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PERSONAL TAX

62(1)

MEDICAL EXPENSES - RETIREMENT HOMES

A *CCRA spokesperson* noted that CCRA will now *permit a medical expense* for the “*attendant care*” portion of the *retirement residence rent* paid by persons eligible to claim the “*disability amount*” - (requires a doctor’s certificate on Form T2201).

The operator of the “retirement residence” should *provide a receipt* showing the “*attendant care*” portion of the rent.

This should not affect people in “*nursing homes*” as they always have been *entitled to claim* the nursing home fees as a medical expense.

MEDICAL EXPENSES - RENOVATIONS

In a March 11, 2003 *Technical Interpretation*, CCRA note that reasonable expenses to *renovate or alter a*



dwelling of an individual who lacks normal physical development, or has a severe and prolonged mobility impairment, to enable the person to gain access to, or be mobile or functional within, the dwelling, would be a *medical expense*.

Also, in a January 7, 2003 *Tax Court* of Canada case, the taxpayer had a four year old son who suffered from severe *allergies*. Therefore, a doctor made a number of recommendations whereby the taxpayer

replaced the carpets with hardwood floors at a cost of \$8,179. The Court permitted \$6,000 as a medical expense as being a reasonable average cost to replace the rugs.

MEDICAL EXPENSES - SUPPLEMENTS AND ORGANIC FOOD

In a July 11, 2002 *Tax Court* of Canada case, the Court noted that prescriptions must be “*recorded by a pharmacist*” to qualify as a medical expense. The Judge commented: “whatever that accomplishes, I do not know, but the legislation is clear that they must be recorded by a pharmacist”.

Editor’s Comment

It appears that the Court is suggesting that simply “*recording by a pharmacist*” may allow a medical expense for necessary prescribed drugs and medicaments.

MEDICAL EXPENSES - ACNE FACIAL TREATMENTS

In a December 11, 2002 *Technical Interpretation*, CCRA notes that where a taxpayer makes a payment to an employee of a dermatologist for *facial treatments* to correct acne problems, the payments would likely be *medical expenses* on the basis that a dermatologist is a “*medical practitioner*”.

DISABILITY TAX CREDIT (DTC) - ORTHOSIS

In a May 9, 2002 *Tax Court* of Canada case, the taxpayer suffered from poliomyelitis and required the use of an *orthosis* to get around. The Court noted that one per-

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son may walk fairly well with an artificial leg (therefore no *disability tax credit*), while others might have a great deal of difficulty. It depends on the person’s own muscle strength and the type of prosthesis or orthosis required.

In this case, the type of orthosis required because of the existing but undeveloped limb still led to an *inordinate amount of effort* to walk. Therefore, the DTC was *allowed*.

EMPLOYMENT INCOME

62(2)

TIPS PROJECT

In some Canadian



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cities, including Calgary, CCRA are carrying out *projects* with respect to *unreported tips* in the hospitality industry. We understand that CCRA *may* just go back one year.

NON-COMPETE AMOUNTS

On March 11, 2003 the *Federal Court of Appeal* unanimously found that the receipt of a non-competition amount is *tax-free*.

The Court noted that:

1. "No doubt many will consider the result of this case to be unsatisfactory in terms of fiscal policy. I am sympathetic to the view that it seems unfair that the shareholder of a corporation who bargains for a non-competition payment in the context of a sale of the shares is not taxed on the payment, even though in economic terms it may represent the realization of a substantial part of the commercial value of the business of the corporation.

However, it is one thing to recognize an unsatisfactory state of affairs, and quite another to repair it."

2. The payments received under the non-competition agreements were *not* proceeds of disposition of property and, are not capital gains, they are *tax-free*.

Editor's Comment

This case may cause the *Department of Finance* to amend the Income Tax Act to deal with *non-competition receipts*. Therefore, it may be wise to take advantage of this decision prior to any legislative amendment.

COMMISSION SALESPERSON

In a November 26, 2002 *Tax Court* of Canada case, Mr. Gajos was a *sales employee* of Future Shop Ltd. paid on *commission*. He was required to sell in the *main store* as well as do comparison shopping at *other stores* and attend training sessions. He

incurred expenses such as the acquisition of supplies, business cards, day timers, trade publications, as well as vehicle expenses, as confirmed in the *Form T2200* signed by the employer.

