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PERSONAL TAX

59(1)

DISABILITY TAX CREDIT

Individuals that qualify for the *Disability Tax Credit* (DTC) save between \$1,300 and \$1,700 per year, depending on your province of residence.

Under the *Fairness Provisions* of the Income Tax Act, CCRA may issue refunds for an *individual* back to 1985 for missed deductions or credits.

However, in an April 19, 2002 *Tax Court* case, the taxpayer suffered a *brain injury* in an accident in 1975 and filed a *Notice of Objection* in 2000 to claim the *DTCs* for the years 1985 to 1998. Unfortunately, CCRA did *not permit* the application of the *Fairness Provisions*. Only 1998 was not statute barred.

In a June 24, 2002 *Tax Court* case, the Court found that the *taxpayer's bipolar affective disorder* met the three requirements to claim a *DTC*.

- (i) was a severe and prolonged mental or physical impairment;
- (ii) the impairment markedly restricts the taxpayer's ability to perform a basic activity of daily living; and
- (iii) the taxpayer provides a doctor's certificate certifying (a) and (b) above.

However, in other *bipolar affective disorder* cases the individual was not sufficiently impaired to qualify for the *DTC*.

In a May 28, 2002 *Tax Court* case, a taxpayer who suffered from *Celiac Disease* was entitled to the *DTC*.

In a January 16, 2002 *Tax Court* case, the Court found that the taxpayer was *eligible for a DTC* with respect to his fourteen year old *daughter* who was markedly restricted in her ability to *think, perceive and remember*. The daughter attends a *private school* for those with learning disabilities.

Unfortunately, the Court could only *permit the DTC* for the year which was not *statute-barred*, 1999. Therefore the *DTC* was not permitted for the years 1987 through to 1998. As mentioned above, under the *Fairness Provisions*, CCRA may permit a taxpayer to go back to 1985 however, in this case CCRA did not agree to this adjustment.

MEDICAL EXPENSES

In an April 25, 2002 *Tax Court* case, the taxpayer paid \$9,266 as *tuition fees* for his eleven year old son to attend a *special education school* as prescribed by a psychologist to correct specific *learning disabilities*.

The Court permitted the amounts as *medical expenses* because the *facilities* at the school included special equipment and personnel for the care and training of individuals suffering from this handicap.

Also, in a *Technical Interpretation* CCRA notes that a



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credit for *medical* related *travelling expenses* is allowed if certain criteria are met, including that *substantially equivalent medical services* are not available in the person's locality.

GUARANTEED INCOME SUPPLEMENTS (GIS)

Every year many low income seniors *lose GIS benefits* because they either fail to renew their application or they do not make an initial application. The *GIS benefit* is available for low-income persons aged 65 or over upon an *annual application*.

In the year a person turns *age 65*, the person *must apply* for the Old Age Security and Guaranteed Income Supplement. After this initial application, in most cases, but not all, the *annual filing* of the tax return *on time* will usually generate the monthly

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cheques. If the senior has missed the application, CCRA generally only allows them *to go back one year* to claim the lost amounts.

The GIS is based on a person's *annual income*, or the combined annual income of the person and their spouse or common-law partner. If a person marries or separates, or if the spouse dies, you must let Human Resources and Development Canada (HRDC) know as it will affect your benefits. Also, if you and your spouse or common-law partner are *separated* for reasons *beyond your control* (for example, if one of you has to live in a hospital or nursing home), you can *each be considered* as a single person if that will give you a higher monthly payment.

For very low income seniors, the maximum GIS payment is \$528 a month. The average monthly GIS benefit for a single eligible retiree is \$373. The GIS benefits *fall to zero* for persons with annual income *above \$12,672*.

It was also noted in the *National Post* that *HRDC* recently paid a *five-year GIS back payment* for \$20,000 to an elderly woman in 1999 even though they normally just go back one year. In this case, HRDC decided that they had made an administrative error by not making sufficient efforts to inform her of her eligibility. The Article notes that approximately *300,000 seniors* who qualify for GIS, but have not applied, *could benefit* by this *precedent* to a total of \$2.5 billion.

The GIS is discussed at www.hrdc-drhc.gc.ca/isp/oas/ispb184.shtml or call 1-800-277-9914.

