paid under non-participating debt to an arm's length person

Type: MC

Topic: International - Part XIII tax on non-residents

45) When an individual ceases to be a resident of Canada (e.g. emigrates), there is a deemed disposition of most types of capital property. However, there are certain exceptions. Which of the following would be among the exception?

A) An extremely valuable coin collection.

B) A 72 foot sea-going yacht.

C) Shares of a CCPC that primarily provides nursing services.

D) Shares of a CCPC that primarily owns rental properties for resale.

Answer: D

Explanation: D) Shares of a CCPC that primarily owns rental properties for resale.

Type: MC

Topic: International - immigration & emigration

46) Mr. Winsome is a Canadian citizen who nd has been resident in Canada for the past 35 years. His company has offered him a position with its Australian branch, which Mr. Winsome has accepted. The position is a transfer and Mr. Winsome plans to remain in Australia for the rest of his life. Given the temperate climate in Australia, he thinks it will be a good country in which to retire. Mr. Winsome has the following properties in Canada on December 15, 2022, the date that he ceases to be a resident of Canada (e.g. emigration):

**As At December 15, 2022**

**FMV ACB**

Shares in Bell Canada, a public company $10,000 $ 7,000

Shares in TNX Co., a private company 8,000 5,000

Mutual Funds 10,000 10,000

Sailboat (that he is shipping to Australia) 15,000 18,000

Which of the following is correct?

A) Mr.Winsome will be deemed to have disposed of his mutual funds, sailboat, TNX Co. shares and Bell Canada shares for FMV on December 15, 2022.

B) Mr.Winsome can elect to defer the gain on the Bell Canada shares until they are sold, only if security acceptable to the CRA is provided.

C) Mr. Winsome can elect to have a deemed disposition of the Bell Canada shares on December 15, 2022, only if security acceptable to the CRA is provided.

D) None of the above.

Answer: A

Explanation: A) Mr. Winsome will be deemed to have disposed of his mutual funds, sailboat, TNX Co. shares, and Bell Canada shares for FMV on December 15, 2022.

Type: MC

Topic: International - immigration & emigration

47) Because of his distaste for Canadian winters, Rob Johnston has emigrated (ceased to be a resident) from Canada to Florida. At the time of his departure, the FMV of property owned by the RRSP is $1,500,000. Which of the following statements is correct?

A) There will be a deemed disposition of all of the property of the RRSP at the time Rob ceases to be a resident of Canada.

B) There will be no income tax consequences at the time Rob ceases to be a resident of Canada. However, any withdrawals from the RRSP subsequent to ceasing to be a resident of Canada will be subject to Canadian Part I tax.

C) There will be no income tax consequences at the time Rob ceases to be a resident of Canada. However, any withdrawals from the RRSP after ceasing to be a Canadian resident will be subject to Part XIII tax.

D) Part XIII tax will have to be paid at the time Rob ceases to be a resident of Canada, but there will be no further income tax in Canada on subsequent withdrawals from the plan.

Answer: C

Explanation: C) There will be no income tax consequences at the time Rob ceases to be a resident of Canada. However, any withdrawals from the RRSP after ceasing to be a Canadian resident will be subject to Part XIII tax.

Type: MC

Topic: International - immigration & emigration

48) Joan Bias, a U.S. citizen, became a resident of Canada in 2020. At that time, she owned shares in a U.S. company that had an ACB of $150,000 and a FMV $210,000. In 2022, she sold the shares for $170,000. What are the income tax consequence of the sale?

A) There would be a taxable capital gain of $20,000.

B) There would be an allowable capital loss of $20,000.

C) There would be a taxable capital gain of $10,000.

D) There would be a business investment loss of $40,000.

Answer: B

Explanation: B) There would be an allowable capital loss of $20,000 [(1/2)(POD $170,000 - ACB $210,000)].

Type: MC

Topic: International - immigration & emigration

49) In 2022, Barton Ferris is entitled to $50,000 in dividends from a publicly listed foreign corporation in which he owns shares. The foreign jurisdiction withholds $10,000 (20%), providing him with a net payment of $40,000. In addition to the dividend, Barton has Canadian rental income of $130,000. He has no personal tax credits other than the BPA and any credits related to foreign income tax withheld. He has no taxable income deductions. What is his 2022 net income and taxable income? All amounts are in Canadian dollars.

A) $170,000.

B) $177,500.

C) $180,000.

D) $199,000.

Answer: B

Explanation: A) $170,000 ($130,000 + $40,000)

B) $177,500 ($130,000 + $50,000 - $2,500\*)

\* [(20% - 15%)($50,000)] ITA 20(11)

C) $180,000 ($130,000 + $50,000)

D) $199,000 [$130,000 + ($50,000)(138%)]

Type: MC

Topic: International - foreign property income (of Canadian residents)

50) Which of the following conditions must be met in order for a resident Canadian corporation to be able to claim a taxable income deduction with respect to dividends received from a non-resident corporation?

A) The dividend must be paid out of active business income.

B) The active business income must be earned in a country with which Canada has an income tax treaty or has entered into a tax exchange information agreement (TIEA).

C) The non-resident corporation must be a foreign affiliate of the resident Canadian corporate shareholder.

D) All of the above.

Answer: D

Explanation: D) All of the above.

Type: MC

Topic: International - ITA 113(1) taxable income deduction

51) In each of the following Cases, determine whether Rawlings Inc., a non-resident U.S. corporation, is subject to Canadian income tax:

**Case 1 -** Rawlings is the parent company of Delma Ltd., a company incorporated in British Columbia. Rawlings produces and sells small construction equipment, while Delma produces and sells hand tools. Rawlings sells pieces of equipment to Delma, who in turn sells them in Canada.

**Case 2 -** Rawlings manufactures small construction equipment in the U.S. Rawlings ships pieces of equipment to a warehouse located in Winnipeg that is rented on a seven year lease. Rawlings has employed an individual in Winnipeg to sell the equipment throughout central Canada. The employee is not allowed to conclude contracts without approval by the U.S. office.

**Case 3 -** Assume the same facts as in Case 2, except that the employee has the authority to conclude contracts on behalf of the employer.

