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PERSONAL TAX

54(1)

CHILD CARE EXPENSES

In a *Tax Court* case, Mr. Bell claimed \$4,184 of *child care expenses* with respect to Little League, Mad Science Club, soccer club, swim club, speech and language therapy, etc. The Court *disallowed* the child care expenses on the basis that they were to develop the physical, social and artistic abilities of the children, even though the activities were carried out while the parents were working. The Court found that, to be deductible, the *overwhelming component* must be guardianship, protection and child care.

Also, in a *Technical Interpretation*, CCRA notes that where two parents are *divorced* and only one parent is the custodial parent, child care expenses will be allowed *only to the custodial parent* - the person who "resided with the child at the time the expense was incurred".

If the non-custodial parent *directly pays* the child care expenses, *neither* the non-custodial nor custodial parent may deduct those expenses.

In the case of *shared custody*, since each parent resides with the child, each parent could claim child care expenses incurred in a taxation year for an eligible child.

COMMON LAW SPOUSE - CONJUGAL RELATIONSHIP

It is important to know if a taxpayer is a

"spouse" for many *provisions* of the *Income Tax Act*.

For the year 2000, a *spouse* included a person of the *opposite sex* who *cohabited* with the taxpayer in a *conjugal relationship* and has so cohabited throughout a twelve-month period ending before that time.

This will also apply to *same-sex* couples effective *2001*, unless the couple elects, in which case it may be effective for the years *1998, 1999 and 2000*.

In a *Tax Court* case, the Court reviewed a situation where persons were living under the same roof but claimed they were *not* in a *conjugal relationship* and, therefore, were *not spouses* for purposes of the Child Tax Benefit credit. The Court found that they were in a conjugal relationship and provided comments and a *list of issues* to consider.

Editor's Comment

Remember - if two persons claim they are *not spouses*, this will likely *preclude* tax-free rollovers of property on death or on a breakdown of the relationship. It may also impair a claim on the other person's assets in a relationship breakdown.

EQUIVALENT-TO-SPOUSE CREDIT (ETSC)

In a *Tax Court* case, Mrs. S claimed the *ETSC* for her son for the 1996 and 1997 taxation years on the basis that she was *separated* from her husband even though they lived in the same apartment unit. The

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Court *did not allow* the ETSC and noted that:

1. If Mr. and Mrs. S were living lives otherwise independent of each other, as Mrs. S claims, she did not offer any credible reason why they were so financially dependent on each other.
2. That Mrs. S accompanied Mr. S to visit his mother in Jamaica added weight to the Minister's position that Mr. and Mrs. S were not living separate and apart.

EMPLOYMENT INCOME

54(2)

DAMAGE PAYMENTS

In a *District Office Memo*, Canada Cus-

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toms and Revenue Agency (CCRA) notes that when a loss of *employment* involves a *human rights violation* and is settled out of Court, a *reasonable* amount in respect of general damages can be excluded from income. A reasonable amount is influenced by the maximum that can be awarded under the applicable *human rights legislation* and the evidence presented in the case.

EMPLOYER-PAID EDUCATION COSTS

In a *District Office Memo*, CCRA notes that where *employer-paid training* is taken primarily for the benefit of the employer, there is *no taxable benefit* whether or not the training leads to a degree, diploma or certificate.

In two, *Advance Tax Rulings*, CCRA Ruled that the lease of a number of *computers* to be provided to *employees*, along with *internet access*, would be deductible to the company and a *non-taxable benefit* to the employees on the basis that it meets the guidelines in *Income Tax Technical News No. 13*.

The programs were to improve employees' electronic, computer and internet skills for employment purposes, even though there would also be some personal use. The programs also address the urgent need for the employees to become fully *PC literate* and to develop and maintain the electronic communication skills required to improve productivity, create more mobility in the work force and overall reduce costs in an increasingly wired environment.

FREE PARKING

In an Informal *Tax Court* case, the *employer* provided *free parking* to employees in its parkade which, was also available on a fee basis to the general public. The Court found that the free parking was *not a taxable benefit* and noted that the em-

ployee was not *economically enriched* by the free parking.