CONJUGAL RELATIONSHIP

The term "*spouse*" has been extended to include a "*common-law partner*" which is "a person who *cohabits* in a *conjugal relationship* with the taxpayer and has so

cohabited with the taxpayer for a continuous period of at least one year, or would be the *parent of a child* of whom the taxpayer is a parent..." Also, where there is a conjugal relationship, this status will continue unless they are not cohabiting for a period of at least *ninety days*.

In a June 11, 2002 *District Office Memo*, CCRA notes that the characteristics of a *conjugal relationship* include shared shelter, sexual and personal behavior, social activities, economic support and children, as well as the societal perception of the couple. However, these elements may be present in *varying degrees* and not all are necessary for the relationship to be found to be "*conjugal*".

A couple may, after many years together, be considered to be in a *conjugal relationship* even though they have neither children nor sexual relations.

EMPLOYMENT INCOME

59(2)

EMPLOYEE'S SPOUSE

In a May 8, 2002 *Technical Interpretation*, CCRA notes that where an *employee's*

spouse accompanies the employee on a *business trip*, the payment by the employer of the spouse's travelling expenses is a *taxable benefit* to the employee *unless* the spouse went on the trip *at the request* of the *employer* and, it can be established that the *main purpose* of the spouse's attendance was to assist in obtaining the *business objectives* of the trip.

In this *Technical Interpretation*, *spouses* of the President and CEO *accompany* them to meetings and, while there, participate in networking to foster respect and coopera-



tion between the attendees. Therefore, there was *no taxable benefit* to the President and CEO.

SALES EXPENSES

In a June 19, 2002 *Technical Interpretation*, CCRA note that a *commissioned salesperson* may deduct expenses if *required to incur* the expenses under his/her contract of employment. CCRA also notes that where an amount paid to a *substitute or assistant* by a commission sales employee is *reasonable*, it would generally be *deductible*.

BUSINESS/PROPERTY INCOME

59(3)

REASONABLE EXPECTATION OF PROFIT (REOP)

In a May 23, 2002 *Supreme Court* case, the Court found that losses should *not be denied* to a taxpayer by CCRA under the *REOP* argument unless there is a *personal element* to the business and, only then if it is not clearly a commercial enterprise.

In this case, Mr. Stewart acquired four condominiums for a total of \$280,000, having debt against them of \$276,000, and incurred losses in the years 1990, 1991 and 1992 totalling \$58,000. The Federal Court had previously found that the losses were not allowed but, the *Supreme Court* reversed this opinion and *allowed* the losses.

TRANSFER OF COMMISSIONS TO CORPORATION

In an April 11, 2002 *Technical Interpretation*, CCRA notes that a *corporation* may carry on a *profession unless* provincial law or the regulatory body for the profession provides that *only individuals* may carry on such a business.

CCRA note that where such individuals are

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legally precluded, either by *statute* or *contractually*, from assigning their commissions to a corporation, then the commission income must be reported by the *individuals*, and not their corporations.

In a May 17, 2002 *District Office Memo*, CCRA again note that if *insurance agents*, *financial planners*, or other professionals are *legally*, whether contractually or by statute, *precluded* from assigning their income to a corporation, then the income *must be reported* by the *individual*.

PROFESSIONAL EDUCATION

In a January 25, 2002 *Tax Court* case, the taxpayer, a licensed *pharmacist* in Ontario, attended *five professional development courses* in the *year* costing \$2,084. CCRA disallowed the expenses on the basis that this was an *excessive* number of courses.

Good News!

The Court *permitted* the deductions and noted that:

1. CCRA should say to the appellant, “*Good for you*. You are making sure that your qualifications are right up to snuff...”
2. This concern for professionals to *maintain proper standards* is similar to that faced by lawyers, doctors, engineers, etc.
3. All of the courses were *recognized* by the Ontario College of Pharmacy’s continuing education program.



EXPENSE FOR ACCUMULATED VACATION PAY

In a February 23, 2001 *Federal Court of Appeal* case as at *December 31, 1992* the amount of *vacation pay* payable for the year was \$3,010,563 (8% of the 1992 salaries of \$37,632,000). This was shown as an *expense* during *1992* and *accepted* by *CCRA*. The employer also deducted an

estimated amount of the *employer contributions* on this vacation pay at a weighted rate for 1992 for all the Plans. (25% x \$3,010,563 = \$752,640) *CCRA disallowed* this deduction.