The Court *permitted* most of the travel expenses and expenses such as advertising, meals, supplies and long distance telephones.

BUSINESS/PROPERTY INCOME

62(3)

AUTOMOBILE ALLOWANCE

In a January 10, 2003 *Technical Interpretation*, CCRA notes that an employer may pay a *reasonable automobile allowance* to an employee and deduct up to 41 cents per kilometre for the first 5,000 kilometres and 35 cents for each additional kilometre (45 cents/39 cents for the Yukon Territory, Northwest Territories and Nunavut).

Also, these per kilometre amounts will be considered *reasonable*, and therefore *not taxable* as employment income. However, CCRA also notes that where the payment exceeds the prescribed amounts, it may still be considered *reasonable*, and *not taxable*, given the proper circumstances.

An amount will be deemed *not to be reasonable* unless it is based solely on the number of employment kilometres driven.

INTEREST EXPENSE

The *February 18, 2003 Federal Budget* notes that the Department of Finance is not pleased with recent *Supreme Court* decisions which permit *interest expense deductions* when personal debt is reorganized into investment debt or, where the interest expense is significantly higher than the income generated. Therefore, the Department of Finance proposes to introduce *interest deductibility legislation* shortly with a period of public consultation to follow.

Editor's Comment

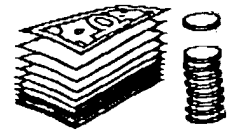
It may be important to *restructure debt* prior to the Department of Finance introducing new legislation.

MUTUAL FUNDS

Mutual funds may earn interest income, dividends, foreign interest and capital gains. These types of income *retain their character* when they are *distributed* to the investors. Investors holding units of a fund on distribution day must include that amount in income. Trusts distribute income to avoid having the income taxed in the Trust at top tax rates. Therefore, if an investor purchases units of a fund just before it pays a distribution, that person will be required to report *all of the income*.

TAX-FREE RECEIPTS

In a 2002 *Tax Court* of Canada case, IPSCO sued a supplier for additional costs of



\$7.6 million which they incurred because of the acquisition of a *faulty pipe treatment system*. IPSCO received an out-of-court *settlement of \$4.8 million*. For accounting purposes, IPSCO reduced the cost of the asset but, for tax purposes they showed the \$4.8 million as a *tax-free receipt*. CCRA reassessed on the basis that the asset cost should also be reduced for capital cost allowance purposes.

Good News!

The \$4.8 million was found to be a *tax-free receipt* with *no reduction in the cost of assets* acquired.

Also, in a November 28, 2002 *Federal Court of Appeal* case, the taxpayer received \$12 million from the City of Toronto on a *quasi expropriation* of their building - \$2.9 million for the land, \$1 million for the building, and \$9 million "in respect of *damages* occasioned as a result of the

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inability of the appellant to relocate its business". CCRA argued that the \$9 million should be shown as a disposition of *eligible capital property* with three-quarters, or \$6.5 million, shown as taxable income.

Good News!

The Court found that the \$9 million was a *non-taxable capital receipt*.

CAPITAL GAINS

62(4)

PRINCIPAL RESIDENCE EXEMPTION

It is noted on Page 42 of CCRA's *Capital Gains Guide* (T4037) that the amount of land that is considered as a tax free *principal residence* on disposition is usually limited to *one-half hectare (1.24 acres)*. However, if a taxpayer can show that more land was *needed* to use and enjoy the property, that amount is eligible as a principal residence. For example, if the *minimum lot size* imposed by a municipality at the *time you bought the property* is larger than one-half hectare.



CAPITAL DIVIDEND ACCOUNT (CDA)

If a *corporation* had *taxable capital gains* in the *three preceding* years, the corporation may trigger a capital loss on its loser investments in the *current* year to be *carried back* against those taxable capital gains. However, it is important to remember to *pay out the CDA* on the capital gain before the capital loss is triggered. For example, if a corporation had a capital gain in 2000 of \$100, taxable capital gain of \$75 and CDA of \$25, it is important to elect to pay the tax free \$25 CDA before a capital loss is triggered in 2003 which effectively negates the CDA if the CDA is not paid

out before triggering the capital loss.

