

## Sections 1-2

Author : admin

[Income Tax Act](#), *An Act Respecting Income Taxes*, R.S.C., 1985 c.1 (5th Supplement), as amended

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1. **Short Title** – This Act may be cited as the *Income Tax Act*.

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### Part I – Income Tax

**Policy & Principles:** Part I is the only part of the Act that is further divided into Divisions (10 of them) and subdivisions (Divisions B and E). It is also the only part that is a true income tax. The other parts are more accurately thought of as discrete taxes applicable in particular circumstances.

The structure of Part I follows the manner of calculating the amount of income tax payable under the Part by individuals, trust, corporations, and partnerships. Division A determines who is liable to tax. Division B sets out the rules of measuring a taxpayer's income (net income), while Division C sets out the rules for determining "taxable income". Division D deals with non-residents and the taxable income they earn in Canada. Division E sets out the rules for calculating tax, and contains the tax credits and tax rates. Division E.1 contains the minimum tax provisions, while Division F contains a set of special rules in certain circumstances (e.g. bankruptcies, mutual fund trusts, etc). Division G deals with special income arrangements (RRSP, TFSA, etc), Division H contains exemptions, and Divisions I and J deal with administrative and appeals matters.

### Division A – Liability for Tax

**Policy & Principles:** Division A consists of one section assigning liability to tax. The provisions assigning liability for tax set three of the fundamental parameters of an income tax: (1) the "tax unit" as the "person", (2) the "tax period" as the "taxation year", (3) the "tax base" (the amount that the tax rates are applied to) as "taxable income" [further defined in s 3]. The tax base for resident and non-resident persons is different. The difference represents a limitation on the theoretically universal taxing jurisdiction on the basis of economic allegiance to a jurisdiction. Canadian

The tax base for resident and non-resident persons is different. The difference represents a limitation on the theoretically universal taxing jurisdiction on the basis of economic allegiance to a jurisdiction. Canadian tax-residents (not the same as immigration residence) are liable to tax on all their income both inside and outside of Canada - they are taxable on their world-wide income. This is because the factors that reflect a person's tax residence are those that are also seen as indicating a person's economic allegiance to Canada. Non-resident persons are taxable only on their Canadian source income because their allegiance to Canada is not seen as extending beyond the income they earn from Canada. For more see [IncomeTaxAct.ca- Who pays tax on what?](#).

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**2. (1) Tax payable by person resident in Canada** – An income tax shall be paid, as required by this Act, on the taxable income for each taxation year of every person resident in Canada at any time in the year.

#### **Related Provisions:**

[ITA](#): 2(2) – calculation of taxable income; 3 – Income for taxation year; 94(3)(a)(i) – Application to trust deemed resident in Canada; 96 – Partnerships and their members; 104 – Trusts and estates; 114 – Residents for part of year; 126 – Foreign tax credit; 127.5 – Alternative minimum tax; 149 – Exempt persons; 150 – Filing of Returns; 250 – Extended meaning of resident; 255 – Canada.

[ITR](#): 401-414– Computation of taxable income; 1300-1302 – Elections in respect to taxpayers ceasing to be resident in Canada

#### **Definitions:**

[ITA](#): 2(2) - “taxable income”; 249 - “taxation year”; 248(1) - “person”, “Canadian resident partnership”, “non-resident”, “taxable income” (cannot be less than nil); 250 generally, 250(1) – Person deemed resident, 250(3) – Ordinarily resident, 250(4) – Corporation deemed resident

[Interpretation Act](#): 5 – “Canada”; 35(1) “Canada”

[Income Tax Conventions Interpretation Act](#): 4 – Permanent establishment in Canada

#### **Government Documents:**

**Folio:** [S5-F1-C1](#): Determining an Individual's Residence Status (replaced IT-221R3); [S6-F1-C1](#): Residence of a trust or estate (replaced IT-447);

**Interpretation Bulletin:** [IT-106R3](#): Crown corporation employees abroad;

**Guides:** [T4131](#): Canadian residents abroad; [T1248](#): Schedule D, Information about your residency status; P151: Canadian residents going down south;

**Income Tax Technical News:** [No. 38](#): Canada-US Treaty's Competent Authority Provision; [No. 33](#): Permanent Establishment- The Dudley Case Update; [No. 25](#): E-Commerce

**Rulings:** 2005-0116031E5; 2009-0332851M4; 2011-0407961E5; 2012-0453461I7; 2014-0547641E5; 2015-0580471E5

**Other:** Travel Canada Doc: [Taxation For Canadians travelling, living or working abroad](#).

**Notes:** Canadian resident persons are liable to pay income tax on their worldwide income sources (note with space being a source of income for some taxpayers, such income would also be taxable). Income from outside of Canada attracts the foreign tax credit (s 126) and the Act's rules are modified by any relevant tax treaty provisions between Canada and the source jurisdiction. Losses from international income can be used to reduce Canadian-source income.