Answer:

**Case 1 -** Rawlings is not carrying on business in Canada and would not be subject to Canadian income tax.

**Case 2 -** The income tax treaty allows Canada to tax business income only if such income is attributable to a permanent establishment (PE) in Canada. The warehouse constitutes a fixed place of business regardless of whether it is owned or leased. However, since it appears to be used exclusively to maintain an inventory for delivery, it would be an excluded activity and would therefore not be considered to be a PE. A further consideration is the employee who sells the product. Since the employee is not allowed to conclude contracts without approval, the employee would not be considered to be a PE. Rawlings would not be taxable in Canada.

**Case 3 -** In this Case, because the employee has authority to conclude contracts on behalf of a non-resident corporation, the employee is deemed to be a PE. This means that Rawlings is taxable in Canada under ITA 2(3) on its business profits attributable to the PE (i.e., the employee).

Type: ES

Topic: Carrying on business in Canada

52) Ms. Michelle Walker, a U.S. citizen and a U.S. resident, has Canadian employment income of $22,000 and U.S.employment income of $40,000 Canadian for the current year. The Canadian employment income is from a British Columbia company that can deduct the payments in determining its Canadian income. She lives in Seattle, Washington. Ms. Walker does not believe that she is subject to Canadian income tax. Is she correct? Explain your conclusion.

Answer: She is not correct. Under ITA 2(3) she would be subject to Canadian income tax on her Canadian employment income. There would be an exception to this if:

• the amount was less than $10,000 in Canadian dollars, or

• if she was in Canada for less than 183 days in any 12 month period beginning or ending in the current year and the employer was not a Canadian resident in a position to deduct the payments.

As neither of these exceptions apply, Michelle would be subject to Canadian income tax on her Canadian employment income.

Type: ES

Topic: International - non-resident liability for Part I tax

53) In each of the following Cases, determine whether the employment income is subject to Part I tax and is therefore taxable in Canada:

**Case 1 -** Mary is a U.S. resident currently living in the state of Maine. She accepted temporary employment as a personal trainer with a Canadian company for clients in New Brunswick beginning August 1, 2022 and ending on December 31, 2022. The Canadian employer agreed to pay her $2,660 in Canadian dollars per month. Mary remained a non-resident of Canada throughout her Canadian employment.

**Case 2 -** Assume the same facts as in Case 1, except the employer was resident in Maine and did not have a permanent establishment (PE) in Canada.

**Case 3 -** Bill resides in Watertown, New York and has commuted daily to his full-time employment in Kingston, Ontario for the last five years. In 2022, he spent 217 days at his job in Canada. He works for the municipality of Kingston and earned $53,000 Canadian in employment income. Bill is a U.S. resident throughout the year.

Answer:

**Case 1 -** The Canadian employment income is subject to Part I tax and is therefore subject to Canadian income tax. The Canada/U.S. income tax treaty allows Canada to tax employment income earned in Canada unless either of the following two exceptions applies:

• The first exception is the $10,000 rule. This exception however does not apply since Mary earned $13,300 in Canadian dollars in 2022 [($2,660)(5 months)].

• The second exception is the 183 day rule. Although Mary was in Canada for only 153 days of 2022 and therefore met the first part of the test, she failed the remaining part of the test since the employer was a Canadian resident and could deduct the payments in determining its Canadian income.

**Case 2 -** The employment income is not subject to Part I tax and is therefore not taxable in Canada. The 183 day rule exempts the income because the employer was not resident in Canada, nor had a PE in Canada, and could not deduct the payments in determining its Canadian income.

**Case 3 -** The employment income is subject to Part I tax and is therefore taxable in Canada. The Canada/U.S. income tax treaty would exempt the income from Canadian tax if the amount was less than $10,000 Canadian, or if Bill spent 183 days or less in Canada. As he earned $53,000 Canadian and spent 217 days at his job in Canada, neither of these exceptions would apply to exempt the employment income from Canadian income tax.

Type: ES

Topic: International - non-resident employment in Canada (Canada/U.S. treaty)

54) In each of the following Cases, determine whether the employment income is subject to Part I tax and is therefore taxable in Canada:

**Case 1 -** John lives in Blaine, Washington and is a U.S. citizen and a U.S. resident. However, he is employed by a business in Chilliwack, British Columbia. His salary for 2022 is $72,000. As he is able to do some of his work in his home office in Blaine, he commutes to Chilliwack for 150 days during 2022.

**Case 2 -** Martin is a U.S. citizen and a U.S. resident who lives in Vermont. He is employed by a U.S. business that does not have a permanent establishment (PE) in Canada. During the period March 1, 2022 to June 30, 2022, Martin is required to work in Montreal. His $5,000 per month salary is paid by his U.S. employer.

**Case 3 -** Assume the same facts as in Case 2 except that his U.S. employer has a subsidiary in Montreal. During the period that he is working in Montreal, his salary is paid by the Montreal subsidiary.

Answer:

**Case 1 -** John would be subject to Part I tax and is therefore taxable in Canada. In general, employment income of non-residents is taxable in Canada under ITA 2(3). The Canada/U.S. income tax treaty provides two exceptions to this general rule as follows:

• The first exception is for individuals with employment income of less than $10,000 in Canadian dollars. As John's salary is $72,000, this does not apply.

• The second exception is when the individual is in Canada for 183 days or less and the amounts are paid by an employer who is not a Canadian resident and cannot deduct the salary payments for Canadian income tax purposes. While John is in Canada for 183 days or less, his employer is a Canadian business that can deduct the payments.

**Case 2 -** The employment income is not subject to Part I tax and is therefore not taxable in Canada. While his earnings exceed $10,000, he is Canada for 183 days or less and his employment income is paid by a U.S. company that cannot deduct the payments for Canadian income tax purposes. This means that, under the Canada/U.S. income tax treaty, he is exempted from the general rule under ITA 2(3).

**Case 3 -** In this case, the employment income would be subject to Part I tax and is therefore taxable in Canada. As noted, the 183 day or less exception is only available when the employment income is not paid by an employer that can deduct the amounts paid for Canadian income tax purposes. The Montreal subsidiary will be able to deduct the payments for Canadian income tax purposes.

Type: ES

Topic: International - non-resident employment in Canada (Canada/U.S. treaty)

55) In each of the following Cases, determine whether the U.S. resident who is disposing of property is taxable under Part I in Canada on any capital gain resulting from the disposition.

