



January 2012

Inside This Issue

1 Preview of
February 28, 2012
Breakfast Seminar

1 Survey Says

2 -3 Information for
Canadian Residents
Receiving German
Social Security

4 Joint Ventures –
Elimination of Fiscal
Period

*This newsletter is
prepared by the Canada
Revenue Agency (CRA)
for the Toronto Centre
CRA & Professionals
Group*

Preview of February 28, 2012 Breakfast Seminar

Surviving an international tax audit - Current issues, best practices and dispute resolution

Geri Porteous, Manager, International Advisory Services, Compliance Programs Branch, Canada Revenue Agency

Blair Vokey, Regional International Tax Advisor – Ontario, Compliance Programs Branch, Canada Revenue Agency

Patricia Spice, Director, Competent Authority Services, Compliance Programs Branch, Canada Revenue Agency

Douglas A. Cannon, Partner, McCarthy Tétrault LLP

Paul F. Mulvihill, Partner, Ernst & Young LLP

The panel will discuss a range of international tax compliance topics, including transfer pricing and arbitration under the Fifth Protocol to the Canada-US Tax Convention.

Current Cases

Cliff Rand, Partner, Stikeman Elliott LLP

Eric Noble, General Counsel, Department of Justice

Our discussion of current cases will include an update on recent decisions, including the Supreme Court of Canada judgment in the *Copthorne Holdings Ltd. v. Her Majesty the Queen (F.C.) (33283)* appeal.

Survey Says

Once again we would like to thank you for taking the time to share your thoughts. The survey is a valuable tool that is used to identify future newsletter topics and breakfast seminar presentations and inform our decisions around our general approach. The highest rated topic from the November Seminar was A Conversation with Associate Chief Justice Rossiter.

Some of your comments on the Seminar and presenters:

"Open and enthusiastic speaker, refreshing!"

"Very interesting 'behind the scenes' view"

Contact Us

We are always looking for issues to discuss. If you have any questions, comments or suggestions concerning the topics presented in this newsletter, or would like a topic addressed, please email us at

TCTSO-TPG@cra-arc.gc.ca

Please note that your email address will not be shared and is strictly for the use of the Toronto Centre CRA & Professionals Group.

Information for Canadian residents who receive social security pensions from Germany

This Notice is intended to provide assistance to Canadian resident recipients of German social security pensions. The Canada Revenue Agency has made every effort to ensure the accuracy of all comments and examples regarding Germany's tax laws and tax administration contained in this Notice. However, should there be any inconsistency between this notice and the German tax law and tax administration positions, the German position will prevail. We urge you to consult the German web site at the link provided below for further information.

Under German law, Canadian residents who receive German social security pensions must file a German tax return to determine their tax liability to Germany. Germany is issuing "requests to file" to Canadian residents who received such pension in the 2005 to 2009 tax years.

How to report the pension in Germany

The taxpayer is required to report the German social security pension on form ESt1C including annex R. For more information on completing forms, go to the German Web site <http://www.finanzamt-rente-im-ausland.de/en/> or contact the tax office in Neubrandenburg. You can also contact them as follows:

- **Mail:** Finanzamt Neubrandenburg (RiA)
Postfach 11 01 64
17041 Neubrandenburg, Germany
- **Telephone:** 01149-395-44222-47000
- **Fax:** 01149-395-44222-47100
- **Email:** ria@finanzamt-neubrandenburg.de

As a non-resident of Germany you are only taxable in Germany on your income from sources in Germany and you are not entitled to claim any personal allowances to reduce your tax liability. However, you may be able to elect to be treated as if you were a resident of Germany and benefit from certain allowances.

If you elect to be treated as a resident of Germany you will be required to report your income from all sources (both inside and outside of Germany).

While you are not taxable on your income from all sources, it will be taken into consideration to determine the tax rate that will be used to calculate your tax liability on your income from sources in Germany.

You are entitled to make such an election if at least 90% of your income from all sources is taxable in Germany or if your income that is not subject to German tax is less than the basic personal allowance in Germany.