CORPORATE TAX

62(5)

SHAREHOLDER AGREEMENT - DEEMED CONTROL/DEEMED ASSOCIATION

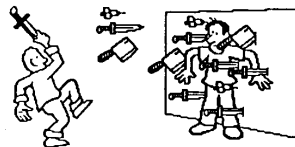
The Income Tax Act extends the *control* and *association* concepts to situations where a *shareholder* has a *right under a contract*, in equity or otherwise, either immediately or in the future and either absolutely or contingently to acquire shares... He/she will be deemed to have owned those shares unless the right is under a *death, bankruptcy or permanent disability*.

In a January 7, 2003 *Technical Interpretation*, CCRA reviewed a situation where the shares of OPCO were owned by Corporations A, B and C which were subject to the following "*cash-call provision*".

1. Under certain circumstances OPCO can issue a *demand for cash* to each shareholder in proportion to its shareholdings;
2. If a shareholder fails to advance the funds, another shareholder *may advance* the funds;
3. If the defaulting shareholder fails to repay the advancing shareholder within 90 days, the advancing shareholder may cause OPCO to proportionately *reduce* the defaulting shareholder's *shareholdings* in OPCO.

Bad News!

CCRA concluded that each corporation would be *deemed to own* all the shares of the other corporation for *control* and *association*



purposes.

FEBRUARY 18, 2003 FEDERAL BUDGET

62(6)

On February 18, 2003, the Honourable *John Manley*, Minister of Finance, presented his first Budget to the House of Commons.

Some of the more important *tax changes* include:

Child Disability Benefit

A *\$1,600 Child Disability Benefit* (CDB) for children who meet the criteria for the disability tax credit (DTC).

Medical Expense Tax Credit

New eligible medical expenses including:

- *Real-time captioning* for individuals with a speech or hearing impairment;
- *Note-taking* services used by individuals with mental or physical impairments and the cost of *voice recognition* software used by individuals with a physical impairment as certified by a medical practitioner; and
- The incremental cost associated with the purchase of *gluten-free food* for individuals with celiac disease.

Registered Pension Plan (RPP) and Registered Retirement Savings Plan (RRSP) Limits

The money purchase *RPP limit* will be increased to *\$15,500* for 2003, *\$16,500* for 2004 and *\$18,000* for 2005.

The *RRSP limit* will be increased to *\$14,500* for 2003, *\$15,500* for 2004, *\$16,500* for 2005 and *\$18,000* for 2006.



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Small Business Deduction

The *small business deduction* reduces the basic federal *corporate* income tax rate to **12 per cent** for the first \$200,000 of active business income of a Canadian-controlled private corporation (CCPC).

The annual amount of active business income eligible for the reduced 12-per-cent tax rate will be increased to **\$225,000** (year 2003); to **\$250,000** (2004); to **\$275,000** (2005) and after 2005, to **\$300,000**.

Federal Capital Tax

Eliminate the .225 per cent federal capital tax over **five years**, starting January 1, 2004.

Resource Taxation

Change the taxation of *resource income* by phasing in, over a period of **five years**: a *reduction* of the corporate income *tax rate* from 28 per cent to 21 per cent; a *deduction* for provincial and *Crown royalties* and mining taxes paid and the *elimination* of the existing 25-per-cent *resource allowance*; and a new tax credit for qualifying *mineral exploration expenditures*.

MARRIAGE BREAKDOWN

62(7)

SPOUSAL SUPPORT MADE AFTER DEATH

In a February 26, 2003 *Technical Interpretation*, CCRA notes that where Mr. A is paying *tax deductible support payments* to his former spouse (Ms. A), if, upon **Mr. A's death**, the Estate is required to continue to make the periodic payments, the amounts will **not be deductible** to the Estate, or be **taxable** to Ms. A.

RRSP ROLLOVER

The Income Tax Act provides for **an RRSP**



rollover from one spouse to the other spouse under a *division of property* arising on the breakdown of a marriage or common-law partnership.

In a favourable 2002 *Advance Income Tax Ruling*, the taxpayer and the spouse had **previously entered** into a separation agreement which provided for periodic *monthly support* amounts.

The agreement is to be amended to *delete* the future *support payments* and replace them with a transfer from the *taxpayer's RRSP* to the former spouse's RRSP on a rollover basis.

CANADA PENSION PLAN (CPP) - CREDIT SPLITTING

When a *relationship ends*, the *Canada Pension Plan* pension credits which the couple built up during the time they lived together can be **divided equally** between them.

