

# Tax Tips & Traps

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**WHEN BUSINESS  
SOLUTIONS COUNT**



Members of the Certified General  
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## Yearend Tax Planning

### Some 2003 year-end tax planning tips include:

1. If the following expenditures are made by individuals by December 31, 2003 they will be eligible for 2003 tax deductions: moving expenses, child care expenses, safety deposit box fees, charitable donations, political contributions and medical expenses.
2. 2003 eligible Registered Retirement Savings Plan (RRSP) contribution amounts are noted on the 2002 personal income tax return assessment notices. You have until March 1, 2004 to make tax deductible RRSP contributions for the 2003 year. Consider contributing to a spousal RRSP to achieve income splitting in the future. The maximum 2003/2004 additions to deductible RRSP contribution room are \$14,500 and \$15,500 respectively. The 2004 contribution requires 2003 earned income of \$86,111 ( $\$86,111 \times 18\% = \$15,500$ ).
3. Persons turning age 69 in 2003 must mature their RRSP into cash, an annuity or a Registered Retirement Income Fund by December 31, 2003. Certain 2003 excess contributions may be deducted in the year 2004 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, 2003.
6. An individual whose 2003 net income exceeds \$57,879 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 \$28,193. Individuals facing these problems should contact their professional advisors for assistance in managing their 2003 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 income must be paid or payable to the beneficiary by December 31, 2003.
10. Individuals may claim a tax credit related to the interest portion of student loan payments made in 2003.
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 children (maximum \$400 per child per year).
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 cover 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.

(Continued on page 2)

## Yearend Tax Planning cont'd

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 2003.
14. 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.
15. 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.
16. A refund of Employment Insurance paid for non-arm's length employees may be available upon application.

## Employment Income

### SPECIAL WORKSITE

An employer may make non-taxable board and lodging payments to an employee at a special worksite. In an August 14, 2003 Tax Court of Canada case, the taxpayer was employed to work at a "special worksite" but, did not receive payments from the employer for his board and lodging. The taxpayer took the position that had he been paid these amounts they would be tax-free. Therefore, the incurring of expenses related to this "special worksite" should be deductible. Unfortunately, the Court did not agree.

#### Editor's Comment:

It may have been better to have part of the remuneration paid separately as "board, lodging and transportation" expenses at the special worksite.

### COMMISSION SALESPERSON

In a July 14, 2003 Internal Technical Interpretation, CCRA concluded that a commission salesperson may deduct internet fees if the fees are paid to earn commission income. However, internet fees were not deductible by regular employees.



### TIPS

In a June 30, 2003 Tax Court of Canada case, CCRA included tip income on the taxpayer's return of \$918 for 1993 and \$4,785 for 1994 rather than the \$102 and \$2,214 that the taxpayer claimed were the actual amounts of the tips. CCRA's calculation was based on the taxpayer's pro-rata percentage of the tips received by the restaurant based on her percentage of salary as compared to the total salaries paid. The tips received by the restaurant were based on the average percentage of tips paid to waitresses on sales at the restaurant of 11.24%.

The Court agreed with CCRA and noted that they found the taxpayer's evidence evasive and did not discharge the onus of proving CCRA's assessment incorrect.

### INDIVIDUAL PENSION PLANS (IPPs)

A 62 year old person who had been maximizing RRSP contributions every year established an IPP in his corporation for 2003. The deductible corporate contributions for 2003 are - past service \$109,600, current service \$22,400, for a total of \$132,000. For 2004 and 2005 the deductible contributions are \$24,100 and \$25,900 respectively. The deductible contributions will vary, depending on the taxpayer's circumstances. These tax deductible contributions are considerably greater than would be available with an RRSP. These Plans are complicated and require actuarial calculations. They are generally beneficial to individuals over age, say, 40 earning a base salary of more than \$100,000.

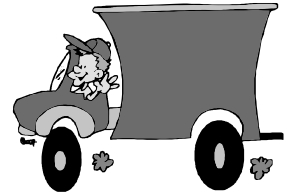
# Personal Tax

## DISABILITY TAX CREDIT (DTC) - NEWBORN

In a July 9, 2003 Tax Court of Canada case, the taxpayer's son was born on November 27, 1993 without a left hand. The Court found that a missing left hand is a disability that qualifies for the DTC transfer to the parent.

## MOVING EXPENSES

In a June 12, 2003 Technical Interpretation, CCRA reviewed a situation where a taxpayer moved and, because of employment commitments, the spouse joined the taxpayer three years later. Therefore, three years after the change of employment, the old house was sold and the taxpayer successfully deducted the selling cost as a moving expense.



## MEDICAL EXPENSE - HARDWOOD FLOORING

In a June 17, 2003 Tax Court of Canada case, the taxpayer incurred expenses of approximately \$11,000 in 1999 to install hardwood flooring which was successfully claimed as a medical expense. The flooring was acquired because the taxpayer's spouse suffered from serious allergies. The doctor noted that, "because of significant health impairment... the spouse was unable to be functional in his home until the carpets were removed and replaced with hardwood...".

