

# TAX TIPS & TRAPS

## JUNE 2005

### PERSONAL TAX

#### MEDICAL EXPENSES

In an October 21, 2004 CRA Document, CRA notes that an amount paid in respect of a "medical service" provided by a licensed medical practitioner qualifies as a medical expense. This includes a weight-loss program offered for therapeutic or rehabilitative reasons.

Also, a medical expense includes care at a school, institution or other place when a qualified person certifies that the patient, by reason of a physical or mental impairment, requires the equipment, facilities or personnel specially provided by that place.

In a February 10, 2005 Tax Court of Canada case, the Court permitted medical expenses for the costs at a Kelowna retirement home (Hawthorn Park) of \$21,270, \$20,912, and \$28,055 for the years 2001, 2002 and 2003.

#### MOVING EXPENSES

In a November 26, 2004 Tax Court of Canada case, moving expenses were permitted when the taxpayer moved from London, Ontario to Mississauga, Ontario including packaging materials, temporary lodging, real estate commissions, legal fees, taxes paid for registration of title on new residence, title insurance fees, conveyance closing, mortgage registration and transfer fee, Hudac enrollment fee, hydro and water meter, and household travel expenses.

In a February 4, 2005 Tax Court of Canada case, even though the move occurred seven years after the change of employment location, the Court permitted the

moving expense on the basis that the delay in moving was caused by business problems and a lien registered against a Nanaimo property.

#### CAMP FEES - CHILD CARE EXPENSES

In a December 7, 2004 External Technical Interpretation, CRA note that a sports camp for young children which is not of an ongoing nature and has a sufficient degree of child care may be eligible as a child care expense even though the program is enriched by sporting activities.

The key is whether the Camp is providing a sufficient degree of child care services or, whether a portion of the Camp fees were really for training/education.

#### EMPLOYMENT INCOME WELLNESS PROGRAMS

It was noted in "The Business Executive" that 83% of U.S. companies and 40% of Canadian companies have wellness programs in place for their employees.

In an independent evaluation of its wellness program over a ten-year period, Canada Life reported a return of \$6.85 for each dollar spent. These findings are based on aspects such as reduced employee turnover, decreased medical claims and greater productivity.

The article notes that worldwide wellness programs produce a return of between \$1.95 to \$3.75 per employee for each dollar invested.

#### FLEX BENEFIT PLANS

In a November, 2004 Advance Income Tax Ruling, the company provides its employees with a flexible benefit plan on which an

employee may choose from a menu of benefits such as medical and dental insurance, disability insurance, and group life insurance.

The company now proposes to introduce a Health Care Expense Account (HCEA) for its employees.

CRA Ruled that the allocation of credits to the HCEA will not be considered taxable employment income.

#### CRITICAL ILLNESS GROUP INSURANCE

In a January 14, 2005 External Technical Interpretation, CRA notes that a Critical Illness (CI) Group Insurance Policy does not constitute a taxable benefit. Also, payment of a lump-sum benefit under the Policy in the event of a critical illness may not be a taxable benefit.

In a February 10, 2005 External Technical Interpretation, CRA notes that where a contract of employment is renegotiated to decrease the salary with corresponding additional Private Health Service Plan premiums to be paid by the employer, these premiums would probably not be taxable employment income if the contract of employment is renegotiated after the expiry of the former employment contract.

#### EMPLOYER-PROVIDED PARKING

In a November 26, 2004 External Technical Interpretation, CRA notes that there is no taxable employment benefit when an employer provides free parking if the employee is regularly required to use the vehicle to carry out the

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duties of employment.

### **EMPLOYER-PROVIDED SCHOLARSHIP PROGRAM FOR EMPLOYEES' DEPENDANTS**

In a December 1, 2004 External Technical Interpretation, CRA notes that where an employer has a scholarship program for dependants of employees, and former employees, the amounts paid will be scholarship income to the student (not income to the employee) if the program meets objective criteria.

#### **Editor's Comment**

Generally the first \$3,000 of scholarship income is tax free.