The free parking gave the employer many extra hours of employment. Also, it was cheaper for the employer to provide a parking space than to pay taxi fares. Therefore, the *employer* was the *primary beneficiary* of the benefit.

Caution: Regardless of this decision, CCRA may reassess certain "free parking" as taxable employment benefits.

TAXABLE BENEFITS

In the 2001 *Employer's Guide*, CCRA advised of a change to the procedure for calculating the *taxable*

benefit where there is a *combination* of flat-rate and reasonable per-kilometre travel reimbursements.

Previous Procedure

Previously, if the allowance paid to an employee was a combination of flat-rate and reasonable per-kilometre allowances, only the flat-rate portion was taxable.

Amended Procedure

Starting *January 1, 2001*, if the allowance is a combination of flat-rate and reasonable per-kilometre allowance that covers the *same use* for the vehicle, the *total* combined allowance is *taxable*.

GROUP SICKNESS OR ACCIDENT INSURANCE PLAN

In a *Technical Interpretation*, CCRA notes that the Income Tax Act permits *deductible/non-taxable* payments by an employer to a "*group sickness or accident insurance plan*" for an *employee*. However, where the plan is for a *shareholder/employee*, it is a question of *fact*

whether the benefit is employment or shareholder related.

CCRA will presume it to be *shareholder related* unless it is comparable to benefits generally offered to employees who perform similar services. Unlike employment benefits, *shareholder benefits* are *non-deductible/taxable*.

WAGE LOSS REPLACEMENT PLANS

In a *Technical Interpretation*, CCRA notes that benefits received from an "*employee-pay-all plan*" are not included in computing income of the recipient.

In this Technical Interpretation, the legal obligation for paying the premiums was split 50-50 between the employer and the employee. Therefore, the receipts were taxable.

SHAREHOLDER LOAN

In a *Technical Interpretation*, CCRA note that where a *shareholder* receives a loan from a corporation, the loan is to be included in income of the shareholder for the year in which the loan was received unless a *specific exception* is met, such as a loan to enable the individual to acquire a dwelling, treasury shares or a motor vehicle and the loan was received because of the individual's employment, rather than shareholding. Also, bona fide repayment arrangements must be made at the time the loan was incurred.

Whether or not a loan was received in the *shareholder* or *employee* capacity, is a question of fact.



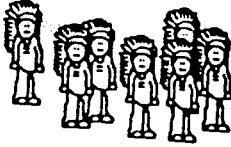
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BUSINESS INCOME

54(3)

INDEPENDENT CONTRACTOR VS. EMPLOYEE

In a *Tax Court* case, Company A desired its workers to be *independent contractors*, not employees, to avoid EI and CPP.



The Court found that the workers were employees, not independent contractors, and noted that:

1. The tests of *control, ownership of tools, chance of profit and risk of loss* and *integration* caused the Judge to conclude that this was an *employment* arrangement.
2. *Control* - Corporation A set the hours, detailed the work to be done and oversaw and inspected the work.
3. *Tools* - Corporation A provided the main tools (lathe and welders) whereas the workers only provided minor tools such as a welding helmet, shield, gloves, hard boots and some small tools including wrenches.
4. There was no chance of additional *profit or risk of loss*.
5. With respect to *integration*, it was obvious that this was Corporation A's business.

ADVERTISING EXPENSE

In an Informal *Tax Court* case, Mr. Harris was the president and sole shareholder of a corporation operating a construction business in New Brunswick. The corporation *advertised* by promoting *stock car and snowmobile racing* and, in fact, owned a stock car and snowmobile which Mr. Harris drove in competitions. CCRA

disallowed the expenses on the basis that these were *personal* in nature.

However, the *Court permitted* the deductions as *advertising expenses* but noted that when advertising has a *significant personal element* the taxpayer has a *greater than normal onus* to establish that the expense was truly incurred for the purpose of advertising the business.

RESORTS AND LODGES

In a *Technical Interpretation*, CCRA notes that Paragraph 18(1)(l) of the Income Tax Act *disallows* an expense made for the use or maintenance of a *yacht, a camp, a lodge or a golf course or facility* unless it was part of the taxpayer's business of providing the property for hire or reward. However, if a resort hotel or lodge is used for a *genuine business purpose*, which does not include the entertainment or recreation of clients, suppliers, shareholders or employees, the related expenses are *not caught* under Paragraph 18(1)(l). However, the Paragraph *would apply* where some business meetings may be involved but the *main activity* is recreation or *entertainment*.

