Weekly Updates Issue # 559

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1. Weekly Markets Changes

[April 8, 2016]

S&P TSX	S&P 500	Dow Jones	NASDAQ	CAD/USD	Gold	WTI Crude
13,396.73 -43.71 -0.33%	2,047.60 +5.69 +0.28%	17,576.96 -215.8 -1.21%	4,850.69 -63.85 -1.30	$0.7702 +0.14¢ +0.18%	$1,240.10 +16.50 +1.35%	$39.72 +3.09 +8.44%

2. Labour market surges despite Calgary, Edmonton data

[April 8, 2016] Canada's labour market surged when it came to full-time and private-sector work last month, which helped drive down the national unemployment rate to 7.1%, says Statistics Canada.

The agency's latest labour force survey says Canada generated 40,600 net new jobs in March, pushing down the national unemployment rate from 7.3% in February. This is largest month-over-month increase recorded since 43,100 jobs were added in October.

The data also shows:

- 35,300 of March's net new jobs were full time;
- 65,100 jobs were created in the private sector;
- public-sector positions fell by 2,600; and
- 74,700 net new positions were in the services sector.

Even in Alberta, the provincial unemployment rate fell to 7.1% in March, compared to 7.9% in February, thanks to more retail and wholesale trade positions. This change came despite the fact the jobless rate rose in both Calgary and Edmonton—Calgary's unemployment rate rose to 8.6%, reaching its highest mark in at least 20 years, while the rate crept up to 6.9% in Edmonton.

Statistics Canada cautions the figures for individual cities may fluctuate widely because they are based on small samples. Still, a consensus of economists had been predicting the country would add only 10,000 net jobs and that the unemployment rate would stay at 7.3%, according to Thomson Reuters. Compared to 12 months earlier, Canada added 129,600 net new jobs, an increase of 0.7%.

On the downside, the country's youth unemployment rate crept up 13.4% last month, from 13.3% in February. The data also shows self-employed positions across Canada reached last month 22,000 while the net number of employee jobs increased by 62,600.

3. Housing starts dip

[April 8, 2016] In March, housing starts dropped, says the Canada Mortgage and Housing Corporation. The trend measure of starts was 196,783 units, compared to 201,618 in February.

"Starts [fell] in March due to a slowdown in multi-unit construction," says Bob Dugan, CMHC chief economist. The only exception was British Columbia, "where declining inventories of new and unsold units, as well as low levels of new listings in the resale market, spurred builders to start new projects."

The standalone monthly SAAR for all areas in Canada was 204,251 units in March, down from 219,077 units in February. In particular, the SAAR of urban starts decreased by 7% in March to 185,022 units, while multiple urban starts decreased by 9.7% to 123,207 units. Single-detached urban starts decreased by 1.1% to 61,815 units.

Overall, in March, the seasonally adjusted annual rate of starts decreased in British Columbia, Québec, Atlantic Canada and the Prairies, but increased in Ontario.

Rural starts were estimated at a seasonally adjusted annual rate of 19,299 units.

4. ECB worried low inflation becoming ingrained

[April 7, 2016] Officials at the European Central Bank worried weak inflation was becoming ingrained in the economy when they launched more stimulus last month — and said they were ready to do more if things don't pick up.

A written account of that March 10 meeting says "risks of second-round effects appeared to have increased" since the bank's previous meeting.

Second-round effects are when people expect low or falling prices, leading them to set lower wage and price agreements. That can be poison for the economy as it can depress spending and investment.

If inflation gets a further push downward from troubles with the global economy, the 25-member governing council "would not rule out future cuts in policy rates," the account says.

That would take rates down from current extreme lows. The bank lowered its main benchmark for short-term lending between banks to zero at the March meeting. It also lowered its penalty rate for banks that leave money at the central bank to minus 0.4%. That is aimed at pushing banks to lend the money instead of leaving excess funds at the central bank.

Officials at the U.S. Federal Reserve also took a cautious view of the global economy at their last meeting, minutes released Wednesday indicated. The Fed lowered its projection for rate increases this year to only two quarter-point hikes, from four. The Fed started raising rates in December, but since has held off amid fears about slowing growth in China and turmoil on stock and bond markets.

The decision on the ECB stimulus in March wasn't unanimous, however. It faced questioning from at least a few members on several key points.

