INCOME FROM PROPERTY (PROPERTY INCOME)

What is property income?

- Income from investments, where **little or no effort** is needed to generate the income (also called passive income)
- Examples of property income:
    - Rent
    - Interest
    - Dividend
    - Royalties
- Capital gains are not considered property income
- Note that a person who is in the business of earning these passive income (such as a property management company), would treat these as business income rather than property income

Rules specific to property income

1. When property income is being earned, you cannot use **CCA** to create or increase a **"property loss"**
    - For example, a person may earn rent revenues; this person cannot use the CCA on the building being rented out to create or increase a rental loss
2. No requirement to prorate CCA on depreciable capital assets for shortened tax years
3. For **corporations** property income (with the exception of dividends from taxable Canadian corporations), are not eligible for the **small business deduction**. They are taxed as **aggregate investment** income at a rate of 34.67% federal with a refundable portion of 26.67% (see corporate tax notes)
4. For individuals **property income** is subject to **attribution rules** (see attribution notes)

Interest Income: Individuals and Corporations

- Both individuals and corporations MUST use the **accrual basis** when reporting interest income; however, the accrual method used for corporations differs from individuals
    - Corporations – must accrue the interest income earned up to the end of yearend
    - Individuals – only report interest income **every anniversary date** on an accrual basis; and report this interest income in taxation year that every anniversary date falls.
        - The anniversary date = one year less one day
        - i.e. June 26, 2011 to June 25, 2012

- **The following example will help you understand this concept:**
    - **CORPORATION:** Suppose on January 23, 2013, ABC incorporated invests in a $100,000 bond with 10% interest payable annually. Suppose the yearend is December 31.
        - Interest income for 2013 = 100,000*10%*(342/365) = $9,370

        - Note how even though, no cash was received, this corporation still needed to accrue interest income

    - **INDIVIDUAL:** Suppose on January 23, 2013, Mr. Smith invests $100,000 bond with 10% interest payable annually.
        - Individuals also need to accrue; but unlike a corporation which needs to accrue to the year end, an individual only needs to accrue and report income only in the taxation year where the anniversary date falls.
        - Therefore, since the anniversary date will be January 22, 2014 **and** Mr. Smith received no interest income in cash, Mr. smith does not need to report any interest income for 2013.
        - Interest income reported in 2013 = $NIL
        - Mr. Smith will report $100,000*10%*365/365 = $10,000 in his 2014 personal tax return (since the anniversary date, January 22, 2014, falls in the 2014 tax year)

Dividend Income: Individuals and Corporations

Individuals

- Two things happen when individuals get dividends
    - When individuals get dividend income they need to **gross up** their dividends and include this amount in property income
    - Individuals also get a **Dividend Tax Credit** to lower taxes payable

- CRA taxes dividends like this because they want to achieve **integration**:
    - **Integration: how does it work?**
        - Suppose you have Mr. Smith who is a sole proprietor and sells shoes. He earns $100,000 in business income.
        - Suppose Mr. Jones, is the owner of a corporation Jones Co. that sells shoes. Jones Co. earns $100,000 in business income
        - With the dividend gross up and dividend tax credit, CRA's goal is such that:

          Taxes Mr. Smith pays on his business income = the total taxes paid by Jones Co. + the taxes paid by Mr. Jones on dividends from Jones Co.

        - **Therefore, integration, is there to set a level playing field between people who choose to incorporate and people who choose not to.**

        - Since dividends are paid after tax, the gross up serves the purpose of getting the dividends to a before tax amount; and the dividend tax credit theoretically is the taxes that the corporation already paid.

- **Eligible vs. non-eligible dividends and capital dividends**
  - **Eligible dividends** = dividends paid by public Canadian companies, CCPC's who paid dividends from active business income taxed at the general rate (not the small business rate)
    - In short, in the paying corporation is a CCPC; this is dividends paid out of the General Rate Income Pool (GRIP) – see corporate tax notes
    - Eligible dividends get taxed at a more favourable rate at the personal tax level – approx. **30% (in the highest tax bracket) for 2012 in Ontario**
  - **Non-Eligible Dividends** = all other dividends (except for capital dividends)
    - Non-eligible dividends are taxed at higher rates; approx. **33% (in the highest tax bracket) for 2012 in Ontario**
  - **Capital Dividends** = dividends that are paid out of the capital dividend account (generally the accumulated non taxed portion of net capital gains and ECP gains)– see notes corporate taxes notes
    - These are tax free for the recipient

Summary of Gross up and Dividend Tax Credit: 2012 taxation year

	Gross Up	Grossed Up Dividend (div + GU)	Federal Dividend Tax Credit
Eligible Dividends	38%	138%	6/11 * gross up Or 15% of the grossed up dividend
Non-Eligible Dividends	25%	125%	2/3*Gross Up or 13.33% of the grossed up dividend

- In the 2013 Federal Budget there is a proposal to decrease the gross up factor for non-eligible dividends from 25% to 18% and the dividend tax credit (DTC) from 2/3*the gross-up amount to 13/18*the gross-up amount
- At the highest federal tax bracket, the effective tax on non-eligible dividends will increase from 19.58% to 21.22%

	Before 2013	2013
NE Dividends	100	100
Gross Up	25	18
Grossed-up Dividends	**125**	**118**
Top Federal Tax Rate	29%	29%
Federal Tax on Dividends	**36.25**	**34.22**
Dividend Tax Credit	(16.67)	(13.00)
Net Tax	**19.58**	**21.22**

Foreign Corporation Dividends:

- If individuals receive dividends from foreign (non-Canadian resident) corporations, then the gross up and dividend tax rule does not apply
- Its treated just like interest income

Corporations

- If a corporation receives dividends from a Canadian taxable corporation; the dividend is included in division B income and deducted under division C in arriving at taxable income
  - Therefore, dividends from Canadian taxable corporations are not part of taxable income and not taxed
  - CRA did this to avoid double taxation
- No gross up or dividend rules for corporations; just a simple division c deduction

- However, if a corporation receives dividends from foreign corporations, the dividend is treated just like interest and it is taxed!

Rental Income

Special Rules for CCA:

- Each rental building that costs **$50,000 or more** needs to be placed in a separate CCA class for calculating CCA deduction, CCA recapture, and terminal loss
  - This is done because CRA knows that buildings generally appreciate in value; and by having it in a separate class, you will likely have a CCA recapture when you sell the building
- You **cannot create or increase a rental loss** with CCA; however, you can claim CCA of one building against income generated by another building