SUPPORT PAYMENTS

It is noted in CCRA's *Guide P102*, that if a person wishes to **deduct alimony** he/she must **register** their *Order or Agreement* by completing *Form T1158*. Also, a payor of alimony may request CCRA to **reduce** the amount of *income tax* that an employer is deducting from salary by completing Form 1213 (Request to Reduce Tax Deductions at Source).

COMMON-LAW COUPLES

The December 20, 2002 issue of the *Globe and Mail* notes that *common-law partners* (unlike married couples) **do not** have a guaranteed right to a **50-50 split** of assets when the relationship collapses based on a recent *Supreme Court of Canada case*.

This *case* involved Susan Walsh and Wayne Bona, a couple who cohabited for ten years and had two children. After the breakup, Ms. Walsh wanted a share of the assets in Mr. Bona's name. She sought to

have Nova Scotia's Matrimonial Property Act declared unconstitutional because it **excluded** common-law *partners* from its definition of *spouse*. The Court noted that extending the legal consequences of marriage to common-law partners would "nullify the individual's freedom to choose alternative family forms, and to have that choice respected by the state".

REDO THE DEAL

It was noted in the October 28, 2002 issue of the *National Post* that Eric Miglin is appealing an *Ontario Court of Appeal* Decision to the Supreme Court of Canada. The Ontario Court had ruled that Mr. Miglin's spouse could **reopen their property settlement and alimony agreement** if there are material changes and circumstances that would have likely led to a different agreement if they had been known at the outset.

In this case, Ms. M got the Toronto home worth \$500,000 as well as \$60,000 a year to support their four children. Mr. M retained the Killarney lodge which receives millions of dollars annually. The Ontario Court adjusted the agreement to provide Ms. M with an additional \$4,400 a month for personal support.

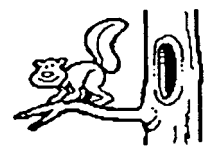
This case could affect thousands of **divorced couples** who would like to **redo** their Divorce Agreement.

FARMING

62(8)

SALE OF TIMBER

In a December 5, 2002 *Tax Court* of Canada case, the taxpayers entered into a **five-year plan** to have **trees removed** from their farm property. The Court concluded that the gain was **capital** (not business income)



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even though the property was *not being used for farming*.

Arguments *in favour* of “*capital*” included that the property was originally acquired with the *intention* of farming, the property had been owned for over *forty years* and there was no timber sold until recently.

CCRA’s argument that the amounts should be income on the basis that it was a sale based on *production or use*, was *not correct* because it was really a *single final transaction* transferring all the timber.

Also, on January 3, 2003, CCRA introduced new *IT-373R2* which discusses the *taxation of woodlots* including woodlots operated as farms. The criteria needed for capital treatment and capital gain exemption are discussed.

SEASONAL AGRICULTURAL WORKERS

In February, 2003 CCRA introduced *Guide RC4004* - Seasonal Agricultural Workers Program. This Guide discusses how *seasonal agricultural workers* are taxed, employer withholdings, waivers from withholding tax, transferring a worker to another employer, and the filing of tax returns, and double taxation issues.

ROLLOVER TO CHILD

In a December 23, 2002 *Technical Interpretation*, CCRA notes that where *farm property* is *rolled over* to an adult child and the property is *then sold* within a *three year period* by the child who uses the *qualified farm property* capital gain deduction, CCRA can deny the tax deferred rollover.

NISA FUNDS - NOT SEIZABLE BY CREDITORS

It was noted in the December 12, 2002 issue of the *Manitoba Co-operator* that the Manitoba Court of Appeal ruled that a *creditor* may *not seize* the farmer’s *NISA*

account. This overturns a lower court ruling. (*Mini G. Enterprises Ltd. vs. Gary and Ron Kendrick*)

ESTATE PLANNING

62(9)

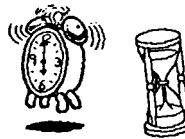
LOAN TO TERMINALLY ILL POLICYHOLDER

In a February 25, 2003 *Technical Interpretation*, CCRA notes that the *Financial Services Commission of Ontario* has recommended that *life insurance companies* should *provide funds* to *terminally ill* policyholders who have a life expectancy of less than *twenty-four months*.