CCRA further note that where the employees or customers are taken to a resort to attend meetings but the *main activity* is *business* related, even though they did participate in some recreational activities, the use of the resort would be *deductible*, subject to the 50% *meal and entertainment* limitation. However, if the *main activity* is *recreation* or *entertainment*, no portion of the costs is deductible.

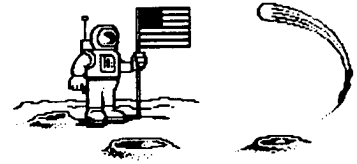
SCIENTIFIC RESEARCH

It was noted by CCRA that, under certain circumstances, where a business funds *research* at a *post-secondary institution*, the expenditure may be eligible for *investment tax credits*.

CAPITAL GAINS

54(4)

FOREIGN SPIN-OFFS



As a result of the *October 18, 2000 Economic Statement*, it will be possible for Canadian taxpayers to claim a refund of taxes previously paid in respect of certain 1998 and 1999 *foreign corporate "spin-off"* transactions and *to defer the tax* in respect of 2000 and subsequent transactions.

To *qualify* the share distribution to the taxpayer must consist only of common shares of a corporation (spin-off corporation) owned by the distributing corporation and both the distributing corporation and the spin-off corporation must have never been resident in Canada. Also, the original shares must be widely held and actively traded on a prescribed stock exchange.

Remember: It is up to *the taxpayer* to identify and make the necessary timely elections to obtain this *tax relief*.

MUTUAL FUNDS

In an *Advance Income Tax Ruling*, CCRA made the following general comments with respect to *mutual fund dispositions*:

1. The *switch or transfer* of units of a *mutual fund trust* by a unit holder generally results in a *taxable disposition*.

However, when units of one class, or series, of a mutual fund trust *are changed* to another *class, or series*, of

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the *same mutual fund trust*, whether or not there is a disposition of units is a question of *fact*. In cases where the *trust agreement* provides that more than one class, or series, of units may be issued by the fund and makes provision for changes between classes, or series, of units of that fund, a change of units will generally *not result* in a *disposition*.

2. A *redesignation* or *reclassification* of a class, or series, of units to another class, or series, of units of the same fund will *not* result in a *disposition* assuming that the attributes of each class, or series, of units were substantially the same, the unit holder would not be entitled to proceeds of disposition for the units, and the redesignated or reclassified units would not be cancelled or redeemed.
3. Where a mutual fund is a *mutual fund corporation*, different rules apply. For example, when shares of a mutual fund corporation are exchanged for other shares of the same corporation, and no consideration other than the new shares is received by the shareholder, the exchange is deemed *not to be a disposition*.

MARRIAGE BREAKDOWN

54(5)

ARREARS

In a *Tax Court* case, the taxpayer's former husband (Mr. G) made a payment to the *Family Maintenance Enforcement Program* which was credited as a *payment to arrears* owed by him to the appellant (Mrs. G). CCRA included the amounts in Mrs. G's income and allowed a deduction to Mr. G on the basis that payments do not change in character merely because they are not made on time - i.e. arrears payments

are deductible/taxable.

Mrs. G had unsuccessfully argued that the payments were a *settlement* of arrears, as opposed to a payment on arrears.

LEGAL FEES - CHILD SUPPORT

In a *Committee Report*, CCRA note that they will accept that *legal costs* incurred in respect of a *Child Support Order* issued under the *Divorce Act* would generally be deductible. Because this change results from a *Court case*, it is effective for all *future* assessments and reassessments. The *only prior years* that could receive this tax treatment are those for which a *Notice of Objection* had been filed and is still outstanding, and those for which a *Notice of Objection* can still *be filed*. Generally, a taxpayer can file a Notice of Objection for a particular year up to one year after the date on which the return for that year was due.



Therefore, the taxpayer's request to have adjustments made for the years *1985 to 1989* was *not accepted* by CCRA.

