



NOVEMBER 2008

NOTICE TO READER

The following commentary has been prepared by Parker Garber & Chesney, LLP based on information available to the public on the date of publishing.

Readers are cautioned that this commentary is informational only and that any issues specific to the reader's needs be addressed with the appropriate tax professional.

The reader is cautioned that this document is not meant to provide advice specific to the reader's particular situation and that advice cannot be given in such a manner.

CORPORATE TAX

ONTARIO CORPORATE TAX INSTALMENTS

It should be noted that, with the integration of the Ontario Corporations Tax Branch with the Canada Revenue Agency (CRA) effective for 2009, all corporate instalments for Ontario for fiscal years ending after December 31, 2008 should be remitted to CRA and not the Ministry of Finance.

TAX RATES

2008 – 2012 PERSONAL TAX RATES (ONTARIO)

	2008	2009	2010	2011	2012
Income	46.41%	46.41%	46.41%	46.41%	46.41%
Employment & Other	23.96%	23.06%	23.65%	25.33%	26.74%
Dividends - eligible	31.34%	31.34%	31.34%	31.34%	31.34%
Dividends – non-eligible	23.20%	23.20%	23.20%	23.20%	23.20%
Capital gains					

2008 – 2012 CORPORATE TAX RATES (ONTARIO)

	2008	2009	2010	2011	2012
Small business	17.00%	16.50%	16.50%	16.50%	16.50%
Manufacturing	31.50%	31.00%	30.00%	28.50%	27.00%
General business	33.50%	33.00%	32.00%	30.50%	29.00%
Investment income	48.67%	48.67%	48.67%	48.67%	48.67%

The Ontario small business limit increased to \$500,000 effective January 1, 2008. The Federal limit remains at \$400,000.

US REAL ESTATE HOLDINGS

THE IMPACT OF HOLDING US REAL ESTATE

There are many factors to consider when purchasing US real estate for personal use. The main concern is the impact of US estate tax if a taxpayer owns US real estate on their death. We have discussed the impact of US estate and gift taxes in previous issues (see March 2007 and May 2008). There are a number of alternatives available for the ownership of property, each of which has its pros and cons.



JOINT-TENANTS WITH RIGHT OF SURVIVORSHIP

This is a very common method for Canadians to own personal property in Canada such as a principal residence or vacation property. However, for US tax purposes this is not recommended because the IRS will deem the whole value of the property to estate of the first to die and it is then incumbent on the estate to prove that the survivor has contributed to the purchase and upkeep of the property in which case the IRS would pro-rate accordingly. This could be an onerous undertaking to demonstrate the source of funds, especially if there were co-mingled to begin with.

Another problem is this would produce a double-tax as the full value of the property would be taxed again when the survivor dies.

TENANTS-IN-COMMON

This is also a well-known Canadian method for owning property. It can be used in the case of US property in limited circumstances such as when the spouse owning the property has a small total estate and both wills create a trust on death to keep the property out of the estate of the survivor. It can also be useful where the children are on title rather than, or with the parents and the parents pay rent to the children (this can be by way paying the operating expenses for the property). This transfers the estate tax liability to the next generation but could be a problem if the children do not get along but does provide for a substantial minimization of the impact of the estate tax.

INDIVIDUAL OWNERSHIP

In the event that the property is held in one individual's name proper estate planning would include having the will create a testamentary trust for the surviving beneficiaries. It is recommended that a separate will be prepared to deal with this property so that an independent trustee (not a beneficiary) can be named in order to avoid restrictions under US law. If the estate is substantial it would be possible to defer the tax until the death of the surviving spouse by creating a qualified domestic trust (QDOT).

USING A CANADIAN CORPORATION

Prior to the changes in the tax treaty to allow a recognition of US estate tax for Canadian tax credits it was common for Canadians to use a single-purpose company to hold the property. Although the IRS expressed the opinion that they would not recognize these companies the risk was considered minor and for the most part was unwarranted. CRA supported the use of these companies until the treaty changes took place and have further agreed to grandfather any structures in existence at that time.



However, on a going forward basis these companies will not be recognized by CRA and further, the tax exposure can be considerable. The most significant issue is that the gain on sale within the corporation would attract a tax of up to 40% versus the rate of 15% if held outside the corporation.

INSURANCE AND MORTGAGES

Using life insurance to fund the estate tax may be useful but it does require careful planning including using a life insurance trust.

A non-recourse mortgage is excellent protection for reducing the estate tax exposure but it may be more difficult to obtain in this economic environment.

USING A TRUST

The use of a trust to hold a vacation property has a number of benefits if structured properly. The settlor cannot be a beneficiary but the spouse and children can. If the spouse were to die the settlor would have to pay rent to the trust for personal use. Problems will arise if the settlor has no spouse (remember under US law common-law and same-sex spouse do not qualify), if the settlor and spouse divorce then there may be issues to address. These can be considered in the terms of the trust. The 21-year rule applies so that there would have to be a distribution at that time or a deemed realization.

USING A PARTNERSHIP

Another option is to use a partnership or limited liability corporation (LLC) to hold the property. In order to avoid US estate tax the partnership should be a Canadian partnership and should be created before purchasing the property. The parents should not control the partnership (this can be addressed in the document) and, in the event of the death of a partner, the partnership must elect with the IRS to be treated as a corporation for US tax purposes. This election must take place within 75 days of death.

INCOME TAX ISSUES

If a property is rented in the US the rent is subject to 30% withholding tax as it is being paid to a non-resident. This can be eliminated by electing to treat the income as "effectively connected" but does result in the necessity to file a US tax return. CRA may not allow a complete offsetting credit of the withholding because the credit is based on a formula using the net income from US property.

When a property is sold in the US by a non-resident there is a withholding tax of 10% of the gross proceeds. This can be reduced by completing a waiver request and submitting to the IRS before closing so that the withholding is restricted to 10% on the gain.

