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YEAR-END TAX PLANNING

56(1)

Some 2001 year-end tax planning tips include:



1. If the following **expenditures** are made by **individuals** by **December 31, 2001** they will be eligible for 2001 tax deductions: moving expenses, child care expenses, safety deposit box fees, charitable donations, political contributions and medical expenses.

2. **2001 eligible Registered Retirement Savings Plan (RRSP) contribution amounts** are noted on the 2000 **personal income tax return assessment notices**. You have until **March 1, 2002** to make tax deductible RRSP contributions for the 2001 year.

Consider contributing to a **spousal RRSP** to achieve income splitting in the future.

The maximum 2001 addition to deductible **RRSP contribution room** is \$13,500. \$75,000 of **2001 earned income** is needed to reach this maximum.

3. Persons turning **age 69 in 2001** must **mature** their RRSP into cash, an annuity or a Registered Retirement Income Fund by December 31, 2001. Certain 2001 **excess** contributions may be de-

ducted in the year 2002 if **contribution room** is available.

4. If you own a business, consider paying a **reasonable salary** to family members for their services rendered to the business.
5. Ensure that all deductible **alimony or maintenance payments** are made by December 31, 2001.
6. An individual whose **2001 net income** exceeds \$55,309 will lose all, or part, of their **old age security**.

Senior citizens will begin to lose their income tax **age credit** if net income exceeds \$26,941.

Individuals facing these problems should contact their professional advisors for assistance in **managing** their 2001 personal income.

7. Consider purchasing assets eligible for **capital cost allowance** before the yearend. For example, **employees** may claim capital cost allowance on **automobiles, aircraft and musical instruments** required to be used in their employment.
8. If you had taxable capital gains in the **year**, or any of the **preceding three years**, consider selling capital properties with an **underlying capital loss** prior to the yearend. This capital loss may be offset against capital gains in the **year**, or in the **three preceding years**.
9. If income in an **inter vivos trust** is to be taxed on a beneficiary's return, the in-

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come must be **paid or payable** to the beneficiary by **December 31, 2001**.

10. Individuals may claim a **tax credit** related to the **interest portion** of student loan payments made in 2001.
11. **Registered Education Savings Plan (RESP)**

A **Canada Education Savings Grant (CESG)** for RESP contributions will be permitted equal to 20% of annual contributions for beneficiaries up to and including age 17 (maximum \$400 per child per year).

However, contributions for 16 and 17

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year olds will only qualify for certain previous plans.

12. **Health and dental premiums for the self-employed**

Individuals will be allowed to **deduct** amounts payable in respect of the year for **Private Health Service Plan** coverage in computing **business income** provided they are actively engaged alone, or as a **partner**, in their business, and either self-employment is their primary source of income or their income from other sources does not exceed \$10,000.

13. **Tax on Split Income**

The Income Tax Act applies the **maximum marginal tax rate** to certain passive income of *individuals* under the **age of 18**.

This includes:

1. Taxable **dividends**, and other **shareholder benefits**, on **unlisted shares** of Canadian and foreign companies (received **directly** or through a **trust** or **partnership**); and
2. Income from a **partnership or trust** where the income is derived from providing goods or services to a business carried on by a **relative** of the child or, of which the relative participates.

Therefore, consider **minimizing** this type of income in **2001**.

14. **Same-Sex Common-Law Couples**

The Income Tax Act extends benefits and obligations to **same-sex** couples effective **2001**. If the couple **elects**, it will also be effective for the years 1998, 1999 and 2000.

15. The tax rate for higher income individuals is now **significantly lower** on **capital gains** than on dividends

thereby presenting an incentive to receive capital gains.

16. Canadian resident shareholders **receiving shares** in **foreign tax-free reorganizations** will be able to treat the shares as a reduction in adjusted cost base, as opposed to a taxable dividend.

2001 REMUNERATION

56(2)

Some general guidelines to follow in remunerating the owner of a Canadian-controlled private corporation earning "active business income" include:



1. In general, **bonus down** active business earnings in excess of \$200,000. However, leaving corporate **active business income** at over \$200,000 but **less than \$300,000**, may present a **tax deferral** but there will likely be an **overall higher tax** to pay when dividends are finally paid out. Some companies may find it advantageous to bonus down to \$300,000.
2. Elect to pay out tax-free "**capital dividend account**" dividends.
3. Consider paying dividends to obtain a refund of "**refundable dividend tax on hand**".
4. Corporate earnings in excess of personal requirements could be left in the company to obtain a **tax deferral**. The effect on the "**Qualified Small Business Corporation**" status should be reviewed before selling the shares.
5. **Dividends**, as opposed to salaries, will reduce an individual's **cumulative net investment loss** balance thereby providing greater access to the **capital gain exemption**.