LEGAL FEES - PENSION

In a *Technical Interpretation*, CCRA notes that where a taxpayer incurs *legal fees* to enforce their rights to a *spouse's pension* assets on a marriage breakdown, the legal fees are *not deductible*.

However, CCRA notes that where a division of assets has previously been negotiated and settled, the *enforcement* of this pre-existing entitlement would be considered to be separate and distinct from the original division of property and Interpretation Bulletin 99R5 deals with the deductibility.

REGISTERED RETIREMENT SAVINGS PLAN (RRSP)

54(6)

BANKRUPTCY

In general, a creditor may *seize an RRSP* if the person becomes bankrupt *unless*:



1. The RRSP is issued by an *insurance company* that has the *spouse* or *child* as a beneficiary.

In most provinces "*spouse*" is not defined in the insurance legislation. Therefore, it is based on general law which usually provides that to qualify as a "*spouse*" the individuals must be *legally married*. The status must be reviewed in each province.

2. *Locked-in RRSPs* may be protected under provincial pension legislation.

However, this creditor protection may *not be valid* if the RRSP is established when the person is in *financial difficulty*.

These are *general guidelines* and vary by province because Provincial Pension and Insurance Legislation is involved.

FOREIGN CONTENT

The 20% *foreign content* limit for 1999 was increased to *25% for 2000* and *30% for 2001* and future years.

However, a *mutual fund* that holds 30% or less foreign assets qualifies as 100% Canadian content. Therefore, if 70% of the RRSP is in this type of mutual fund and the other 30% is in foreign investments, this effectively provides up to a *51% foreign asset* content in an RRSP.

Also, there are a number of "*derivative funds*" that purchase indexes of foreign stocks or bonds that qualify as 100% Ca-

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nadian content.

In addition, by investing in certain *active Canadian businesses*, such as labour-sponsored funds, the RRSP is entitled to extra foreign investments of \$3 for every \$1 of investment to a *maximum* additional foreign content of 20%. For example, a \$5,000 labour-sponsored fund RRSP purchase could add another \$15,000 of foreign investment.

PLANNING

1. Since only 50% of capital gains held outside an RRSP are taxable, there is a general *preference* to hold *growth stocks outside* of the RRSP.
2. RRSP annuities, or payments out of a RRIF, received by persons 65 or older, are eligible for a tax credit on up to \$1,000 of this income. Therefore, consideration should be given to *maturing* at least a portion of an RRSP at age 65, which is prior to the *mandatory crystallization* age of 69.
3. Non-taxable taxpayers with “*earned income*” (example, children with minor employment income) should consider *filing tax returns* to establish *RRSP contribution room* carryforward.

FARMING

54(7)

WOODLOTS

On February 21, 2001, CCRA amended IT-373R2 (Woodlots) to consider a Federal Court of Appeal case where the farmer received *capital gain exemption treatment* on the sale of *standing timber* as “qualified farm property”.

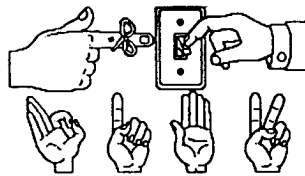
However, the IT notes that where an amount is dependent on the use of, or production from, properties received, it may be considered as income. For example, where

a woodlot owner or operator grants a person *a continuing right to cut* and take timber *over a period of time*, and the consideration that the woodlot owner or operator receives is based on the volume of the timber taken, the amount received is taxable.

Where a person who is *not* operating a woodlot as a *commercial enterprise* receives an amount for allowing someone to cut and remove timber from the woodlot, the sale will be taxable on *capital account* if the following conditions are met:

- (a) the land was not acquired with the intent of selling timber or land;
- (b) it is an isolated sale of capital property by the person (and not the sale of a continuing right to enter and take away timber);
- (c) the total price for the timber sold is fixed; for example, the contract for sale of timber specifies that consideration computed by reference to the timber actually removed within a specified time or from a specified area; and
- (d) the timber is to be removed over a short period of time (such as several months or such period of time that, given the particular set of circumstances, would be reasonable to consider as a short period).