**Case 1 -** In 2017, Anne Mason purchased a condo in Canmore, Alberta that she rented to Canadian residents. She sold the condo in 2022 at a considerable gain. Anne never lived in the condo.

**Case 2 -** Assume the same facts as in Case 1, except that Anne incorporates a private corporation under Alberta legislation which purchases the condo. Anne sells the shares of the private company at a later point for a considerable gain.

**Case 3 -** Assume the same facts as in Case 2, except the corporation is created under Oregon state legislation.

Answer:

**Case 1 -** Anne is taxable on the capital gain. The condo is "Taxable Canadian Property" since it is real property (e.g. land and buildings) situated in Canada. The Canada/U.S. income tax treaty gives Canada the right to tax such gains. The property is not exempt from Canadian income tax as a principal residence since Anne did not purchase the condo for her own habitation.

**Case 2 -** Anne would be taxable on the capital gain on the shares. Shares of an unlisted Canadian corporation are "Taxable Canadian Property" where certain conditions are met including that more than 50% of the FMV of the shares is attributable to certain property such as Canadian real estate. In addition, the Canada/U.S. income tax treaty allows Canada to tax gains on the disposition of shares if the value of the shares is derived principally from real property situated in Canada.

**Case 3 -** Anne would not be taxable on the capital gain on the shares. The shares are "Taxable Canadian Property" because they represent shares of an unlisted non-resident corporation that, at some time in the 60 months preceding the disposition, derived more than 50 % of their value from taxable Canadian property. However, the Canada/U.S. income tax treaty does not list this as one of the exceptions where Canada is allowed to tax the capital gain to U.S. residents.

Type: ES

Topic: International - taxable canadian property

56) In each of the following Cases, determine whether the interest payments made to non-residents are subject to Part XIII tax.

**Case 1 -** Phillip, a U.S. resident, earned interest of $2,250 on Canada Savings Bonds in 2022.

**Case 2 -** Marsha, a Canadian resident, acquired a vacation property in California for personal purposes. The property is mortgaged with a U.S. bank. Marsha paid $16,500 in interest to the U.S. bank in 2022.

**Case 3 -** Assume the same facts as in Case 2, except that Marsha had acquired the California condo in 2016 for cash. In 2022, she mortgages the property with a U.S. bank and uses the money in support of a business she carries on in Halifax.

Answer: The relevant part of the Canada/U.S. income tax treaty reads as follows:

**Article XI** Interest arising in a Contracting State (Canada or the U.S.) and beneficially owned by a resident of the other Contracting State (U.S. or Canada) may be taxed only in that other State (U.S. or Canada).

This means that, with respect to interest paid to U.S. residents, Canada does not have the right to withhold tax under Part XIII. As a result, there would be no Part XIII tax in any of the three Cases.

Type: ES

Topic: International - interest payments to non-residents

57) In each of the following Cases, determine how the rental payments made to non-residents will be taxed by Canada.

**Case 1 -** Carco is a U.S. corporation with worldwide rental facilities dedicated to automobile rentals. Carco has offices in New Brunswick, where it rents out small and medium sized automobiles.

**Case 2 -** In 2019, Danielle Clark, a U.S. resident, acquired several cottages in Manitoba that she rents out. In 2022, she rented the cottages to Canadian residents exclusively. Danielle received $46,000 in gross rents and estimates that expenses, including CCA, totaled $17,500.

**Case 3 -** Assume the same facts as in Case 2, with one additional consideration. Danielle acquired four all terrain vehicles (ATVs) in 2020, which she rented to guests of the cottages for an additional cost. In 2022, she received $4,000 in gross rents and estimates ATV related expenses of $2,500.

Answer:

**Case 1 -** Carco appears to be carrying on business in Canada through a permanent establishment (PE). As a result, Part XIII tax does not apply. However, Carco would be subject to Part I tax on its income attributable to the PE in New Brunswick.

**Case 2 -** As the Canada/U.S. income tax treaty does not reduce the rate for rentals of real property, Danielle would be subject to Part XIII tax of $11,500 [(25%)($46,000)]. Alternatively, Danielle could instead elect under ITA 216 to be subject to Part I tax on the rental income of $28,500 ($46,000 - $17,500). Based on her rental income, the Part XIII tax is at an effective rate of 40.4% ($11,500 ÷ $28,500). Unless she has a significant amount of other income in Canada, the Part I alternative will result in her being taxed at the lowest federal income tax rate or 15% plus 48% of that amount, making this the preferable choice.

**Case 3 -** Danielle would be subject to Part XIII tax on the gross rents received for the ATVs unless she would be considered to be carrying on a business. However, the Canada/U.S. income tax treaty reduces the withholding tax to 10% of the gross rents received, or $400. Note that Danielle would not be eligible to elect under ITA 216 to be taxed under Part I, since the election is generally restricted to real property.

Type: ES

Topic: International - rental income to non-residents (ITA 216)

58) Mr. Ryan Marchand owns publicly traded shares with an ACB of $30,000 and an FMV of $56,000. During the current year, he emigrates from Canada (ceases to be a resident) still owning the shares. What are the income tax consequences of the emigration, if any, with respect to these shares?

Answer: There would be a deemed disposition on his ceasing to be a Canadian resident, leaving him liable for income tax on a $13,000 [(1/2)($56,000 - $30,000)] taxable capital gain. In addition he is deemed to have reacquired the shares for their FMV of $56,000.

Type: ES

Topic: International - immigration & emigration

59) Mrs. Lorna Rand owns a rental property in Calgary, Alberta with a cost of $175,000 and a FMV of $315,000. The cost of the land is $52,000 and the FMV is $70,000. The capital cost of the building is $123,000, the FMV $245,000 and the UCC $91,400. During the current year, Mrs. Rand emigrates from Canada (ceased to be a resident of Canada). What are the current and possible future income tax consequences of the emigration with respect to the rental property?

Answer: As real property is exempt from the deemed disposition rules of ITA 128.1(4)(b), there would be no immediate income tax consequences with respect to the rental property at the time of emigration. However, real property is "Taxable Canadian Property" and, as a consequence, she would be liable for Canadian income tax on both the recapture and capital gains resulting from a subsequent sale of the property, even though she would be a non-resident at that time.