While not legally obligated to provide funding to these policyholders, many life insurers are considering *providing loans* to the policyholders out of the *insurer’s general funds*.

SPOUSAL TRUSTS

CCRA note in a February 4, 2003 *Technical Interpretation* that where the income of a *spousal trust* is payable to the spouse, if the trustee would like the income taxed in the trust an *election* must be made. Otherwise, the amount must be *deductible* to the trust and included in *income* by the spouse.



INTERNATIONAL

62(10)

U.S. REAL ESTATE SALES

The *United States* imposes taxes on profits on the *sale of U.S. real estate* by a Canadian under the Foreign Investment in Real Property Tax Act. To enforce collection, a *10% withholding tax* is paid to the IRS *by the purchaser* at the time of purchase. A Canadian person may be *exempt* from the

10% withholding tax if the selling price is *less than \$300,000* and the *buyer* intends to use the property as a “*residence*”. The buyer must sign an affidavit to this effect. Alternatively, if this exemption is not available, the vendor can *apply to the IRS* for a reduction in the withholding tax to the maximum possible U.S. tax.

Also, some states have a withholding tax on the selling price of real property, including Arizona and Hawaii.

The Canadian person then files a *U.S. tax return* (Form 1040NR - Individual or Form 1120F - Corporation) and shows the withholding tax, if applicable, as a *tax installment*. A *foreign tax credit* may be claimed on the Canadian tax return to the extent that the income is taxed on the Canadian tax return.

EMIGRATION

Individuals who *cease to be resident* in Canada are *deemed* to have *disposed* of property at fair market value with the following exceptions (Subsection 128.1(4)):



- (i) real property located in Canada;
- (ii) property used in a business carried on through a Canadian permanent establishment;
- (iii) certain “rights and interests”, such as pension and deferred income plans, RPPs, RCAs, RRSPs, RRIFs, CPP, OAS, etc.;
- (iv) employee stock options; and
- (v) where the individual was resident in Canada for 60 months or less in the last 120 months before leaving Canada, any property owned by the individual when the individual last moved to Canada or inherited during the period of residency.

The emigrating individual may *defer pay-*

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ment of the tax on the capital gain *by posting security* with CCRA.

However, security is not generally required on the first **\$50,000 of taxable capital gains** resulting from the *deemed disposition*.

TRANSFER PRICING

It was noted in the December 30, 2002 issue of the *Financial Post* that about 85% of Canada's top sixty firms, and more than half of the largest three hundred firms listed on the Toronto Stock Exchange, use some form of *transfer pricing*, possibly with the intent of transferring profits outside of Canada.

For example, a T-shirt costing \$1 to make may be manufactured in a tax haven country and sold to a Canadian subsidiary for, say, \$10 and then subsequently sold so that the \$9 profit is earned outside Canada.

Therefore, CCRA has added **40 new auditors** to the International Tax Department, bringing a total of 278, whose job it is to ensure that *cross-border transfer pricing* is correct and that profits are not being transferred outside of Canada. This is the "number 1" issue of CCRA's International Taxation Department. Therefore, most accountants are advising clients to *review their transfer pricing policies* in light of this recent CCRA attention.

GST

62(11)

SORRY - NO ITC

In an August 26, 2002 *Tax Court* of Canada case, Alexander Nix Group Inc. purchased supplies from 864116 Ontario Ltd. (864). After being provided with a *GST registration number* from 864, the appellant paid **\$3,766 GST** on \$53,874 of services and then claimed the \$3,766



input tax credits (ITCs). The registration number that 864 provided was the company's original GST number but was *invalid* as it had been *deregistered* years earlier.

The Court *denied the ITC*. The primary reason was because it was deemed the appellant's responsibility to obtain a *valid GST registration number*.

INTERNET SUPPLIES

In December, 2002 CCRA released a number of *Rulings* that discuss GST on *internet supplies* to non-residents.

For example, Ruling No. 33017 (August 16, 2002) notes that *job search videos* which may be viewed by Canadians and non-residents are considered to be "*made in Canada*" and, therefore subject to *GST*. However, this may not be the case had access been *limited to non-resident customers*.

In another Ruling No. 32713, CCRA Ruled that *GST* must be charged by an *internet radio station* on fees received for advertising various musician services as this is considered to be supplied in Canada.