Good News!

The *Federal Court of Appeal* permitted the deduction and noted that the *employer’s obligation* to *pay* these premiums occurs *in 1992* when the vacation pay is *earned*. Payment of the vacation pay when the employee takes the vacation in 1993 is irrelevant as the “*expense*” has already *been incurred in 1992*.

CHARITIES

59(4)

FORM T3010

Form T3010 notes that *all charities* must complete *Sections A to J* (which are available to the public) and *Schedules A to C* (which are confidential). The problem is that it is the *same thirteen-page form* for large and very small charities. If a charity *does not submit* Form T3010 it could be *deregistered* by CCRA.



GIFTS IN KIND

In a June 4, 2002 *Technical Interpretation*, CCRA notes that gifts of *cakes, pies or baking supplies* constitute *gifts in kind* for which a registered charity could issue a *tax receipt*. However, the charity should *consider* the impact on its *disbursement quota*. For example, if a charity issues a tax receipt for \$5 in respect of a gift of a pie, the charity’s *disbursement obligation* for the following year would increase by \$4 (80% of \$5).

Also, CCRA note that a charity may pay a

fee for services rendered and the taxpayer may then *donate the amount back* and claim a charitable donation credit. Of course, the amount received for the services would be taxable. However, the donation credit may more than offset the tax on the service income.

MARRIAGE BREAKDOWN

59(5)

THIRD PARTY PAYMENTS

In a May 24, 2002 *Tax Court* case, in 1997 and 1998 Mr. R paid *third-*



party payments under a *marriage breakdown* agreement totalling \$27,000 and \$37,793 which were deducted by Mr. R and included in income by *Mrs. P*, his former spouse. However, in 1999 Mrs. P requested that the \$27,000 and \$37,793 be *taken off her return* on the basis that they were *not taxable* because the provisions of Sections 56.1 and 60.1 were *not mentioned* in the *Agreement*.

The Court agreed and noted that the Agreement did *not* use the *statutory language required*. Therefore, the amounts were *not deductible* to Mr. R or taxable to Mrs. P.

FARMING

59(6)

LOSSES

In an April 30, 2002 *Tax Court* case, Mr. and Mrs. M commenced a llama farming partnership in 1992 and *substantial losses* were claimed each year. In the years *1995 and 1996*, Mr. M’s losses were *restricted* by CCRA to *\$8,750* on the basis that farming was not his principal preoccupation. In those years, Mr. M had T4 employment income of \$52,816 and \$52,860.

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Good News!

The Court allowed the **full deduction** for Mr. M and noted that he was a **legitimate**



startup farmer with a reasonable expectation of profits. He is entitled to a **startup period** of at least **five years** to build up a herd and have a few sales. The three-year period allowed by CCRA is too short in view of the maturity period that llamas require.

It was also noted in the May 23, 2002 issue of the *Manitoba Co-operator* that a **Commons Agriculture Committee** was told by tax experts that a **full-time farmer** who has to take an **outside job** to support the farm should be able to **claim all the farm losses** for tax purposes **without** application of the **restricted farm loss** rules.

This was generally **agreed** to by CCRA. CCRA noted that where a person who has been supporting himself/herself on the farm goes **off-farm to support** the farm, that person may continue to deduct full losses.

PENSIONS

59(7)

REGISTERED RETIREMENT INCOME FUND (RRIF) TRANSFER TO A DEPENDENT CHILD

In a June 14, 2002 *Technical Interpretation*, CCRA notes that **upon the death** of the last annuitant of a **RRIF**, the RRIF is included in the **deceased annuitant's income** for the year of death unless rolled over to a **spouse**.



However, this income inclusion may be

reduced by RRIF allocations to a **child or a grandchild** who was **financially dependent** on the annuitant at the time of death. This amount would be **taxable to the recipient child or grandchild**. However, if the child or grandchild is **physically or mentally infirm**, a deduction may be allowed if the amount is **transferred to an RRSP, RRIF or an annuity** under which the child or grandchild is the annuitant.

Similar rules apply to bequests of **RRSPs** to dependent children or grandchildren.

INTERNATIONAL

59(8)

U.S. CITIZEN OR U.S. RESIDENT - RRSP

A **U.S. citizen or U.S. resident** who owns an **RRSP or RRIF** must either report the income earned in the RRSP/RRIF annually or, make a **special election** on a "timely" filed U.S. Form 1040 Personal Tax Return. Many of these individuals **inadvertently assume** that the income earned in the RRSP/RRIF was also deferred for U.S. purposes.