The bank decided to step up its bond-buying program, offer new ultra-cheap loans to banks, cut its benchmark interest rate to zero, and increase penalties for banks that leave money at the central bank rather than lend it.

At least one skeptic said - more cheap loans to banks risked making them depending on central bank funding.

5. Home prices continue rising in key markets

[April 7, 2016] Canada's residential real estate market showed strong year-over-year price increases in the first quarter of 2016, according to the Royal LePage House Price Survey.

The Greater Vancouver and Greater Toronto Area (GTA) real estate markets continue to lead the country in home price appreciation, with Canada's economic landscape supporting robust housing demand in these metropolitan areas. Additionally, an emerging trend of inter-provincial migration to British Columbia and Ontario from commodity-focused economic regions such as Alberta is expected to put further upward pressure on home prices in these areas in the coming months.

Meanwhile in Quebec, the residential real estate market in the Greater Montreal Area is showing the most promising signs of renewal seen in recent years, posting home price increases and a noticeable surge in unit sales in the first quarter.

The report, based on proprietary property value data in 53 of the nation's largest real estate markets, shows that the price of a home in Canada increased 7.9% year-over-year to $512,621 in the first quarter of 2016. The price of a two-storey home rose 9.2% year-over-year to $629,177, and the price of a bungalow increased 6.8% to $426,216. During the same period, the price of a condominium increased 4.0% to $344,491.

In Alberta, year-over-year home price declines have trailed the drops in sales volumes that began in 2015, but are now starting to emerge in varying degrees across the province. Calgary, with its large population of oil company head-office professionals and less affordable housing, is expected to see more of a price adjustment during the year than will be seen in Edmonton, where prices remain relatively flat. In contrast, the GTA and Greater Vancouver markets are skewed in favour of the seller, with a shortage of inventory and growing demand putting upward pressure on prices.

The survey also showed a noticeable divergence between Canada's two hottest markets: while the GTA sustained its trajectory of an aggregate year-over-year home price increase in the 8% range (8.4%), the Greater Vancouver market accelerated at rarely seen appreciation levels, surpassing a 20% (21.6%) aggregate year-over-year home price increase for the region.

During the first quarter, the Greater Montreal Area real estate market saw signs of renewal, including a dramatic increase in home sales activity, which rose 9.4% year-over-year. In the luxury segment, when looking at condominiums in the $500,000 to $1-million range on the island of Montreal, the year-over-year increase in sales volume jumped to 23% for the quarter and for homes over $1-million, sales volume increased 14% year-over-year. With adequate supply to meet this increased demand, home prices showed moderate growth, posting a 1.8% year-over-year aggregate price increase in the region.

In addition to low interest rates, the low dollar, and an expanding U.S. economy, in the coming year, Montreal's housing market is expected to gain traction as a result of strong export performance driven by a steady recovery in the manufacturing and services sectors. Large infrastructure projects such as work on the Champlain Bridge and on the Turcot Interchange are also expected to contribute to local employment, with the Conference Board of Canada projecting that these two projects alone will reverse three years of decline in Montreal's construction sector.

Outside of British Columbia and Ontario, year-over-year changes in house prices were generally modest in the first quarter. In Atlantic Canada, Moncton saw the largest gains, posting an aggregate home price increase of 3.4%, while the remainder of the Atlantic regions surveyed saw slight to moderate declines. In other parts of Western Canada, Winnipeg home prices increased 3.8% year-over-year, while Regina and Saskatoon, feeling some of the impact of declines in commodity prices and net-migration, saw slight decreases of 1.1% and 0.3%, respectively.

6. Laid-off oil workers who moved provinces could face big tax bill

[April 7, 2016] When times were good, Canadians moved from across the country to the oilpatch in Alberta looking for work.

But crude prices collapsed last year, throwing thousands out of work.

That could mean big bills come tax time for those who returned to their home provinces before the end of last year.

David Steinberg, tax partner at EY, said if someone spent 10 months of the year in Alberta and then moved to New Brunswick, all of their 2015 income will be taxed at New Brunswick's generally higher rate.

"The rule is you're taxed in the province you resided on Dec. 31 of the year," Steinberg said.

The problem some may face is that employers generally withhold taxes on someone's paycheque based on where they are working.

But if they move to a higher-tax jurisdiction, they may not have deducted enough to cover the taxes that need to be paid in their home province.