Type: ES

Topic: International - immigration & emigration

60) Mr. Jordan Koch owns shares in a Canadian private company with an ACB of $115,000 and a FMV of $240,000. In addition, he owns a rental property with a FMV of $105,000 ($27,000 of this can be attributed to the land and $78,000 to the building) and a cost of $200,000 ($55,000 of this can be attributed to the land and $145,000 to the building). The UCC of the building is $121,000. During the current year, Mr. Koch emigrates from Canada (ceases to be a resident of Canada).

Calculate the minimum and maximum net income that could result from the emigration.

Answer:

**Maximum Net Income -** With respect to the shares of the Canadian private company, there would be a automatic deemed disposition, resulting in a taxable capital gain of $62,500 [(1/2)($240,000 - $115,000)]. As the rental property is "Taxable Canadian Property", there would be no automatic deemed disposition at the time Mr. Koch's ceases to be a resident of Canada.

**Minimum Net Income -** While there would be no automatic deemed disposition on the rental property, Mr. Koch could elect under ITA 128.1(4) to have a deemed disposition. The result would be a terminal loss on the building of $43,000 [$121,000 - $78,000] and an allowable capital loss on the land of $14,000 [(1/2)($55,000 - $27,000)]. These amounts can be used to offset all but $5,500 ($62,500 - $43,000 - $14,000) of the taxable capital gain on the shares.

Type: ES

Topic: International - immigration & emigration

61) For many years, Dakota Fox was a resident of Israel. However, in 2021, she concludes that she would like to move to an area with a cooler climate and was offered employment in Canada which she promptly accepted. She became a resident of Canada shortly after her acceptance of the Canadian employment offer. At that time, her capital properties consist of Canadian land which she purchased on a previous visit to research living in Canada, and shares in an Israeli utility company. The ACB of the land is $125,000 and its FMV $200,000. The ACB of the shares is $85,000 and the FMV $115,000.

While she is in Canada, she purchases shares of a Canadian company, Grizzly Bare Inc. for $55,000. In 2023, after finding Canadian winters to be too severe, she decides to move back to Israel at ceased to be a resident of Canada re-establishing residence in Israel. At this time the FMV of her properties are as follows:

Canadian Land $250,000

Israeli Company Shares 135,000

Grizzly Bare Inc. Shares 70,000

What are the income tax consequences of Dakota's emigration from Canada in 2023?

Answer: In the absence of ITA 128.1(4)(b)(iv)], there would be an automatic deemed disposition of both the Israeli shares and the Canadian shares at the time of Dakota's emigration from Canada. However, as she has been in Canada for less than 60 months in the last 10 years, there will be no deemed disposition of the Israeli shares that she owned prior to her immigration to Canada. There will however, be a deemed disposition of the Canadian shares acquired during her stay. This will result in a taxable capital gain of $7,500 [(1/2)($70,000 - $55,000)] There will be no deemed disposition of the Canadian land because real property is exempt from the automatic deemed disposition of ITA 128.1(4)(b). Note, however, that vacant land is "Taxable Canadian Property". This means that any gain resulting from its disposition will be subject to Canadian income tax, without regard to whether she is a Canadian resident or not.

Type: ES

Topic: International - immigration & emigration

62) Shelley Burns is a Canadian resident living in Sudbury, Ontario. In 2022, she earns $23,000 in business income through a permanent establishment (PE) located in a foreign country. Business income tax of $2,300 was charged on that income. All amounts are in Canadian dollars. Assume that her marginal combined federal/provincial/territorial income tax rate is 42% and that the foreign tax credit is equal to the foreign tax withheld. Determine her after tax retention and overall income tax rate on her foreign source business income.

Answer: The gross amount of the foreign business income will be subject to income tax in Canada. Shelley's income tax liability would be calculated as follows:

Gross Foreign Business Income $23,000

Rate 42%

Canadian Income Tax Payable before Credit $ 9,660

Foreign Tax Credit (Given) ( 2,300)

Net Canadian Income Tax Payable $ 7,360

Foreign Tax Withheld 2,300

Total Income Taxes Payable $ 9,660

Based on these amounts, her after tax retention and overall income tax rate would be as follows:

After Tax Retention ($23,000 - $9,660) $13,340

Overall Income Tax Rate ($9,660 ÷ $23,000) 42%

Type: ES

Topic: International - foreign business income [of Canadian residents]

63) Subco is a 100% owned foreign subsidiary of Parco, a resident Canadian company. In 2022, Subco earns $250,000 of investment income and pays 15% foreign income tax on this income. None of the after tax income is paid out as dividends in 2022. What is the effect of this on Parco's 2022 net income?

Answer: Subco is a controlled foreign affiliate (CFA) of Parco. Given this, Parco is required to accrue its proportionate share (100%) of Subco's investment income. The required calculation is as follows:

FAPI [ITA 91(1)] $250,000

Deduct Lesser of:

• FAPI = $250,000

• ITA 91(4) Deduction [(4)(15%)($250,000)] ( 150,000)

Addition to 2022 Net Income $100,000

Type: ES

Topic: International - FAPI

64) Subco is a 100% owned foreign subsidiary of Parco, a resident Canadian company. In 2022, Subco earns $250,000 of investment income and pays foreign income taxes of 15% tax on this income. In 2023, Subco distributes its net after-tax FAPI of $212,500 [$250,000 - (15%)($250,000)] to Parco as a dividend. There are no withholding taxes on the dividend payment. What is the effect of the foreign dividend payment on Parco's 2023 net income?

Answer: The required calculation is as follows:

Foreign Source Dividend — ITA 90(1) $212,500

Deduct Lesser of:

• Previous FAPI after ITA 91(4) Deduction = $100,000

• Dividend Received = $212,500 ( 100,000)

2023 Addition to Net Income $112,500

Type: ES

Topic: International - FAPI

65) A U.S. gun cabinet manufacturer is considering entering the Canadian market. The company will use one of the following approaches to expand its market in Canada:

A. Advertising in gun magazines.

B. Selling cabinets to Canadian distributors. The distributors pay the shipping costs on the cabinets from the U.S. port or border crossing closest to them.

C. Direct sales to wholesalers by non-exclusive agents. The agents will represent other suppliers.

D. Direct sales to wholesalers by full-time salespeople in each of three regions of Canada. No sales offices will be opened, and the cabinets will be shipped from a warehouse in the U.S. Shipment will be made only after a customer's credit and contract are approved by the U.S. head office.