MOVING TO THE UNITED STATES - RRSP OR RRIF

If an RRSP or RRIF is **withdrawn prior** to moving to the U.S. (or to any country for that matter), the amounts will simply be included in income and taxed at the taxpayer's **marginal rates**.

However, if an amount is withdrawn **after becoming a U.S. resident** the payments are subject to a **25% Canadian withholding tax** unless, the payment is a "**periodic**" amount requiring only a **15% withholding tax**.

A "**periodic pension payment**" could apply to an **annuity** from an RRSP or **small withdrawals** from a RRIF.

Therefore, it is **usually advantageous** to leave the **RRSP** intact when moving to the United States.

For U.S. tax purposes, it is possible to avoid paying tax on the **annual accrual** of income in the RRSP by filing an Election with the U.S. tax return.

Upon withdrawal from the RRSP, the U.S. will consider **each withdrawal** to be a combination of **capital and income**. However, a **foreign tax credit** may be claimed on the United States return to offset the Canadian withholding tax of **15% or 25%**.

Also, it may be important to **crystallize** the cost in an RRSP before leaving Canada so that the **sum of contributions** to the **plan** will be equal to the **fair market value**.

SNOWBIRDS

New United States legislation proposed that there would be a **thirty-day cap** on **visits** by **foreign nationals** to the United States. However, the head of the U.S. Immigration and Naturalization Service recently sent a letter to the President of the Canadian Snowbird Association noting that **snowbirds** are in fact **eligible for six-month** stays.

GST

59(9)

QUICK METHOD OF ACCOUNTING

A business may use the **Quick Method of Accounting** if the **annual taxable sales** (including zero-rated sales) and those of your associates are **no more than \$200,000** (including GST/HST) in **four**



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consecutive quarters in the five quarters immediately preceding the effective date of the election. The \$200,000 limit does not include supplies of financial services, sales of real property, sales of capital assets, sales of eligible capital property and goodwill.

Under the *Quick Method*, the business *charges* and collects the 7% *GST* (or 15% HST) on taxable goods and services but the amount to be remitted is based on a *lower remittance rate*.

The most common *remittance rates* are:

5% (or 10% for businesses in HST provinces - New Brunswick, Nova Scotia, Newfoundland) for *service* businesses, such as delivery services, dry cleaners, auto repair shops, etc.; and

2.5% (or 5% for businesses in HST provinces) for *retailers and wholesalers*, including grocery and convenience stores, that buy goods to resell in the same form as they are bought or to use in goods they produce or manufacture to resell.

The business is also entitled to a 1% *credit* on the first \$30,000 (including

GST/HST) of *eligible sales* on which you must collect 7% GST or 15% HST.

When a business uses the Quick Method, it *cannot claim input tax credits (ITCs)* for expenses and purchases on operating expenses, meal and entertainment expenses, and inventory purchases. However, it may claim *ITCs* on certain purchases, such as land and purchases eligible for capital cost allowance deductions.

An *annual filer* has up to *three months* from the beginning of the fiscal year to file an election for it to be effective that year. A *monthly or quarterly filer* has until the *due date* of the return for the reporting period in which it wants to start using the Quick Method.

Certain businesses *cannot use* this method, such as *accountants, bookkeepers, notaries, tax consultants, lawyers and financial consultants*.

To use the *Quick Method*, elect on *Form GST74* which is in *CCRA Guide RC4058*.

DID YOU KNOW...

59(10)

THIRD PARTY LIFE ANNUITY CONTRACTS (TPLAC)

A *TPLAC* is a contract owned by and payable to *one person* but where the annuity payments are made throughout the *lifetime* of *another individual*. This could include annuities owned by charitable organizations or trusts, annuities owned by an individual on the life of a spouse or former spouse and corporate-owned annuities.

A *TPLAC* has *very onerous tax implications* such as *income inclusions* that are *significantly higher* than the interest element of the annuity contract.

The *Conference for Advanced Life Underwriting (CALU)* is meeting with the Department of Finance to attempt to rectify this anomaly. See website www.calu.com and click on *June 19, 2002; Third-Party Life Annuity Contracts* for details.

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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