That means a high-earning worker in Alberta who spent most of 2015 working in that province but lost their job and moved to Atlantic Canada before Dec. 31 could face a hefty bill.

Luann Jones-Foster, a tax partner at KPMG in Moncton, N.B., said just how costly that is depends on income and the difference between Alberta and the province people move to.

For someone who earned $125,000 last year in Alberta and then moved to New Brunswick, the bill could be around $5,650 for a single person with no other deductions, she said.

"Alberta versus Ontario, say for instance, is a little over $3,000 and Alberta versus B.C., interestingly enough, is only about $140," Jones-Foster said.

She noted that determining residency can be complicated, so if the difference in tax bills is big, people may want to seek professional advice if they moved late in the year.

"Sometimes it will be clear cut, but sometimes it won't be," she said.

Steinberg said people who moved may be able to claim moving expenses that would help offset part of the higher tax rate, but he noted there are rules governing what can be claimed.
People who don't have the money to pay their taxes when they file their return face interest charges, but the Canada Revenue Agency may be willing to work out a payment plan, he said.
"It is more than likely they will give you a payment plan if you are prepared to pay something," he said.

7. U.S. emerging as tax haven alongside Switzerland, Caymans

[April 6, 2016] The United States is emerging as a top tax haven alongside the likes of Switzerland, the Cayman Islands and Panama, those seeking reform of the international tax system say. And states such as Delaware, Nevada, South Dakota and Wyoming, in particular, are competing to provide foreigners with the secrecy they crave.
"There's a big neon sign saying the U.S. is open to tax cheats," says John Christensen, executive director of the Tax Justice Network.
America's openness to foreign tax evaders is coming under new scrutiny after the leak this week of 11.5 million confidential documents from a Panamanian law firm. The Panama Papers show how some of the world's richest people hide assets in shell companies to avoid paying taxes.
Christensen's group, which campaigns for a global crackdown on tax evaders, says the United States ranks third in the world in financial secrecy, behind Switzerland and Hong Kong but ahead of notorious tax havens such as the Cayman Islands and Luxembourg.
Under a 2010 law, passed after it was learned that the Swiss bank UBS helped thousands of Americans evade U.S. taxes, the United States demands that banks and other financial institutions disclose information on Americans abroad to make sure they pay their U.S. taxes.
But the U.S. doesn't automatically return the favour.
More than 90 countries have signed on to a 2014 information-sharing agreement set up by the Organization for Economic Cooperation and Development, but the U.S. is among the few that haven't joined. American banks don't even collect the kind of information foreign countries would need to identify tax dodgers.
"The banking lobby has resisted changes in the law that would allow more sharing of data," says Peter Cotorceanu, a Zurich-based lawyer who specializes in private banking.

In a report last year, the Tax Justice Network complained that "Washington's independent-minded approach risks tearing a giant hole in international efforts to crack down on tax evasion, money laundering and financial crime." It said foreign elites have "used the United States as a bolt-hole for looted wealth."

Pascal Saint-Amans, head of the OECD's Center for Tax Policy and Administration, says the U.S. often makes information available to other countries upon request. But that means countries can get details only on those they already suspect of tax evasion.

Christensen says Swiss banks report that "many of their tax-dodging clients are talking about moving to the U.S. You go to Switzerland, and that's all they're talking about."

Individual states, including Nevada, Wyoming and South Dakota, are making things worse, critics say.

They compete to make it easier to set up corporations, with few questions asked about who's behind the business. "We have states that set up corporations where there's no information about ownership," says Jack Blum, a Washington lawyer who specializes in financial crime.

Nevada, for instance, makes it easy to incorporate secretly and charges a $500 annual business license fee for corporations and $200 for other businesses. The money is earmarked for teacher salaries.

Many of the businesses are mere shells, financial contrivances that don't employ people or make any investments.

In 2014, a group of academics looked at tax havens for their book "Global Shell Games." Posing as investors who wanted to set up businesses in different places, they kept track of whether the consultants helping them incorporate asked for basic information such as photo IDs or other documents that proved who they were. In the United States, only 25% did; in Delaware, only 6%.

The U.S. Treasury Department says it plans to propose regulations requiring foreign-owned "limited liability companies" to get tax identification numbers disclosing the identities of their owners. Once the rules are in place, the department said in a statement, the Internal Revenue Service will be better equipped to respond to requests for help from foreign governments.