In another Ruling 32742, CCRA Ruled that *digitized artwork* available to residents and non-residents of Canada would be considered to be supplied in Canada.

KEEP THE INVOICES

One of the major reasons for GST reassessments is improper input tax credit documentation. CCRA GST auditors require *proper invoices* to support input tax credits. For example, if the *input tax credit* is supported merely by a *credit card* slip, and not the invoice, it may *not be allowed*.

The source document should show the supplier's GST registration number. This is not available on credit card receipts, bank statements, and cancelled cheques which, some clients, use as substantiation for their input tax credits.

REMITTING GST ON TAXABLE BENEFITS

GST must be *remitted* on an employee *taxable benefit* unless the benefit is zero-rated or tax exempt - such as the benefit on low-interest loans. Taxable benefits that are not exempt include *automobile* standby charges and operating expense benefits.

VOLUNTARY DISCLOSURE

On June 12, 2002, CCRA issued its revised *Voluntary Disclosure Program* (VDP) including the introduction of a policy to make a "*no-name*" disclosure on *Form VDP-1*. The no-name disclosure does *not identify the name* of the taxpayer but should be *complete* and include all relevant information to permit the CCRA officer to review the situation.

The taxpayer would then proceed with a *full disclosure* by a negotiated deadline, or alternatively choose not to follow the Voluntary Disclosure process.

This Program is administered by CCRA's *Appeals Division*.

DID YOU KNOW...

62(12)

WEB TIPS

1. *Financial Advice, Rates and Comparisons*

If you want information on finances, this site contains several useful tools, including *mortgage amortization calculators, mortgage rate comparisons* (updated daily), *rent vs. own calculators, retirement calculators*, and many more.

(<http://finance.canada.com/bin/putform?Type=Calculator> or go to <http://finance.canada.com> and click on the "calculators" button)

This website is hosted by *CanWest*

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Global Communications Corp. (National Post, Global TV etc.)

2. **Canadian Retirement Income Calculator** - <https://srv260.hrdc-drhc.gc.ca/> or go to www.hrdc.gc.ca and search for "Canadian Retirement Income Calculator".

Hosted by H.R.D.C., this calculator provides a **forecast of annual pre-tax retirement income**. With the use of a seven module procedure, this tool allows users to **manipulate most conditions** that affect **C.P.P.** (i.e. taking it early or reducing the number of years paid into the plan), **O.A.S.**, **employer pensions**, **RRSP**, and other **income amounts**. Once the appropriate information is entered, a summary may be printed. One may then change pieces of previously entered data and print out the new summary sheet for comparison.

SPOUSAL C.P.P. SPLITTING

It is possible for **spouses** and **common-law partners** to adjust their **CPP receipts**



so that each person receives half of the pension earned for the years when the two partners **were together**.

To make this "**assignment**" each partner must be at least sixty years old.

This may **significantly reduce income taxes** if CPP income is shifted to a lower income spouse.

CHILD REARING DROP-OUT PROVISION - CPP

It is noted in the Human Resources website (www.hrdc.gc.ca) that where a person left the labour force and had a **child under the age of seven**, these years may be **excluded** in the calculation of the **CPP benefits**. This has resulted in **refunds** to many persons who have been receiving their CPP benefits but are only now advising HRDC of their children. To apply, the child's birth or baptismal certificate will be needed. For further information contact 1-800-277-9914.

WEST AFRICAN/NIGERIAN FRAUD LETTERS

Over the past few years, **fraudulent letters** claiming to originate in Nigeria and other West African nations have been received

by individuals. Recently, there has been a **resurgence** in these letters in an **email form**. Generally, these letters implore the receiver to take part in a **currency transfer plan** where the receiver is promised rewards amounting to millions of dollars. The intent of the sender is to abstract money from the receiver in advance in the form of items such as unforeseen taxes, banking fees, and administration fees.

If you receive a letter or proposal that has these characteristics or is somewhat questionable, contact "Phonebusters" (operated by the **Ontario Provincial Police**) for more information at **1-888-495-8501**, email: waf1@phonebusters.com, web: <http://www/rcmp-grc.ca/scams/nigerian>.

The **website** also includes valuable information about **other telemarketing scams**, how to spot a scam, how to report a fraud and information on charges, arrests, counts and sentencing.

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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