## MEDICAL EXPENSES - ATTENDANT CARE

In a July 3, 2003 Technical Interpretation, CCRA notes that where a senior citizen pays for various homecare services, such as meal preparation and laundry, these expenses could qualify as "attendant care expenses" and be eligible as medical expenses if the taxpayer is entitled to the disability tax credit. Only attendant care expenses that do not exceed \$10,000 for the year (\$20,000 in the year of death) qualify for the credit. Depending on the situation, eligible tasks could include meal preparation, housework, transportation, and personal services such as banking and shopping. However, attendant care expenses would not normally include a payment to a person employed to do a specific task, such as a drycleaner.

## MEDICAL EXPENSE - SCHOOL TUITION FEES

In a July 8, 2003 Tax Court of Canada case, in the year 2000 the taxpayer paid tuition fees and room and board to an Academy for his two attention deficit children and successfully claimed a medical expense credit of \$42,662. A doctor certified that the children required the equipment, facilities and personnel specially provided by this Academy.

## INTEREST ON A STUDENT LOAN

Interest paid on a student loan made under the Canada Student Loans Act or a provincial statute is eligible for a tax credit.

In a June 27, 2003 Tax Court of Canada case, the taxpayer took out a "new loan" to repay a loan subject to the Canada Student Loans Act.

### Bad News!

The interest on the "new loan" is not eligible for the tax credit.



# Business and Property Income

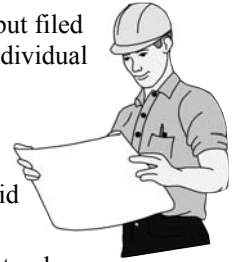
## EMPLOYEE VS. INDEPENDENT CONTRACTOR

In a June 26, 2003 Tax Court of Canada case, the taxpayer was a “supervisor” with a construction company but filed his tax return as an independent contractor and deducted expenses accordingly. CCRA argued that the individual was an employee and his deductions were restricted.

### Good News!

The Court found that the individual was an “independent contractor”, not an “employee”, and noted that:

1. Control Test — there was very little control over the services provided by the taxpayer - “Not once did they check to see if I was there, or told me to be there at any set time or date.”
2. Ownership of Tools - The taxpayer owned his own hand tools, forms, scaffolding, and provided his own truck.
3. Chance of Profit and Risk of Loss - Even though the taxpayer had responded to a question from the field auditor that he had, “no chance of profit”, upon investigation in Court, it was determined that he “wasn’t thinking properly” when he answered this question. In fact, there was evidence that a profit or loss did apply in his case.
4. Integration - The taxpayer was providing the services as a person in business on his own account.



### The Court was also influenced by:

- The wording of the actual contracts between the construction company and the taxpayer.
- The taxpayer had income from other sources in previous years.
- The taxpayer paid salaries to other persons - a further indication of the limited degree of control exercised by the construction company.

### Editor’s Comment

There are serious implications for the payer if CCRA successfully challenges the “independent contractor” status. A CCRA Ruling could be considered

# Corporate Tax

## ASSOCIATION

The Income Tax Act has rules that “associate” two corporations that have the same de facto control. Therefore, they have to share the small business deduction.

For example, if Mr. A and Mrs. A each own a corporation and there is no signing authority, or business transactions, or shareholdings between the two corporations, it is arguable that the companies are not associated. Therefore, the family could have two small business deductions.

The corporations should strive for separate and distinct financing, customers, employees, offices, business licenses, Workers Compensation registration, GST registrations, CPP and EI and source deduction registration and any other stand-alone issue.

Professional advice is needed in this area.

## DISSOLUTION FOR FAILURE TO FILE ANNUAL RETURNS

In a June 10, 2003 Tax Court of Canada case, the corporation was struck in the late 1980s for failing to file Annual Returns but was revived in February, 1999 under an Application for Revival.



### Bad News!

The Court noted that the Certificate of Revival did not have the effect of reviving the corporation retroactively. The corporation was simply non-existent at this time. The income earned belongs to the owner who generated that income through his activity.

## Remuneration

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 the annual business limit - \$225,000 for a December 31, 2003 yearend. Leaving corporate active business income over this amount 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 have greater than , say, \$225,000 of active business income because of other federal and provincial tax incentives.
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 effect provincial and federal capital tax and certain provincial claw-backs.
7. Excessive personal income affects receipts subject to claw-backs, such as old age security, the age credit, child tax benefits, GST credits, etcetera.
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.



## Capital Gains and Losses

### GUARANTEEING CHILD'S DEBTS - OUCH

In a June 10, 2003 Tax Court of Canada case, the mother had guaranteed the debts of her son's corporation. The son's corporation was unsuccessful and the mother paid off the loans over the years 1989 to 1993 and claimed business investment loss deductions.

The sole motivation for the guarantee was to help her son. No guarantee fee was charged and no possibility of income was available.

Therefore, the Court disallowed the mother's business investment loss on the basis that the guarantees were not incurred to earn income.