Still, Treasury says, Congress needs to come up with a broader, better solution. Lawyer Cotorceanu doubts that will ever happen.

American lawmakers "do not want to hurt the U.S.'s banking industry," he wrote last year in the journal Trusts & Trustees. "It is no secret that U.S. banks, particularly in Miami, are awash in undeclared Latin American money. … How ironic — no, how perverse — that the USA, which has been so sanctimonious in its condemnation of Swiss banks, has become the banking secrecy jurisdiction du jour."

8. Governments face fallout from offshore accounts report

[April 5, 2016] Governments around the world tried to contain the fallout from the publication of thousands of names of rich and powerful people who conducted offshore financial activity through a Panamanian law firm.

China dismissed reports that relatives of current and retired politicians, including President Xi Jinping, own offshore companies.

The state media are ignoring the reports, and search results for the words "Panama documents" have been blocked on websites and social media.

Iceland's prime minister has vowed to not resign despite thousands of angry protesters demanded he step down and call new elections. The leaks showed possible links to an offshore company that could represent a serious conflict of interest.

And Ukraine's president was accused of abusing his office and of tax evasion by moving his candy business offshore, possibly depriving the country of millions of dollars in taxes.

The reports are from a global group of news organizations working with the Washington-based International Consortium of Investigative Journalists. They have been processing the legal records from the Mossack Fonseca law firm that were first leaked to the German Sueddeutsche Zeitung newspaper.

Shell companies aren't by themselves illegal. People or companies might use them to reduce their tax bill legally, by benefiting from low tax rates in countries like Panama, the Cayman Islands and Bermuda. But the practice is frowned upon, particularly when used by politicians, who then face criticism for not contributing to their own countries' economies.

Because offshore accounts and companies also hide the names of the ultimate owners of investments, they can be used to illegally evade taxes or launder money.

Mossack Fonseca says it obeys all laws relating to company registrations and does not advise people how to evade or legally avoid taxes.

The firm says in a statement that "our industry is not particularly well understood by the public, and unfortunately this series of articles will only serve to deepen that confusion.

"The facts are these: while we may have been the victim of a data breach, nothing in this illegally obtained cache of documents suggests we've done anything wrong or illegal, and that's very much in keeping with the global reputation we've worked hard to build over the past 40 years of doing business the right way. "

Members of the Group of 20 — which includes China — have agreed on paper to tighten laws relating to shell companies and make sure authorities can find out who the real owners are. Actual legislation at the national level has lagged behind the promises, however.

China's Foreign Ministry spokesman Hong Lei says he would not discuss the reports further and declined to say whether the individuals named would be investigated. "For these groundless accusations, I have no comment."

Sueddeutsche Zeitung, working with NDR and WDR public television, reported Monday that 14 German banks had used Mossack Fonseca's services to set up 1,200 letterbox companies for clients.

The report says use of offshore company registrations had spiked after the European Union introduced regulations in 2005 requiring countries to exchange tax information on physical persons, but not for companies. Many of the accounts, however, have since been closed.

The EU has since tightened its rules on offshore companies under its Fourth Anti-Money Laundering Directive, which is being phased in as national governments pass local laws to comply by June 26, 2017. The new rules tighten requirements for companies to keep accurate information on their real owners and to make that available to authorities.

The appearance of offshore accounts in political scandals is far from new. Shell companies played a role in the Petrobras scandal in Brazil, in which bribes were allegedly funneled to politician's accounts from executives at the oil company and from construction companies. The U.S. Justice Department said in an indictment last year that offshore accounts were used to mask the transfer of bribes to officials at FIFA, the global soccer federation.

9. Investment fees — what's deductible?

[April 5, 2016] Fees can be deducted if they qualify on the following points:

- They have been paid for advice connected to the buying or selling of a specific investment
- They cover the cost of administering or managing an investment owned by the person making the claim
- They are not a commission
- They relate to advice on investments made in non-registered accounts. The CRA will deny a deduction of fees related to registered accounts including RRSPs, RRIFs, RESPs and TFSAs. An investor cannot circumvent this rule by charging fees related to a registered account to

a non-registered account. For the remainder of this article, when referring to investment management fees I mean deductible investment management fees related to a non-registered account.