E. Direct sales to wholesalers by full-time salespeople who report to a sales office in each of three regions of Canada. The sales offices will coordinate marketing and shipping of products from two warehouses located in Canada. However, formal approval of contracts will be administered by the U.S. head office.

F. The sales offices described in Part E would be independent profit centres, with regional credit managers. The four warehouses from which orders are filled will be near the sales offices.

**Required**: For each market expansion approach, determine whether or not the U.S. manufacturer will have a permanent establishment (PE) in Canada. Justify your assessment, and identify any other information required to support your position.

Answer:

A. Advertising in gun magazines would not result in a PE as there is no fixed place of business in Canada.

B. Selling cabinets to Canadian distributors would not result in a PE, as there is no fixed place of business in Canada. As well, the orders are filled from a U.S. warehouse and customers pay for shipping from a U.S. port or border. This would be proof that no fixed place of business exists in Canada.

C. Direct sales to wholesalers by non-exclusive agents would not result in a PE as there is most likely no fixed place of business in Canada. The agents are independent, and do not work exclusively for the U.S. gun cabinet manufacturer. More information is needed on where orders are filled from and on where contracts are approved. If the orders are filled in the U.S., the manufacturer would not be deemed to have a PE in Canada.

D. Direct sales to wholesalers by full-time salespeople would probably not result in a PE because contracts are approved in the U.S. As well, orders are filled from a warehouse in the U.S., again indicating that the business does not have a PE in Canada. While there are no sales offices, the full-time salespeople could be considered to provide permanence to the business arrangement. Questions to ask include:

• Do the full-time salespeople work from their homes and vehicles?

• Can a home or vehicle be considered a PE?

• Is the business listed in telephone directories in Canada?

A case could be made that there is a Canadian PE. However, the fact that contracts have to be approved in the U.S. would likely override this conclusion.

E. Sales offices in each region lend permanence to the Canadian business. Also, filling of orders from Canadian warehouses would also indicate that there is a PE in Canada. But, as formal approval of contracts is controlled by the U.S. head office, a strong argument could be made that there is no PE. Also, because the fixed place of business appears to be used solely to either store or maintain goods for delivery, the Canada/U.S. income tax treaty would likely deem the fixed place of business not to be a PE. Questions should be asked about where goods are manufactured or purchased, and where the business is administered. For example, where are bank accounts located and books of account maintained? If virtually all business is administered in Canada, a Canadian PE is assured.

F. Independent profit centres would likely be assessed as having a PE in Canada as this would be a natural extension of the U.S. business. Further, management and control appears to be in Canada. Orders are filled from Canadian warehouses, lending strong support to the Canadian PE position. Questions should be asked about where contracts are approved and where the business is administered (bank accounts, collections, and books of account).

Type: ES

Topic: International - comprehensive problem: permanent establishments (PE)

66) Each of the following independent cases involves a non-resident individual who has Canadian income in the current year. All amounts are in Canadian dollars.

***Case A***

Hebert Haman is a resident of a country that does not have an income tax treaty with Canada. He owns debt securities issued by a Canadian company that pay interest at a rate that is determined by the profits of the company. During the current year, he receives interest of $1,672 from this investment.

***Case B***

Kerri Kmetz is a resident of a country that does not have an income tax treaty with Canada. During the current year, Kerri receives $6,350 in dividends from a Canadian private company. Kerri owns 20% of the company's voting shares.

***Case C***

Eddy Beale is a resident of the United States. He owns debt securities that were issued by a Canadian public company. The interest rate on the securities is determined by the level of profits earned by the company. During the current year, he receives interest of $1,865.

***Case D***

Tyrell Rodi is a resident of a country that does not have an income tax treaty with Canada. During the current year he earns $1,562 of interest on a savings account in Canada.

***Case E***

Stephen Chow is a resident of a country that does not have an income tax treaty with Canada. He is the owner of a vacation property on Vancouver Island that he rents to Canadian residents. His gross rents for the current year are $56,000. Expenses related to the property, including maximum CCA, are $18,000.

**Required:** For each of these situations, indicate how the Canadian income would be taxed under the ITA if at all. Explain your conclusion.

Answer:

***Case A***

Hebert is a resident of a country that does not have an income tax treaty with Canada. In addition, the interest is paid on participating debt. Given these facts, the interest would be subject to Part XIII tax at the 25% rate which would equal $418 [(25%)($1,672)].

***Case B***

While the Canada/U.S. income tax treaty reduces the Part XIII rate on dividends, Kerri is a resident of a country that does not have an income tax treaty with Canada. Given this, the $6,350 in dividends would be taxed at the full 25% Part XIII rate resulting in tax of $1,587.50 [(25%)($6,350)].

***Case C***

While the interest is being paid on participating debt, Eddy is a resident of the U.S. The Canada/U.S. income tax treaty exempts U.S. residents from Part XIII tax on all interest payments. Eddy would not be subject to Part XIII tax and no Canadian income tax would be payable. The analysis first requires looking to Part XIII which in this case would apply. The next step is to determine the impact of the income tax treaty which overrides Part XIII preventing its application to U.S. residents.

***Case D***

Part XIII tax only applies to interest if the interest is paid on participating debt or is paid to a non-arm's length non-resident. The debt is not participating and Tyrell is at arms' length with the Canadian bank. Given this, Part XIII tax would not apply and there would be no Canadian income tax.

***Case E***

As Stephen is not a resident of a country with which Canada has an income tax treaty, he would be subject to Part XIII tax at a rate of 25% on the gross rents. This would require a payment of $14,000 [(25%)($56,000)]. Alternatively, he could elect to be taxed under Part I on his rental income of $38,000 ($56,000 - $18,000). The Part XIII tax as a percent of his rental income is 36.8% ($14,000 ÷ $38,000). The 2022 federal income tax rate would be 22.2% [(15%)(1.48)] making the election to apply Part I instead of Part XIII preferable.

Type: ES

Topic: International - Part XIII tax on non-residents

67) Ms. Norah Houston is employed by a large, publicly-traded Canadian company. She is a Canadian citizen and resident and, for all of her life, she has been living and working in Canada. She does not have a spouse, common-law partner, or dependants. In 2022, her employer asks her if she would be willing to transfer to their Australian office. As she believes that she will have more challenging work in Australia, she agrees to the move. Both Ms. Houston and the company expect this move to be permanent.