SHARECROPPING



In a *District Office Memo*, CCRA note that where a taxpayer owns *farmland* which is *rented out* to a tenant but, the taxpayer is also *involved* in the farming, these activities may convert the income from rental to *farming business income* thereby qualify-

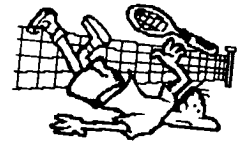
ing for certain tax advantages, such as using the cash basis, for farm businesses.

GST

54(8)

SORRY NO INCOME TAX CREDIT (ITC)

CCRA notes that where *Registrant A orders and is billed* for equipment which is



delivered to, used by and paid for by *Registrant B*, B is not the “recipient” of the supply and is *not* eligible to claim the *ITC* since *B* was not the person liable to pay for the equipment. If the parties would like Registrant B to claim an *ITC*, *A* should “*re-supply*” the equipment to *B* and issue an *invoice to B*. This was discussed in the GST/HST CCRA Newsletter No. 39 for the Winter of 2000-2001.

RETAILER ALERT

CCRA mentioned in the *GST/HST News - Spring 2001*, No 40, that the only individuals who can purchase goods and services without paying the GST/HST are *Indians* where;

- (i) the individual presents a “Certificate of Indian Status” card, *and*
- (ii) the goods are sold on a Reserve, or the goods are delivered (by you or your agent) to a Reserve; or
- (iii) the services (e.g., haircuts, small appliance repairs) are performed entirely on a Reserve.

Although some provinces issue tax exemptions from provincial sales tax to farmers, municipalities and other businesses, these exemptions *do not apply* to the GST/HST.

Local police forces have indicated that they would like to be informed of individu-

Tax Tips & Traps

als attempting to claim GST/HST exemptions to which they are not entitled.

DID YOU KNOW

54(9)

STRUCTURED SETTLEMENT

In an *Advance Income Tax Ruling*, CCRA ruled that where an individual sustains *personal injuries* in a motor vehicle accident and, the insurance company for the defendant agrees to make periodic payments to the taxpayer, those periodic payments may be *non-taxable*.



This applies where the insurer funds the obligations by purchasing a *single premium annuity contract* and providing an irrevocable direction to have the payments made to the claimant. The *annuity contracts* are non-commutable, non-assignable and non-transferrable.

Also, in a *Technical Interpretation*, CCRA notes that personal injury or death awards may be *non-taxable* even if the damages are determined with reference to the loss of

earnings.

TAX EVASION CHARGE THROWN OUT

In an *Ontario Court*, tax evasion charges against a taxpayer who owned seven pharmacies and had received kickbacks from drug companies, such as Apotex Inc. and Novo Pharm Ltd., were *thrown out* on grounds that CCRA abused their powers. CCRA gathered information from the taxpayer and the drug companies through the guise of an *income tax audit* without *disclosing* that they were from the *Special Investigation Division* and, that the information obtained would likely be used in a criminal tax evasion charge.

The Court noted that even though the taxpayer had *clearly received kickbacks*, because of the *procedure used* by Special Investigation, the *tax evasion charges* could not be upheld. The Court did note however that the taxpayer still faces *non-criminal* tax reassessments including the *back taxes* plus *interest* and a *50% penalty*.

In this case, the drug companies provided *volume rebates* to pharmacists to encourage them to sell their products. The tax-

payer had the rebates paid to him in a manner to avoid discovery by CCRA such as payments to U.S. bank accounts and U.S. suppliers.

TAX SHELTERS

There will be a number of tax shelter *flow-through mining and oil and gas investments* in the year 2001 to take advantage of the 50% taxable capital gain rules and the 100% deduction on flow-through exploration investments. For example, if \$100 is invested in a flow-through share, the \$100 may be fully deducted and, the share would have a tax cost of zero, but would be considered *capital* property. Therefore, if the share was subsequently sold for \$100, there would be a \$50 taxable capital gain, giving an overall extra deduction of \$50 even though the selling price is equal to the cash input.

Caution: Tax shelters should always be analysed for their *investment* potential.

The preceding information is for educational purposes only. As it is impossible to include all situations, circumstances and exceptions in a commentary such as this, a further review should be done. Every effort has been made to ensure the accuracy of the information contained in this commentary. However, because of the nature of the subject, no person or firm involved in the distribution or preparation of this commentary accepts any liability for its contents or use.

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