The basic personal allowance in Germany for 2005 is €6,136 and increased to €7,664 for 2008, €7,834 for 2009 and €8,004 for 2010 and onwards. In calculating your income from all sources, with respect to your Old Age Pension (OAS), Canada Pension Plan (CPP), and Quebec Pension Plan (QPP), you only include the taxable portion according to German tax law.

Example 1

Mary is a resident of Canada. In 2010, she receives a German social security pension of €16,000 and the equivalent of €800 in interest from a Canadian bank. These are Mary's only sources of income and she has been receiving the same amount of German pension since 2005.

Under German tax law, 50% of Mary's German social security pension is taxable in Germany because the pension began in 2005 (the base amount was established in 2006, and pension payments have not changed since then).

Mary wishes to determine if she is eligible to reduce her German taxes by making an election to be treated as a German resident. She can make the election if she satisfies either of the following tests:

- at least 90% of her income from all sources must be taxable in Germany; or,
- her income that is not subject to German tax must be less than the basic personal allowance in Germany (€8,004 for 2010).

Mary's income from all sources under German tax law is €8,000 + €800 = €8,800. Since her income that is subject to tax in Germany represents at

Continued....

least 90% of her income from all sources (€8,000 / €8,800 = 90%) and her Canadian interest income that is not subject to Germany tax (€800) is less than the basic personal allowance of €8,004 she satisfies both tests.

Example 2

In 2010, Peter, a Canadian resident receives a German social security pension of €4,800. In addition, Peter receives OAS and CPP equivalent to €11,000. These are Peter's only sources of income and he has been receiving the same amounts since 2004.

Under German tax law, 50% of Peter's German social security pension is taxable because the pension began before 2005 (the base amount was established in 2006, and pension payments have not changed since then).

Peter wishes to determine if he is eligible to reduce his German taxes by making an election to be treated as a German resident. He knows that he can make the election if his income that is not subject to German tax is less than the basic personal allowance in Germany. In this case, his income that is not subject to German tax is 50% of his Canadian OAS and CPP payments received in the year (i.e., €5,500).

Peter can make the election if he satisfies either of the following tests:

- at least 90% of his income from all sources must be taxable in Germany; or,
- his income that is not subject to German tax must be less than the basic personal allowance in Germany (€8,004 for 2010).

Peter's income from all sources under German tax law is €2,400 + €5,500 = €7,900. Since his income subject to tax in Germany does not represent at least 90% of his income from all sources (€2,400 / €7,900 = 30%) he does not satisfy the first test.

However, he does satisfy the second test since his income that is not subject to German tax (i.e., €5,500) is less than the basic personal allowance in Germany.

Making an election

If you decide to make the election available under the German law to be treated as if you were a resident of Germany, you will need to fill out a Non-EU/EEA Certificate, have it certified by the CRA, and attach it to your non-resident German tax return.

Note: The certificate is required **only** if you meet the 90% test or if your income that is not subject to German tax is below the basic personal allowance for the particular year and you make the election. You can also make the election by filing a resident tax return (form ESt1A including annex R).

A tax return for a particular year in Germany must be filed by May 31 of the following year. For example, the filing date for the tax return for 2010 was May 31, 2011. Once your return is processed by the German tax authorities, a notice of assessment showing your German tax liability will be issued by the tax office in Neubrandenburg. Make sure you keep the notice for your records. You might be asked to prove to the CRA how much German tax you paid.

How to report the pension in Canada

The amount that is taxable in Germany is the same amount that will be taxed in Canada. You must include the full amount of pension received on line 115 of your Canadian tax return and claim a deduction of the base amount on line 256.

To eliminate double taxation on your German social security pension, you may claim a foreign tax credit against the tax otherwise payable in Canada for the tax paid to the German tax authority.