On July 31, 2022 she closes all of her Canadian bank accounts. This includes a savings account on which she has received interest of $3,500 in 2022 prior to her departure.

On August 1, 2022, she opens bank accounts in Sydney. Interest on her Australian savings account during the rest of 2022 was earned at a rate of $500 per month. (All amounts given in this problem are in Canadian dollars.)

On August 1, 2022 she departs from Canada. However, because she has taken no time off in several years, she spends the month of August visiting various cities in southeast Asia. She arrives in Australia and establishes residence on September 1, 2022.

Ms. Houston's annual salary for 2022 is $144,000, with monthly payments of $12,000. Because she had accumulated vacation credits, her payments were not altered by the time she spent traveling in August.

Ms. Houston lived in a rented condo and was able to cancel the lease prior to her departure on August 1, 2022. No cancellation payment was required.

At the beginning of 2022, Ms. Houston owned shares in three Canadian public companies. All of these shares were sold prior to her departure, resulting in the following capital capital gains and capital losses:

• The sale of Cando Ltd. resulted in a capital gain of $27,300.

• The sale of Darcy Inc. resulted in a capital loss of $14,500.

• The sale of Marganto Ltd. resulted in a capital loss of $6,800.

Prior to her departure, Ms. Houston was carrying on a mail order business as a sole proprietor out of her condo. On July 31, 2022, she ceased to carry on the business. For the period January 1 through July 31, 2022, she realized a business loss of $27,000.

In 2022, Ms. Houston made support payments to her former spouse of $2,000 on the first day of each month until the individual died in a mysterious boating accident on August 28, 2022. She made a deductible contribution to her Canadian RRSP in the amount of $8,800 on May 1, 2022. The RRSP was not collapsed on Ms. Houston's departure from Canada.

**Required:**

A. Determine Ms. Houston's residency status for 2022 and explain your conclusion.

B. Calculate Ms. Houston's 2022 net income that will be included in her final income tax return as a result of her ceasing be a resident of Canada and any net capital loss or non-capital loss balances. Ignore any possible implications related to the Canada/Australia income tax treaty.

Answer:

***Part A***

As Ms. Houston appears to have severed all residential ties with Canada and she and her employer do not anticipate that she will return in the foreseeable future, it does not appear that she will be considered a Canadian resident after her move to Australia.

Administratively the CRA will consider an individual to have ceased being a resident of Canada as of the latest of:

• the date they leave Canada,

• the date their spouse, common-law partner and/or other dependants leave Canada, and

• the date they become a resident of the country to which they are immigrating.

Assuming that Ms. Houston wishes to take advantage of the CRA administrative position then the latest of these dates of September 1, 2022 will be considered the day she became a resident of Australia meaning that the last day of Canadian residency would be August 31, 2022. This means that she will be considered to be a resident of Canada for the period January 1 through August 31, 2022.

***Part B***

Based on this analysis, the net income for the short taxation year ending August 31, 2022 would be as follows:

Income Under ITA 3(a):

Employment Income while Canadian Resident

[($12,000)(8 Months)] $96,000

Canadian Interest Income 3,500

Australian Interest Income while Canadian Resident

[($500)(1 Month)] 500 $100,000

Income Under ITA 3(b):

Taxable Capital Gains [(1/2)($27,300)] $13,650

Allowable Capital Losses [(1/2)($14,500 + $6,800)] ( 10,650) 3,000

ITA 3(a) + (b) $103,000

Subdivision e Deductions [($2,000)(8) + $8,800] ( 24,800)

ITA 3(c) amount $ 78,200

Deduction Under ITA 3(d):

Business Loss ( 27,000)

2022 Net Income $ 51,200

There would be no 2022 net capital loss or 2022 non-capital loss.

Type: ES

Topic: International - comprehensive problem: emigration, part year & net income

68) Horace Richards, a resident of Nova Scotia, plans to emigrate from Canada on December 31, 2022 at which time he will cease to be a resident of Canada. On that date, he owns the following:

**Savings Account -** The balance in this account is $85,600.

**Residence -** This property was purchased for $130,000, including $45,000 for the land and $85,000 for the building. Its FMV on December 31, 2022 is $240,000, including $60,000 for the land and $180,000 for the building.

**Cottage -** This property was purchased for $345,000, including $95,000 for the land and $250,000 for the building. Because a large nearby development has flooded the market with low price cottages, it has a FMV on December 31, 2022 of $300,000, including a value for the land of $50,000 and a value of $250,000 for the building. Horace has rented out this property since its purchase and reported a small amount of rental income every year. He has never claimed CCA on the property.

**SUV -** Horace owns a Honda SUV that cost $35,000. Its FMV on December 31, 2022 is $18,000.

**RRSP -** The December 31, 2022 balance in Horace's RRSP is $186,000.

**Shares of a CCPC -** Horace is a minority shareholder of a CCPC. The CCPC owns and manages five apartment buildings. More than 80% of the FMV of the shares is derived from the value of these buildings. The ACB of the shares is $87,000 and they have a December 31, 2022 FMV of $123,000.

**Shares of Public Companies -** Horace owns a portfolio of publicly traded shares which have an ACB of $120,000 and a FMV on December 31, 2022 of $135,000.

**Required:**

A. For each of the listed properties, indicate the income tax consequences, including any amounts of deferred income, that would result from Horace's ceasing to be a resident of Canada. Assume that he does not make any elections at the time of his move with respect to any of the property he owns on December 31, 2022. Ignore the capital gains deduction.

B. Under ITA 128.1(4)(d), taxpayers can elect a deemed disposition on certain property that would otherwise be exempt from the deemed dispositions that automatically apply when an individual ceases to be a resident of Canada. Determine if Horace could use an election to minimize his income tax liability. If he can, calculate the amount of the reduction in his net income.