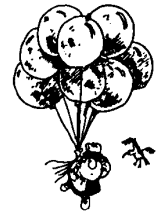
6. Retaining **income in the corporation** may adversely effect provincial and federal **capital tax** and certain **provincial clawbacks**.
7. Excessive **personal income** affects receipts subject to **clawbacks**, such as **old age security**.
8. Salary payments require **source deductions** to be remitted to Revenue Canada on a timely basis.
9. Individuals that wish to contribute to the Canada Pension Plan or a Registered Retirement Savings Plan may require a salary to create "**earned income**".
10. Salaries paid to family members must be **reasonable**.
11. Some provinces have "**payroll taxes**" thereby increasing the costs of paying salaries versus dividends.

PERSONAL TAX

56(3)

MEDICAL EXPENSES

In a **Tax Court** case, the Court found that \$703 paid to a pharmacist for **vitamin supplements** by an **HIV patient**, as **prescribed** by a **physician**, were eligible medical expenses.



Also, **travel costs** and **expenditures** to receive therapeutic touch treatment in **Washington State** by medical doctors were considered as medical expenses even though the same type of treatment was available in her town in Victoria, but not nearly the same quality.

Also, in another **Tax Court** case, the taxpayer suffered **severe chronic pain** and was **prescribed** by a doctor to take various

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herbs, enzymes and vitamins. The Court permitted a *medical expense* for the herbs and vitamins purchased at two *pharmacies* for a total of \$533. The Judge noted that this was *not* an “*open invitation*” for vitamin and herb medical expenses. The decision is limited to those taxpayers in *rare situations* who suffer *severe medical problems* and acquire vitamins and related matters *through a pharmacist as prescribed* by a medical practitioner or dentist.

In another *Tax Court* case, the Court permitted as a *medical expense* the costs to *replace carpeting* with hardwood floor and install an *air cleaner* to resolve the serious *asthmatic* condition of their son as *prescribed* by a medical doctor.

Also, in a *Technical Interpretation*, Canada Customs and Revenue Agency (CCRA) noted that a *custom-built shower* with appropriate grab bars and seat would qualify as a *medical expense* for a person with a severe and prolonged mobility impairment.

MOVING EXPENSES

In a *Technical Interpretation*, CCRA confirmed that where an individual moves and is reimbursed by his employer for the *mortgage interest* on the former house pending its sale, this reimbursement is normally a *taxable benefit*.

However, they permit a *deduction* for interest, property taxes, insurance premiums and heating and utility costs, to a maximum of \$5,000, for the *old residence* during the period that reasonable efforts are being made to sell it, and it is neither rented out nor occupied by the taxpayer or a member of the taxpayer’s household.

EMPLOYMENT

56(4)

LONG-TERM DISABILITY INSURANCE SETTLEMENT

In a *Tax Court* case, the taxpayer was injured in a motor vehicle accident and had to sue the insurer for the *long-term disability benefit payouts*. He received a Court-ordered *settlement* of \$82,500.

The settlement was based on \$1,389 per month, minus \$516 for CPP disability, leaving \$873 per month for 6.5 years plus \$15,000 as a contribution to legal expenses.

Good News!

The Court found that the *lump-sum settlement* was *not taxable* because the Income Tax Act only taxes amounts received *on a periodic basis* under a *disability insurance plan*. This was a lump-sum payment.

REDUCED STANDBY CHARGE

In a *Tax Court* case, the taxpayer claimed a *reduced automobile standby charge* on the basis that his



business use of the vehicle was more than 90% even though he *did not* maintain a *log* for the period in question. The Court *allowed* the reduced standby charge and noted that even though the appellant does not have any records pertaining to the use of his company car for the years under audit (1996, 1997 and 1998), this does not necessarily bar him from claiming a reduced standby charge. *Corroborating oral and other evidence*, if credible, can discharge the Appellant’s evidentiary task of proving on a balance of probability that he used the car more than 90% for employment purposes.

The taxpayer prepared a *travel log for 1999*

and stated that his work duties and travel schedules in 1999 were *the same* as in the years under audit.

Editor’s Comment

Keeping a *log* for the year under audit *may prevent* the cost, time, inconvenience and uncertainty of a *Court case*.

INVESTMENT INCOME

56(5)

INTEREST

Individuals are required to report *accrued interest annually* on the *anniversary date* of the investment. For example, if an August, 2001 Treasury Bill is acquired for \$89,000 to mature in November, 2001 for \$90,000, the \$1,000 of interest must be reported in 2001. However, if the Treasury Bill matured in January, 2002, the reporting of the interest could be delayed until 2002.