In contrast to residents, non-residents are subject to income tax only on their Canadian-sourced income (ss 2(3), 115, 212, 216-19), subject to tax treaties between Canada and their resident state. Tax residence is not the same as immigration residence. Canadian citizens and permanent residents are taxed, when a non-resident for tax purposes, exactly the same as any other non-resident. Passive income sources of non-residents are taxed under Part XIII.

Tax residence is a question of fact determined under common law rules. These rules are subject to deeming provisions (s 250) or treaty tie-breaker rules (see Article IV of OECD Model Treaty). The residence of corporations and trusts are determined through the application of the "central management and control test", which looks at the persons who in fact control the corporation or trust which may be different from where legal control lies (*Fundy Settlement v Canada*, [2012 SCC 14](#)).

A person can be a tax resident of more than one state (*Black v The Queen*, [2014 TCC 12](#), aff'd [2014 FCA 275](#), application for leave to appeal to SCC denied, [2015 CanLII 22996](#) (SCC)) and, absent a tax treaty, will be subject to taxation in both states. A person cannot use a tax treaty to both claim to be a non-resident under a treaty and to be a resident under the Act (s 250(5)). For more see notes under s 250.

The Federal Government's power to impose the income tax is found in section 91 of the [Constitution Act, 1867](#), under subsection 3 which gives it the power of "The Raising of Money by any Mode or System of Taxation". Numerous challenges to the Federal Government's power to impose an income tax have been unsuccessful. See for example *Caron v Canada*, [\[1924\] UKPC 66](#) (JCPC); *Heckendorn v Canada*, [2005 FC 802](#), aff'd [2006 FCA 407](#); *Randall v The Queen*, [2008 TCC 621](#); *Cridge v Canada*, [2016 FCA 87](#).

For an analysis of various free-man-on-the-land, detaxer, and other Organized Pseudo-legal Commercial arguments and their invalidity see *Meads v Meads*, [2012 ABQB 571](#); *Cassa v The Queen*, [2013 TCC 43](#); *Dillon v The Queen*, [2013 TCC 242](#); *Bloom v Canada*, [2010 FC 621](#); *Burse v Canada*, [2015 FC 1307](#). See further Mark Tonkovich, "[Render Unto Caesar: Using the Freedom of Conscience and Religion to Challenge Canadian Taxes](#)" (2015) 34:2 National Journal of Constitutional Law 121.

Income tax flows from the operation of the provisions of the Act and a court cannot make an order that would prevent the operation of the Act's provisions to render income not taxable (*Canadian Red Cross Society, Re*, [2006 CanLII 22141](#) (ON SC)).

**(2) Taxable income** – The taxable income for a taxpayer for a taxation year is the taxpayer's income for the year plus the additions and minus the deductions permitted by Division C.

**Related Provisions:**

[ITA](#): 2(1) – Tax payable by person resident in Canada; 2(3) – Tax payable by non-resident persons; 3 – Income for taxation year; 15.1(2)(c) – Issuer of small business development bond; 56(1) – Amounts to be included in income for the year; 110.5 – Additions for foreign tax deductions; 248(1) – “taxable income” (cannot be less than nil); 261(7) – Functional currency reporting

**Statutory Definitions:**

[ITA](#): 248(1) – “taxpayer”; 249 – Taxation year

[Interpretation Act](#): 37(1) – Construction of “year”

[Income Tax Conventions Interpretation Act](#): 6.1 – Transitional

**Notes:** This subsection provides the definition for taxable income for purposes of subsection 2(1) by reference to the taxpayer's income as determined by the other provisions of the Act.

**(3) Tax Payable by non-resident persons** – Where a person who is not taxable under subsection (1) for a taxation year

(a) was employed in Canada,

(b) carried on business in Canada, or

(c) disposed of taxable Canadian property,

at anytime in the year or a previous year, an income tax shall be paid, as required by this Act, on the person's taxable income earned in Canada for the year determined in accordance with Division D.

**Related Provisions:**

[ITA](#): 4 – Income or loss from a source or from sources in a place; 18(4) – Limitation on deduction of interest; 94(3)(a)(i) – Liabilities of non-resident trusts and others; 96(1.6) – Members deemed carrying on business; 110(1)(f)(i) – social assistance exempt by treaty; 111(9) – Exception; 114 – Individuals resident in Canada for only part of year; 115(1) – Non-Resident's taxable income in Canada; 115(2)(a)-(d) – Non-resident deemed employed in Canada; 120(1) – Federal surtax on non-resident's income not earned in a province; 153(1)(g) – withholding on certain payments to non-residents; 212-229 – taxation of non-residents; 217(3) – Taxable income earned in Canada; 250.1 – Non-resident person's taxation year in income; 253 – Extended meaning of carrying on business; 255 – Canada.