Answer:

***Part A***

Assuming no election is made, the result of Horace's ceasing to be a resident of Canada would have the following income tax consequences and/or deferred income for each of the listed properties:

**Savings Account -** There would be no income tax consequences and no deferred income associated with this account.

**Residence -** As the residence is "Taxable Canadian Property", there would be no deemed disposition on Horace's ceasing to be resident in Canada. Given this, there would be no immediate income tax consequences. However, there would be a deferred gain calculated as follows:

**Land Building**

FMV $60,000 $180,000

ACB ( 45,000) ( 85,000)

Capital Gain $15,000 $ 95,000

Inclusion Rate 1/2 1/2

Deferred Taxable Capital Gain $ 7,500 $ 47,500

As this real property is Taxable Canadian Property, a future disposition would be subject to Part I tax even after Horace ceases to be a Canadian resident.

**Cottage -** As the cottage is "Taxable Canadian Property", there would be no deemed disposition on ceasing to be a resident of Canada. Given this, there would be no immediate income tax consequences. However, there would be a deferred loss calculated as follows:

**Land Building**

FMV $50,000 $250,000

ACB ( 95,000) ( 250,000)

Capital Loss/Terminal Loss ($45,000) Nil

Inclusion Rate 1/2

Deferred Allowable Capital Loss ($22,500) Nil

As this real property is Taxable Canadian Property, a future disposition would be subject to Part I tax even after Horace is no longer a Canadian resident.

If he continues to rent the cottage, a 25% Part XIII tax will apply to the gross rents received once he becomes a non-resident. Horace can also elect to have the rental income taxed separately under Part I. This may be preferable in that he can deduct expenses against the gross rents if he makes this election.

**SUV -** As this SUV is personal use property, the loss arising from its deemed disposition would not be deductible. There would be no income tax consequences.

**RRSP -** Unless Horace decides to collapse this plan prior to ceasing to be resident in Canada, there will be no income tax consequences. However, future withdrawals, subsequent to terminating his Canadian residency, would be subject to Part XIII tax.

**Shares -** There would be a deemed disposition of the CCPC and public company shares resulting in the following taxable capital gains:

**CCPC Public Company**

FMV $123,000 $135,000

ACB ( 87,000) ( 120,000)

Capital Gain $ 36,000 $15,000

Inclusion Rate 1/2 1/2

Taxable Capital Gain $ 18,000 $ 7,500

Taxable Canadian Property includes a share of an unlisted corporation, if, at any time within the preceding 60 months, more than 50% of the FMV of the share or interest was derived from certain properties including Canadian real property. The CCPC shares are therefore Taxable Canadian Property. As a result, any additional gain on the disposition of these shares would be subject to Canadian income tax even though Horace is no longer a Canadian resident.

The total inclusion in 2022 net income that results from Horace's emigration can be calculated as follows:

CCPC Shares $18,000

Public Company Shares 7,500

Total 2022 Additional Net Income $25,500

Horace can pay the related income tax when he files his income tax return for the year of departure. However, he is not obliged to pay the income tax until he actually disposes of the shares [note that this deferral requires an election under ITA 220(4.5)]. Further, he is not required to post security for the estimated income tax payable as the total taxable capital gains of $25,500 are within the $50,000 exemption.

***Part B***

The ITA 128.1(4)(d) election could be used to trigger a deemed disposition on the principal residence and/or the cottage. Horace should elect to have a deemed disposition on both properties.

With respect to the residence, the gain resulting from such a deemed disposition could be completely eliminated by designating it as his principal residence.

With respect to the cottage, the loss resulting from the deemed disposition could be used to offset the gains on the CCPC and public company shares. The result would be as follows:

Additional Income before Election $25,500

Allowable Capital Loss on Cottage ( 22,500)

Revised Additional Net Income $ 3,000

The use of the election would decrease net income by $22,500.

With respect to future years, both the residence and the cottage are Taxable Canadian Property and, when they are sold, any gains would be subject to Part I tax. The deemed dispositions have resulted in an increase (principal residence) and reduction (cottage) in the ACB of the properties. The revised ACB would be used to determine the capital gain or capital loss on the subsequent actual dispositions.

Type: ES

Topic: International - comprehensive problem: emigration, part year & net income

69) The following foreign properties are owned by different Canadian taxpayers. All amounts are in Canadian dollars. For each property, determine whether the foreign property reporting rules apply. Explain your conclusions.

A. Shares in a U.S. public company with a cost of $317,000 and a current FMV of $84,000. One-half of these shares were purchased in the taxpayer's Canadian brokerage trading account and the other half were purchased in the taxpayer's self-directed RRSP.

B. A condo in Palm Beach, Florida, purchased for $425,000. The condo is rented to Canadians for 8 months of the year and used by the individual taxpayer the remaining 4 months.

C. A yacht with a cost of $725,000 which was purchased and is docked in Seattle, Washington. The yacht is used by an individual taxpayer from Calgary for his legendary monthly parties.

D. A cottage in Cape Hatteras, North Carolina, purchased for $100,000 cash down, and assumption of a $400,000 mortgage. The cottage is used by the individual taxpayer and his family throughout the year.

E. A warehouse in Livonia, Michigan, with a cost of $1,250,000, owned by a Canadian corporation, and used to store its products for distribution as part of its active business in the U.S.

F. A U.S. bank account and a mortgage resulting from the sale of a farm in North Dakota to a U.S. resident three years ago. The original amount of the mortgage was $120,000. However, the amount owing at the beginning of the current year is $55,000. The taxpayer's bank account in a U.S. bank has a balance of between $5,000 and $10,000 throughout the year.

Answer:

A. Foreign property reporting is required for the shares held outside of the RRSP. The cost of one-half of the shares is greater than $100,000 [(1/2)($317,000) = $158,500]. The current FMV is not relevant. Specified foreign property held in an RRSP is excluded from foreign reporting requirements.

B. Foreign property reporting is required. The condo is primarily a rental property and its cost is greater than $100,000.

C. Foreign property reporting is not required since the yacht is personal use property.

D. Foreign property reporting is not required. Since the cottage is personal use property, the fact that the total cost of the Cape Hatteras cottage is greater than $100,000 is not relevant.

E. No foreign property reporting is required when property is used in an active business.

F. Foreign property reporting is not required. The total of the amount owing on the mortgage for the current year ($55,000) and the highest balance in the U.S. bank account for the year ($10,000) do not exceed $100,000.