If, say, a *five-year* term deposit is acquired for \$80,000 in October, 2001 and accrues interest of \$4,000 a year, the \$4,000 must be reported in income each year beginning with the 2002 year.

Planning

A *maturity or anniversary date* in *January*, rather than, say, December, will *defer* the reporting for *one year*.

MARRIAGE BREAKDOWN

56(6)

EQUIVALENT-TO-SPOUSE CREDIT

In a *Tax Court* case, Mr. and Mrs. B

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divorced and had *joint custody* of their daughter. In 1998 Mr. and Mrs. B agreed that the daughter would *live with*



Mr. B for all of the year, except for weekends, and Mrs. B would give up the \$500 child support on the basis that Mr. B will be responsible for clothing, school and extra-curricular activity expenses. Both parents claimed the *equivalent-to-spouse tax credit* because they could not agree as to whom may claim the credit.

The Court permitted the credit to *Mr. B* on the basis that the daughter was *wholly dependent for support* on Mr. B and living in *his residence*.

SAME-SEX PARTNERS - RRSP ROLLOVER

In a *Technical Interpretation*, CCRA note that beginning with the *2001 taxation year* the term "common-law partner" extends spousal provisions to *unmarried same-sex couples*. For example, a *transfer of RRSPs* on a breakdown of a common-law partnership is allowed if the transfer is made under a *decree, order or judgment* of a competent tribunal, or under a *written separation agreement* relating to a division of property.

Editor's Comment

This may also apply to the years *1998, 1999 or 2000* if *jointly elected* by the common-law partners.

ARREARS

In a *District Office Memo*, CCRA notes that where *arrears* are *settled* for an amount which is *less than* the total periodic amounts due, the amounts paid and received, whether as a lump sum or by way of installments, would *not* generally be *deductible* to the payor or taxable to the recipient.

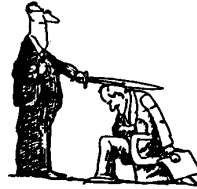
STOCK OPTIONS

56(7)

Stock options were discussed in a May 7, 2001 *Paper* by CCRA which notes that:

History

Stock options are used by corporations to *attract and retain* key employees, most notably in the fast-growing high technology industries. Also, cash strapped startup companies may use stock options as the primary source of future revenue for employees.



Other than in the case of stock options granted by certain *Canadian-controlled private corporations (CCPCs)* and certain *publicly listed shares*, stock option benefits are *generally taxed* in the year that an employee *acquires a share* equal to the *difference* between the *fair market value* of the share at the time the option is exercised and the *amount paid* to acquire the share. Consequently, employees with insufficient cash to pay the income taxes resulting from the stock option benefit inclusion may be forced to sell some of their shares. In the case of *CCPCs* and *publicly listed shares*, the taxable *employment benefit* is generally *deferred* until the year of *disposition* of the share.

Publicly Listed Shares

The February 28, 2000 Budget, subject to an annual \$100,000 limit, *defers* the employee income inclusion from exercising stock options after February 27, 2000 until the earlier of the employee's death, the employee ceasing to be a resident of Canada or, the employee's *disposition* of the shares.

A number of *conditions* must be met to qualify including the employee must be a

Canadian resident, the share is *listed* on a Canadian or foreign prescribed stock exchange, the *amount paid* by the employee to acquire the security was *not less than the fair market value* of the security when the option was granted, the employee was dealing at *arm's length* immediately after the option was granted with the employer, the share is an ordinary *common share*, and immediately after the option was granted, the employee was *not a specified shareholder* of the employer. (A 10% test)

Subsequent Decrease in Fair Market Value

Many employees had to report significant taxable benefits in 2000 even though the shares had *dropped significantly* in value as a result of the recent decline in the markets. For example, if shares valued at \$100 are acquired under a stock option for \$20 and then subsequently drop in value to \$20 when they are sold, the employee will have a *\$80 taxable employment benefit* and a *\$40 allowable capital loss* (\$80 capital loss @ 50% allowed). Any *allowable capital loss* can only be offset against *taxable capital gains* and cannot be applied against previous employment benefits.

However, this issue is *under review* and when a final determination is made by Finance *taxpayers will be informed*.

Possible Changes

The *Canadian Advanced Technology Alliance (CATA)* are lobbying CCRA and the Department of Finance for changes which would prevent this problem.

CATA wants employees who exercise stock options to only pay tax on the difference between the *option price* and the price at which the *employee finally sells the shares*.