### **GIFTS AND AWARDS**

In a March 10, 2005 Fact Sheet, CRA reminds employers that they may make up to two non-taxable gifts and two non-taxable awards to an employee but the total cost of the gifts or the awards cannot be over \$500 per employee (including all taxes) per year.

#### **Caution!**

Specific tests must be met.

### **BUSINESS/PROPERTY INCOME**

#### **SHARE SALES**

In a June 25, 2004 Tax Court of Canada case, the taxpayer had losses of \$45,356 on security transactions. The Court permitted the full business loss treatment and noted that the business losses were claimed on share sales in three technology and computer companies. The taxpayer was seeking growth, not dividends, in the share investments.

The taxpayer also did report

“capital losses” (only one-half deductible and only against capital gains) totalling \$7,267 on other less speculative shares such as Bell Canada.

#### **SALARIES TO CHILDREN**

In a February 11, 2005 Tax Court of Canada case, the taxpayer deducted from his business income salaries to two of his children in 1999 of \$7,600 and in 2000 to his five children totalling \$34,800.

Because the taxpayer's book-keeping was deficient and, certain of the letters from the children with respect to the hours worked and the hourly rates were not signed and, two of the children did not testify and, there was some doubt as to whether the full amounts were actually paid, the Court reduced the deductions by one-half. The children were ages 16, 16, 18, 20 and 21 and were allegedly paid at the rates of \$10 to \$15 per hour worked.

#### **LIFE INSURANCE COMMISSIONS**

In a February 24, 2005 Tax Court of Canada case, Mr. M was employed by London Life Insurance in 1998 when he allocated \$30,000 of commissions to his corporation on the basis that the corporation earned this commission income.

#### **Taxpayer Loses!**

The commissions were taxed on the individual's return because there was no proof that the corporation had taken over the contracts with London Life prior to 1999.

#### **CAPITAL GAINS**

#### **CAPITAL GAIN DEFERRAL**

Where an individual sells shares of a qualified small business corpo-

ration and uses the proceeds to invest in Treasury shares of another qualified small business corporation there may be a deferral of the capital gain.

However, there are many technicalities that must be met.

#### **BUSINESS INVESTMENT LOSS**

In a January 7, 2005 Tax Court of Canada case, the taxpayer had losses when she loaned funds to her husband's corporation on a non-interest bearing basis and guaranteed the debts of her husband's corporation for no consideration.

#### **Bad News - Loans**

The loans by Mrs. E to her husband's corporation were not eligible for capital loss treatment because they were not incurred to earn income. They were non-interest bearing and, she did not own any shares in the corporation.

#### **Good News - Personal Guarantees**

The \$40,245 that Mrs. E paid for the company's obligations under her personal guarantee was 50% deductible as a “business investment loss”.

#### **2005 FEDERAL BUDGET**

On February 23, 2005, the Honourable Ralph Goodale presented his 2005 Budget to the House of Commons.

Some of the proposals include:

#### **Qualified RRSP Investments**

Add to the list of qualified investments, investment-grade gold and silver bullion coins and bars, and certificates on such investments purchased on or after Feb-

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ruary 23, 2005.

### **Foreign Property Rule**

The 30% limit of foreign property that may be held by pension funds and other deferred income plans is proposed to be eliminated.

### **Canada Deposit Insurance Corporation Coverage**

To be increased from \$60,000 to \$100,000.

### **Medical Expense Tax Credit**

There will be added to the list of eligible expenses amounts paid for certain phototherapy equipment, oxygen concentrators, deaf-blind intervening services, reading services, drugs and medical devices obtained under Health Canada's Special Access Programme, and certain medical marihuana.

### **Adoption Expense Tax Credit**

An individual will be entitled to deduct in computing tax payable 16% of the lesser of \$10,000 (indexed after 2005) and amounts paid in respect of eligible adoption expenses.

### **Agricultural Cooperatives**

Introduces a tax deferral for eligible shares issued after 2005 in respect of patronage dividends paid by an agricultural cooperative corporation until the cooperative shares are disposed.

### **International Tax Enforcement**

CRA proposes to invest \$30 million annually in enhanced CRA audit and collection activities with respect to cross-border and international transactions.