Type: ES

Topic: International - foreign property reporting rules - ITA 233.3 (T1135)

70) Amy Borody works and resides in Winnipeg, Manitoba. In 2022, Ms. Borody has diversified her investment portfolio by investing in shares of a German company through her Canadian registered securities dealer. The cost of her German company shares total €50,000. Ms. Borody owns a rental property in Munich, Germany which cost €400,000 in 2021. She has a bank account in a German bank. Its balance fluctuates from €500 to €25,000 during 2022. Its year end balance is €10,000.

In 2022, she earned the following amounts of investment income:

Dividends from German Public Corporations

Net of 15% Withholding € 5,100

Interest on Bank Account € 2,000

Gross Rental Income from Munich Apartment €30,000

Rental Expenses for Munich Apartment €12,000

The dividends are net of German withholding taxes of 15%. Ms. Borody has left the interest in her German bank account and has not transferred it to Canada.

As Ms. Borody does not claim CCA on the rental property, all of the rents and related expenses can be converted to Canadian dollars using the 2022 exchange rate.

Assume that the exchange rate throughout 2022 was €1 = $1.45.

**Required:** Indicate the amounts of investment income that would be included in Ms. Borody's 2022 net income, as well as any tax credits that would be available to her.

Answer: As a Canadian resident, Ms. Borody would be subject to Canadian income tax on her worldwide income. This would include all of the German investment income. The amounts to be included in her net income for 2022 would be as follows:

**Dividends -** Since 15% was withheld from the dividends, the gross dividend income totals €6,000 (€5,100 ÷ 85%). Converted to Canadian dollars, the amount to be included in Ms. Borody's net income would be $8,700 [($1.45)(€6,000)]. The German dividends will not be grossed up as would be eligible dividends received from public Canadian corporations. They would also not give rise to a dividend tax credit. The foreign income tax withheld would generate a foreign tax credit against income tax payable of $1,305 [($1.45)(€6,000 - €5,100)].

Since the withholding tax is not more than 15%, all of the withholding can be used in the foreign tax credit calculation. The problem does not provide Ms. Borody's Division B Income or her Income Tax Payable, therefore the full calculation for the foreign tax credit cannot be done.

**Interest -** The interest income would be converted to Canadian dollars and the amount included in Ms. Borody's net income would be $2,900 [($1.45)(€2,000)]. The fact that it has not been paid from the German bank account is irrelevant as she is subject to Canadian income tax on her worldwide income.

**Rental Income -** The amount to be included in Ms. Borody's net income would be based on the rental income of €18,000 (€30,000 - €12,000). Converted to Canadian dollars, this amount would be $26,100 [($1.45)(€18,000)]. As no German income taxes were withheld, there would be no foreign tax credit available with respect to this amount.

Type: ES

Topic: International - foreign property income (of Canadian residents)

71) Matt Farcus is a Canadian resident who is employed on a full time basis in Ottawa. He has the following additional income in 2022:

Employment Income $83,600

Taxable Capital Gains 6,850

Eligible Dividends 17,460

Dividends from Foreign Companies before Foreign Income Tax:

Foreign Country 1 - GB Ltd. ($6,500 of foreign income tax) 26,000

Foreign Country 2 - GR Ltd. ($1,350 of foreign income tax) 13,500

He has the following potential taxable income deductions available for 2022:

2020 Net Capital Loss Balance $13,100

2020 Non-Capital Business Loss balance 9,850

His only personal tax credits are the BPA, employment related credits, and any credits related to the dividends received.

**Required:** Determine Matt's 2022 federal income tax payable.

Answer: The GB Ltd. withholding equals 25%($6,500 ÷ $26,000) of the dividend paid. The GR Ltd. tax withholding equals 10% ($1,350 ÷ $13,500) of the dividend paid.

As the foreign non-business tax credit is limited to 15%, the additional 10% (25% - 15%) withheld by Foreign Country 1 will have to be deducted in the determination of Matt's 2022 net income under ITA 20(11).

Employment Income $ 83,600

Taxable Capital Gains 6,850

Eligible Canadian Dividends 17,460

Gross Up [(38%)($17,460)] 6,635

GB Ltd. Dividends (No Gross Up) 26,000

GR Ltd. Dividends (No Gross Up) 13,500

Excess CPP ($3,500 - $3,039) ( 461)

Excess Withholding [(25% - 15%)($26,000)] ( 2,600)

2022 Net Income $150,984

2020 Net Capital Loss \* ( 6,850)

201 Non-Capital Loss ( 9,850)

2022 Taxable Income $134,284

\* The net capital loss carry forward is limited to the $6,850 of taxable capital gains.

Using this result, Matt's 2022 Taxable Income would be calculated as follows:

Tax on first $100,392 $17,820

Tax on next $33,892 ($134,284 - $100,392) at 26% 8,812

Income Tax Payable before Credits $26,632

BPA ($14,398)

EI ( 953)

CPP ( 3,039)

Canada Employment ( 1,287)

Total Credit Amount ($19,677)

Applicable Rate 15% ( 2,952)

Tax Otherwise Payable $23,680

Eligible Dividend Tax Credit [(6/11)($6,635)] ( 3,619)

Foreign Tax Credits (See Note)

GB Ltd. (See Note) ( 3,900)

GR Ltd. (See Note) ( 1,350)

2022 Federal Income Tax Payable $14,811

**Note** - The foreign non-business tax credits are calculated on a country by country basis (see Chapter 11).

For use in the following formula, the Adjusted Division B Income that would be used in the foreign tax credit formula would be equal to $144,134 ($150,984 - $6,850). Note that the 2020 non-capital loss is not deducted in this calculation. The Tax Otherwise Payable that would be used in the foreign tax credit formula would be before the dividend tax credit.

The tax credit on the GB Ltd. shares would be the lesser of:

• Amount Withheld (Limited to 15%) = [(15%)($26,000)] = $3,900

• [(Foreign Non-Business Income

÷ Adjusted Division B Income)(Tax Otherwise Payable)]

= ($26,000 ÷ $144,134)($23,680) = $4,272

The tax credit on the GR Ltd. shares would be the lesser of:

• Amount Withheld (10%) = $1,350

• [(Foreign Non-Business Income

÷ Adjusted Division B Income)(Tax Otherwise Payable)]

= ($13,500 ÷ $144,134)($23,680) = $2,218

Type: ES

Topic: International - comprehensive problem: foreign dividends, foreign tax credits and net & taxable income of a Canadian resident individual