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FARMING

56(8)

SALE OF TIMBER RIGHTS

In a *Tax Court* case, the farmer *sold timber rights* in 1992 thereby triggering a *capital gain* of \$76,000 which was incorrectly *not reported* on the return.



Upon discovering the 1992 taxable capital gain, *CCRA reassessed* this and did *not allow the capital gain exemption*.

Good News!

Upon review, the Court found that the taxpayer should be *allowed* to claim the *capital gain exemption* because the omission of claiming the exemption was *done innocently* and not with the intent to defraud CCRA.

CANADA CUSTOMS AND REVENUE AGENCY (CCRA)

56(9)

TAX PROTESTER HIT

On August 30, 2001, CCRA announced that Mr. L and his corporation were *finned* more than *\$2.4 million* after being found guilty of *tax evasion*. Mr. L was also sentenced to more than *five years in jail*. Mr. L *failed to file* both personal and corporate tax returns for the 1993 through 1998 tax years and failed to report more than \$8 million of income.

Mr. L *unsuccessfully* argued that income tax was *unconstitutional* and that the Income Tax Act was *invalid and unenforceable*.

TAX SHELTERS

In an August 14, 2001 *Publication*, CCRA warned potential investors *to be wary* of any *tax shelter* promotion where the anticipated *net return* in the first few years comes mainly from projected income *tax refunds*, especially where:



- (i) no real business activity will be carried on,
- (ii) the business has no reasonable expectation of profit,
- (iii) the expenses are inflated or unreasonably high,
- (iv) losses for tax purposes will exceed the amount of the investment that is actually at risk, or
- (v) the promoter or others are making verbal assurances of income tax consequences that are different from, or are not confirmed by, professional opinions contained in the investment documents.

Even if the tax shelter has an *Advance Income Tax Ruling*, CCRA *warn* that they do not generally Rule on the above-mentioned items. Therefore, the Ruling does not necessarily guarantee proposed deductions.

CHARITABLE DONATIONS

56(10)

REGISTERED CHARITIES NEWSLETTER NO. 11

This *eight-page* newsletter notes that:

1. An example of *charities that were*



challenged by CCRA involved Mr. J, the executive director of three religious charities. Mr. J was found guilty of *tax evasion* when he *unsuccessfully argued* that he did not have direct knowledge of the donations tendered and that *his wife* filled out the particulars on the receipts.

The evidence showed that he issued tax receipts *far in excess* of the amounts received from the donors.

Mr. J was ordered to perform 240 hours of community work and was fined \$32,000 (50% of the \$64,000 in tax evasion).

2. From the year April 1, 1999 to March 31, 2000 the *CCRA Charities Directorate* received *3,974 new applications* for registration, *registered 3,285* organizations, advised *885* applicants that they did *not qualify*, *revoked 2,742* charities because they did not file their annual *Registered Charity Information Return* (Form T3010) in the six month period after their fiscal year-end, and *audited 419* charities, most of whom had complied with the Income Tax Act.

Some charities misunderstood the requirement to keep adequate books and records and were given a *letter of explanation* by CCRA.

CULTURAL PROPERTY

On August 22, 2001 CCRA introduced revised *IT-407R* regarding donations of *cultural property* (example, works of art, antiques) to *designated Canadian institutions* (example, art galleries, museums).

The advantages include an *exemption from the capital gains* realized on the disposition, and a *donation* for the *fair market value*.

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REGISTERED RETIREMENT SAVINGS PLAN (RRSP)

56(11)

LOCKED-IN RRSP

Up to 10,000 investors in Ontario, Quebec and Western Canada were *taken in by a scheme* where



locked-in retirement savings were *swapped* for near-worthless *shares* in private corporations for a fee of 30% or more of a pension's value.

In another version, "*loans*" were given to the RRSP holder using the locked-in ac-

counts as collateral. CCRA notes that this triggers a *deregistration* of the RRSP.

Securities and pension authorities are cooperating with the RCMP and commercial crime divisions to attack these schemes.

GST

56(12)

NEW RESIDENTIAL RENTAL PROPERTY REBATE

On August 7, 2001 CCRA introduced a twenty-nine page *Guide RC4231 - GST/HST New Residential Rental Property Rebate*.

The Guide provides information for landlords of *residential rental properties* on how to apply for the rebate and how to com-

plete Forms *GST524 and 525*.

GST/HST TELEFILE

Businesses may now file GST/HST returns through

TELEFILE offered to business clients on an invitation-only basis.



An Access Code will be printed on the business' personalized GST/HST return.

The return must also have a nil balance or a refund of \$10,000 or less, and cannot be making a rebate claim.

For more information, see www.cra.gc.ca/gsthst-telefile

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