### **ESTATE PLANNING**

#### **REWARD POINTS**

It is possible to donate retail re-

ward points to a charity and receive a charitable donation tax credit. Some companies that encourage such donations include Hudson's Bay Company, Shoppers Drug Mart Corp., Royal Bank of Canada (RBC) and Petro-Canada.

Also, Royal Bank of Canada Visa cardholders can donate points to Hope Air - a registered charitable organization.

### **Editor's Comments**

Total donations in excess of \$200 trigger a personal income tax credit at top marginal rates.

### **DONATION RECEIPTS**

In a January 18, 2005 Release, CRA notes that registered charities now have to include the website address of CRA ([www.cra.gc.ca/charities](http://www.cra.gc.ca/charities)) on donation receipts as of January 1, 2005.

However, CRA will honour receipts that do not contain the new information and will not penalize for not including this new information in 2005.

### **Editor's Comments**

Donors should check the validity of questionable organizations by referring to [www.cra.gc.ca/charities](http://www.cra.gc.ca/charities) and clicking on "list of Canadian Registered Charities".

### **NON-PROFIT ORGANIZATIONS (NPO) - RENTAL INCOME**

In a November 25, 2004 External Technical Interpretation, CRA notes that where a NPO rents out its excessive space, this may jeopardize its non-profit status.

### **CANADA PENSION PLAN**

The November 23, 2004 issue of the Globe and Mail notes that there is an estimated underpayment of CPP benefits in the \$1 billion range. About 90% of the errors were blamed on improperly completed applications such as incomplete disclosure about the Child Rearing Dropout Provision and other dropout provisions.

Also, the report notes that many seniors are not aware that CPP benefits may be split after separation or divorce, or be split between spouses who have reached age 60.

### **DEATH**

Where Mr. A dies his RRSP is terminated at that time. However, if he did have RRSP contribution room, the legal representative can make a contribution to the surviving spouse's RRSP in the year of death, or within sixty days after the yearend, and claim a deduction on the husband's final tax return.

### **LEAVING CANADA**

It is usually best not to cash in your RRSP before giving up Canadian residence. If the amounts are withdrawn after leaving Canada, they will only be subject to a 25% withholding tax, or 15% if received on a periodic basis in certain Treaty countries.

Also, it may be important to crystallize the cost base of RRSP assets before leaving Canada as the cost base can be taken out tax-free in the United States.

Also, it is possible to defer the reporting of income in the RRSP in the United States by electing with the IRS.

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### FARMING

#### CANADIAN AGRICULTURAL INCOME STABILIZATION PROGRAM (CAIS)

##### Cattle

One problem with CAIS is the way it values cattle. For example, a bred cow worth \$1,200 on January 1, 2005 may only be worth, say, \$800 at December 31, 2005. Because CAIS uses a one-price system, based on the end-of-the-year price, it will value that cow at \$800 for the entire year.

##### Ideas to Help Minimize the Stress of CAIS

Farmers should keep records of information needed by CAIS but not readily available after the fact. For example, the number of calves born, number of animals died, amount of production during the year like hay/straw bales produced by field, bushels of crop produced by field, an inventory count at yearend, and details of any barter transactions (i.e. a hay crop is baled and the custom operator receives a share of the bales as payment). The other information needed for the CAIS program is found in sales and purchase invoices (i.e. crops sold and seed purchased, feed bought and sold, cattle bought and sold).

#### SEASONAL AGRICULTURAL WORKERS

In February, 2005, CRA released Guide RC4004 which discusses how seasonal agricultural workers are taxed, employer withholdings, and related matters.

#### JOINT OWNERSHIP

In a February 9, 2005 External Technical Interpretation, CRA notes that where farmland is put

into joint ownership, there will not be a disposition if there is no change in the beneficial ownership of the property.

However, if the beneficial ownership does change, there will be a disposition for tax purposes.

#### MARRIAGE BREAKDOWN CHILD SUPPORT

In a December 16, 2004 Federal Court of Appeal case, Ms. K was entitled to receive child support payments under a 1991 Minutes of Settlement. However, a portion of the amounts were not paid. Therefore, on September 24, 1997 the Ontario Court issued a Judgment providing for the payment of child support on the same terms and conditions as the 1991 Minutes of Settlement. Ms. K took the position that this was a post-April, 1997 Judgment and, therefore, receipts were non-taxable.