With respect to tax years that you have already filed a Canadian tax return for, or for any future tax years, you will need to request a reassessment of your Canadian tax return once you have received your notice of assessment for the German tax payable. Contact your local tax services office to request a reassessment of your Canadian tax return to allow your eligible claim for any foreign tax credit.

Joint ventures - Elimination of fiscal period

At the 1989 Canadian Tax Foundation Conference, the CRA announced it would allow, on an administrative basis, a joint venture to establish a fiscal period that may differ from the fiscal periods of the joint venture participants where the participants have different fiscal periods and there is a valid business reason that justifies a separate fiscal period for the joint venture. As a result, the income earned by a taxpayer as a participant (participant taxpayer) of the joint venture has been allowed to be included in the participant taxpayer's income for its tax year in which the fiscal period used by the joint venture ends.

What's new?

On March 22, 2011, the 2011 Budget proposed to limit the tax deferral opportunities for certain corporations with significant interests in partnerships where the partnership fiscal period is different from the corporation's tax year.

On November 29, 2011, the CRA announced that joint ventures will no longer have a fiscal period. Therefore, participant taxpayers who entered into joint venture arrangements will no longer be eligible to compute income as if the joint venture had a separate fiscal period. For tax years ending after March 22, 2011, income from a joint venture will be required to be calculated for each participant taxpayer based on the fiscal period of the particular participant taxpayer.

Impact on joint venture participants

This may result in the inclusion of significant incremental income of a participant taxpayer of a joint venture for the first tax year of the participant taxpayer ending after March 22, 2011. Accordingly, for the first tax year that ends after March 22, 2011, the CRA will allow, on an administrative basis, transitional relief similar to the relief under amended section 34.2 of the *Income Tax Act*) for **qualifying transitional income** to members of partnerships.

The income that may generally qualify for this transitional relief will be based on the actual additional income for the stub period to the extent the amount would not have otherwise been included in income for the first tax year of the participant taxpayer that ends after March 22, 2011. This transitional relief will generally result in no additional income being included in the first tax year of the participant taxpayer in the joint venture. Instead, the participant taxpayer will bring the additional income into its income over the five tax years that follow that first tax year in a manner similar to the reserve mechanism as provided for under amended section 34.2. In general, and subject to the conditions as similarly stipulated under amended section 34.2, the reserve mechanisms will effectively allow the participant taxpayer to include 15% of additional income in 2012, 20% in 2013, 2014 and 2015, and 25% in 2016.

Which participants are impacted

For tax years ending after March 22, 2011, all participant taxpayers of joint ventures will be expected to include in income all amounts that had been deferred as a result of fiscal periods that differed from the tax years of the participant taxpayer, including those structures in which the participant taxpayer has taken the position that income was deferred as a result of tiered structures.

Transitional relief

To avail itself of this joint venture transitional relief for the first tax year ending after March 22, 2011, a participant taxpayer will be required to file an election in writing, on or before the filing due date for that tax year, by attaching a letter to their return of income for that tax year. The letter should indicate that the participant taxpayer is including income from the joint venture for which it is seeking transitional relief. If a return has already been filed or is filed electronically, to be eligible a participant taxpayer will be required to send a letter to their Tax Centre indicating their election to benefit from this administrative policy in respect of transitional relief.

Impact of not reporting the accrued income

Failure to report all the accrued income in a participant taxpayer's first tax year that ends after March 22, 2011 in accordance with this administrative policy will result in the participant taxpayer's ineligibility for transitional relief.

Reporting requirements for partnerships

In circumstances in which a partnership is a participant in a joint venture, for the first fiscal period of the partnership ending after March 22, 2011, the income from the joint venture (including any deferred income) will be required to be included in the computation of the partnership's income for that fiscal period. This income will be computed in accordance with the provisions of the *Income Tax Act* (for example, subsection 96(1) and amended section 249.1).

What if you did not rely on the former administrative policy?

This administrative policy, which allows for transitional relief, is not available to participant taxpayers of joint ventures who did not rely on the former administrative policy to calculate income based on the fiscal period established by the joint venture.