[ITR](#): 105 – Non-residents; 202 – Payments to non-residents; 800-809 - Non-resident taxes;

## Definitions:

[ITA](#): 94(3)(a) – “resident in Canada”; 115(2)(d) – “employed in Canada”; 248(1) – “business”, “disposition”, “employed”, “person”, “property”, “taxable Canadian property”, “taxable income”; “taxable income earned in Canada”; 249 – Taxation year; 253 – employed  
[Interpretation Act](#): 5 – “Canada”; 35(1) “Canada”; 37(1) – Construction of “year”  
[Income Tax Conventions Interpretation Act](#): 4 – Permanent establishment in Canada

## Government Documents:

**Folios:** [S5-F1-C1](#): Determining an individual’s residence status [replaced IT-221R-3]

**Interpretation Bulletin:** [IT-113R4](#): Benefits to employees – stock options; [IT-168R3](#): Athletes and players employed by football, hockey and similar clubs; IT-171R2: Non-resident Individuals – computation of taxable income earned Canada and non-refundable tax credits [cancelled]; [IT-176R2](#): Taxable Canadian property – Interests in and options on real property and shares; [IT-262R2](#): Losses of non-residents and part-year residents; IT-298: Canada-US Tax Convention – number of days “present” in Canada [cancelled]; [IT-379R](#): Employees profit sharing plans – allocations to beneficiaries; [IT-393R2](#): Election re tax on rents and timber royalties – non-residents; [IT-420R3](#): Non-residents – Income earned in Canada; [IT-421R2](#): benefits to individuals, corporations and shareholders from loans or debt; [IT-434R](#): Rental of real property by individual.

**Guides:** [NR73](#): Determination of residency status (leaving Canada); [NR74](#): Determination of residency status (entering Canada); [T1-NT12](#): Residency information for tax administration agreements; [T1248](#): Schedule D, Information about your residency status; [T2062](#) – Notice by a non-resident of Canada of concerning the disposition or proposed disposition of Canadian taxable property; [T4058](#): Non-residents and temporary residents of Canada.

**Income Tax Technical News:** [No. 44](#) – Services provided by a US resident to a Canadian subsidiary of a US customer, Services provided by a US employee to a Canadian subsidiary; [No. 41](#) – Meaning of “Business”, Provincial Income Allocation – Section 400 of the *Income Tax Regulations*; [No. 35](#) – Treaty Residence – Residence of convenience; [No. 34](#) – Permanent Establishments, Treaty Interpretation and the meaning of “liable to tax”; [No. 33](#) – Permanent Establishment – The *Dudney* Case Update; [No. 25](#) – E-Commerce.

**Rulings:** 2004-0082661R3, 2009-0307001R3; 2010-0383661R3; 2010-0386191M4; 2011-0426551R3; 2012-0441941E5; 2012-0459481E5.

**Notes:** Non-resident persons are subject to income tax only when, anytime in a year or previous year, they engaged in one of the three enumerated activities. A person who was resident in Canada in a previous year may be deemed to be employed in Canada in respect to certain amounts paid by a Canadian resident (ss 115(2)(c) and (d)).

A person carries on business in Canada when the activities meet the definition of “business” in 248(1) expanding the common law definition of “anything which occupies the time and attention and labour of a man for the purpose of profit is business” (*Smith v Anderson* (1880), 15 CH D 247 (CA); *Graham v Green (Inspector of Taxes)*, [1995] 2 KB 37). This is extended by s 253 for non-resident persons and trusts. The common law distinction between income from business versus income from property is applicable here (*Lois Hollinger v MNR*, [1972] CTC 592

(FCTD; 71122 *Ontario Ltd. v Sagaz Industries Canada Inc.*, [2001 SCC 59](#)). Where interest income is the core of a taxpayer's activities as part of an investment holding business, the interest income will be income from a business carried on in Canada and not income from property (*Inter-leasing Inc v Ontario (Revenue)*, [2014 ONCA 575](#)).

Similarly, the common law rules that differentiate between contractors and employees are relevant when dealing with non-resident individuals. Where a person is an independent contractor and they are resident in a treaty jurisdiction, they won't be taxable unless they have a permanent establishment in Canada (*Wolf v Canada*, [2002 FCA 96](#)).

Passive income not meeting the definition of business is subject to a withholding tax under Part XIII of the Act on a gross basis (ss 212(1), 214(1)). The income sources subject to Part XIII tax are rents, royalties, interest, dividends, management fees [etc]. Under these circumstances the tax is withheld and remitted by the Canadian resident payor (s 215). The non-resident is not required to file a return, though in some circumstances the non-resident may be permitted to file a return to be taxed on a net basis (ss 216-217).

Where the non-resident is resident in a country that has a tax treaty with Canada, the treaty will modify the rules in the Act. For business income, most treaties raise the bar for being taxable in Canada to requiring that the non-resident carry-on business through a permanent establishment in Canada. Tax treaties generally lower the withholding rates on passive income and can have rules that determine where a taxpayer is employed and income is sourced.

***Sas Ansari, BSc BEd PC JD LLM PhD (exp) CPA In-Depth Tax 1, 2 & 3***

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