### Editor's Comment

Charge a guarantee fee next time.



# Farming

## GRAVEL SALE

In a 2003 Advance Income Tax Ruling, CCRA Ruled that where a farm corporation owns land with gravel, when the corporation sells all the gravel for a lump sum the proceeds received will be a capital gain not regular income. Capital gains are only 50% taxed.

However, in an August 29, 2003 Technical Interpretation, CCRA note that where an individual receives an amount based on the shale extracted from the property, the amount received will be considered income because it is based on production.

## SALE OF TREES

In a July 22, 2003 Technical Interpretation, CCRA notes that where a farmer receives an amount for allowing someone to cut and remove timber from his/her farm, the gain on the sale may be a capital gain, not regular income, if all of the following conditions are satisfied:

1. the taxpayer did not acquire the property with the intention of selling the timber or land;
2. the sale agreement is an isolated transaction;
3. the price is a fixed amount;
4. the timber is removed over a short period of time; and
5. the purchase price does not depend on the use or production of the land



# GST

## AGENCY

GST is payable on the selling price when a person is acting as an agent in making a sale on behalf of a supplier. On August 18, 2003 CCRA introduced 17-page Publication P-182R - Agency which discusses this. It also provides four examples.

- Example 1 reviews a property management company which manages a number of residential apartment buildings for various landlords.
- Example 2 reviews a cost-sharing arrangement where three professionals share office space and operating expenses.
- Example 3 and 4 reviews a contract which includes a reimbursement of expenses.

## INPUT TAX CREDITS (ITC)- MILEAGE ALLOWANCES

In a July 22, 2003 Tax Court of Canada case, Melville Motors Ltd. paid mileage allowances to each of its employed vehicle salespersons. The Excise Tax Act permits an ITC of 7/107th of the reasonable allowances paid.



### Good News!

The Court found that the allowances were based on kilometres driven and were reasonable. Therefore, the ITCs were allowed.

## INPUT TAX CREDITS

In a January 15, 2003 Tax Court of Canada case, the taxpayer carried on a courier proprietorship business. CCRA successfully disallowed some of the input tax credits on the basis that the taxpayer did not keep a log for the use of his vehicle or receipts for his entertainment expenses.

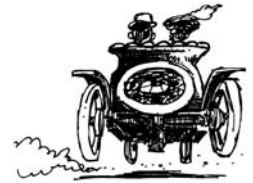


## Web Tip

### USED CAR VALUATION

If you are looking for values of used vehicles, this site is perfect for you. On the left hand column of the website is a link named "Appraise Your Vehicle" that will take you to the "Canadian Black Book" valuation tool.

[http://www.gmcanada.com/english/financing/fin\\_financ.html](http://www.gmcanada.com/english/financing/fin_financ.html)  
<http://www.canadianblackbook.com/>



### GST ONLINE FILING

If you have a GST refund or a nil return, you can now file on-line. Go to the website below and follow the simple steps. The refund cheques arrive in about a week.

<http://www.ccra-adrc.gc.ca/gsthst-netfile/>

## Marriage Breakdown

### RRSP TRANSFER

The Income Tax Act permits a tax-free transfer of an RRSP from one spouse to another as a division of property in a "settlement of property or support rights" in a marriage breakdown.

### RETROACTIVE CHILD SUPPORT

The British Columbia Supreme Court recently required Mr. G to pay a retroactive child care payment of \$641,842 (\$3,565/mo. for 15 years) because he did not fully disclose his wealth and income when the original \$500/month child support agreement was made.



## Did You Know

### ADMINISTRATIVE MONETARY PENALTY SYSTEM (AMPS)

The AMPS system was fully implemented by CCRA on October 7, 2002 to assess penalties for non-compliance with Customs laws. These penalties are significantly higher than previous. A non-compliant taxpayer could face increased monetary penalties, increased audit activity, inspections and seizures, as well as loss of importing privileges. CCRA's Voluntary Disclosure Program will allow importers to come forward and avoid AMPS penalties.





\*

Dan McNeill, CGA, CFP  
Matthew Jackson, CGA

\* A Professional Corporation

303-1268 Fifth Ave.  
Prince George, BC V2L 3L2

Phone: 250-563-7812  
Fax: 250-563-4115  
Email: [info@mcneillcga.com](mailto:info@mcneillcga.com)

We're on the web:  
[www.mcneillcga.com](http://www.mcneillcga.com)

## Office News

Vickie has left our office after fifteen years. She will be sadly missed by us as well as by many of our clients. We wish her well in her new position at a forestry company.

Dan and Pat are on vacation from November 23rd to December 7th. If you require assistance while Dan is away, please call the office and speak to Matthew.

Our office will be closed on December 24th and will re-open on January 5th. If you need to contact us during that time, please leave a message and we will get back to you or send an email to us at [dan@mcneillcga.com](mailto:dan@mcneillcga.com)

Check out our new website!  
[www.mcneillcga.com](http://www.mcneillcga.com)

May your Holidays be  
Merry & Bright

From all of us at McNeill & Co.



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