##### Taxpayer Loses

The 1997 Judgment did not alter this obligation. It simply made collection procedures simpler for Ms. K. Therefore, the receipts were taxable.

#### SPOUSAL SUPPORT

The Federal Department of Justice has released Spousal Support Guidelines which provide formulas suggesting a range of spousal support under certain circumstances. These Guidelines range generally between 1.5% and 2% of the difference between the salary earned by the payor and that earned by the recipient times the number of years the couple were married. These Guidelines include 160 pages of detail.

#### RETROACTIVE PAYMENTS

An Alberta Court of Appeal unanimous Ruling held that when the income of a person paying child support goes up, the obligation to pay higher support for the children would generally commence at that time. Therefore, a child support payor could owe substantial amounts for retroactive child support if the payor's income has increased since the original settlement date.

Other Appeal Courts, such as Ontario and British Columbia, have been moving in the same direction but this Alberta Decision is the clearest and most comprehensive to date.

#### LEGAL FEES

##### Recipient

In a February 2, 2005 External Technical Interpretation, CRA confirms that legal fees to obtain support amounts may be deducted on an accrual basis.

##### Payer

In a January 14, 2005 Tax Court of Canada case the Court disallowed the deduction and noted that expenses incurred by the payer of support are not deductible.

#### GST

#### TRAVEL ALLOWANCES AND REIMBURSEMENTS

The Excise Tax Act provides input tax credits/rebates in respect of non-taxable travel allowances and reimbursements paid to employees.

#### CONSIGNED GOODS

In November, 2004, CRA introduced Guide GI-009 which explains the application of GST/HST

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to goods sold on a consignment basis.

### WEB TIPS

#### WEB SEARCH ENGINE

##### **Dogpile.com**

If you are looking for an alternative search engine to use, try dogpile.com. This engine also contains the feature of a short list of similar "search word" suggestions.

#### DESKTOP SEARCH ENGINE

##### **Blinkx.com**

A desktop search engine is a tool that searches your computer for files.

Blinkx.com offers a free search tool that instantaneously returns results without even having to hit the enter key.

The first advantage of this search engine over others is that you can quickly sort your results based on file type.

The second advantage is that this program does not have the same bias towards Microsoft products that the Google search engine does.

#### RADIO ON THE NET

If you work in an environment that allows for sounds or music, consider using your computer to connect to a radio station via the Internet.

<http://radio-locator.com>

This website provides links to radio stations across the globe.

#### DID YOU KNOW...

##### **DUE DILIGENCE DEFENSE**

In an October 6, 2004 Tax Court of Canada case, Mr. F was one of

three directors who was assessed with personal liability for unpaid GST (\$38,000) and source deductions (\$92,000). The Court noted that to successfully use the due diligence defense, the director usually must take active steps to ensure that a corporation makes its remittances. An outside director will not be held to the same standard as an inside director. Also, a director's background and experience in business will be given great weight in determining whether the director has met due diligence.

##### **Taxpayer Wins!**

The Court accepted the due diligence defense and noted that:

1. Mr. F was born in Italy, came to Canada at the age of thirteen, had education limited to grade 3 in Italy and eight months in Canada, had limited reading and writing skills and spent most of his working life as a carpenter.
2. Mr. F rarely went into the head office in Toronto.
3. Mr. F took no active steps to ensure the corporation made its remittances because he was involved in the out-of-town field work and relied on the financial director to make remittances. Mr. F did not have the experience, ability or know-how to do anything else.

The Court noted that, "He could no more remit deductions than most of us could split the atom".

##### **Taxpayer Loses!**

In another Tax Court case, the financial director, Mr. D, was

found to be personally liable for the unremitted source deductions and GST as he was involved in the financial administration of the corporation.

##### **COMPARISON OF INDUSTRY STANDARDS**

CRA may target a company for an audit if their financial information (for example, cost of goods sold) varies significantly from industry norms.

For more information on industry norms see <http://strategis.ic.gc.ca/epic/internet/inpp-pp.nsf/en/home>.

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