Investment management fees are paid in different ways and the tax implications show up differently too. Investors in mutual funds do not pay fees directly; they pay a management expense ratio (or MER) that's built in so the fee is implicit. MERs are not disclosed separately on income tax slips or returns as mutual funds deduct the fees and report distributions net of fees. Investors in wrap accounts or separately managed accounts (for which annual or quarterly fees are charged for management of a portfolio) will pay fees directly so they are explicit. The amounts are deducted separately on income tax returns. For example, the investor reports gross income from his or her investment accounts and deducts investment management fees separately as a carrying charge.

Different payment methods, same results

No matter how these qualifying investment management fees are paid—meaning whether the fee is implicit or explicit in the investor's tax picture—the net results are the same. What follows is an example of the tax and investment consequences for an individual at a 45% tax rate who pays investment fees indirectly or directly. The first column assumes an investor is paying fees inside a mutual fund (indirectly). The second assumes the investor has a separately managed account and the payment is outside a fund (directly). The bottom line in both cases is identical. The investor ends up keeping the same amount of principal and after-tax income and paying the same amount of tax.

	Indirect	Direct	
Initial investment	100,000	100,000	
Realized income	10,000	10,000	
Less: MER @ 2.3%	(2,530)	—	
Net Asset Value (NAV)	107,470	110,000	
Distribution	(7,470)*	(10,000)	
Remaining investment	100,000	100,000	(A)
Income	7,470	10,000	
Management fee @ 2.3%	—	(2,530)	
Net income before tax	7,470	7,470	
Personal tax @ 45%	(3,362)	(3,362)	
Net income after tax	4,108	4,108	(B)

What the investor keeps

Remaining investment	100,000	100,000	(A)
Net income after tax	4,108	4,108	(B)
Investment and cash in hand	104,108	104,108	

* Funds generally distribute all income to avoid paying tax at the fund level.

Be reasonable

As with any deduction, the CRA requires that investment management fees be reasonable in order to qualify for a deduction. So what's reasonable? Generally, fees that are based on a sensible percentage of the fair market value of the underlying investments are considered acceptable and the deduction will be allowed by the CRA. The amount of time spent and type of work done by the person providing the advice or service should also be taken into consideration in determining whether a fee is reasonable. Arm's length terms and conditions should apply to fees, although this is not a concern when the investor has no family or corporate relationship with the investment manager.

Exceptions to the rule

As mentioned above, commissions are specifically excluded from the definition of investment fees. This is logical since commission fees are not for investment advisory services but for a transaction. It is worth noting, however, that commissions increase the adjusted cost base (or ACB) of an investment at purchase and reduce the proceeds when the investment is sold. Commissions, therefore, work to reduce the potential capital gain (or increase a loss) on an investment, and, in turn, the resulting tax payable. Capital gains (and losses) are reported in the year in which an investment is sold or realized; investors should remember to adjust the gain (or loss) for the commissions paid. The capital gain (and loss) inclusion rate is 50%, so in effect only 50% of the commission fee is deductible.

The definition of investment management does not include financial planning services. Where a portion of the annual fee relates to financial planning, that portion will not qualify as a deduction. Similarly, when an investor pays an all-in fee, some of it likely will relate to commissions; again that portion is not deductible. The CRA has not provided guidance on fee allocation, so this is not an easy task. Ultimately, the investor and his or her tax preparer need to determine how much of the total fee is deductible.

It should also be noted that investment fees, whether paid inside or outside of a fund, are subject to GST/HST. For separately managed accounts, the rate of GST/HST that is payable on investment fees depends on the province in which the investor resides.

However, for investors of mutual funds, the rate of GST/HST applied on the investment management fees embedded in the MER is typically a blended rate and depends on the proportion of a mutual fund’s investors residing in a particular province and the GST/HST rate of that province. For example, if a mutual fund has 50% of its investors in Alberta (where the GST rate is 5%) and 50% of its investors in Ontario (where the HST rate is 13%), the blended HST rate would be 9%.

For now, having an understanding of the basics of investment management fee deductibility will help you provide your clients with meaningful answers regarding the tax efficiency of their investments. It should also help you navigate the ongoing debate regarding the tax advantages and disadvantages of certain investment arrangements in relation to others.

Have a nice and fruitful week!