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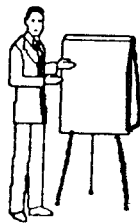
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## PERSONAL TAX

63(1)

### DISABILITY TAX CREDIT (DTC) - PROSTHETIC DEVICE

In an April 8, 2003 *Tax Court* of Canada case, the taxpayer suffered from a congenital birth defect that required him to wear a *prosthetic device* - a partial artificial



left leg. The device may only be worn for ten to twelve hours a day and, even while worn, the taxpayer feels a certain amount of pain.

The Court permitted the DTC and noted that Mr. R could *not* use the prosthesis *at all times* and, even when it was used, his ability to walk could not be compared favourably to an able-bodied person.

## EMPLOYMENT INCOME

63(2)

### DEFENSIVE DRIVING COURSE

In a March 25, 2003 *Technical In-*



*terpretation*, Canada Customs and Revenue Agency (CCRA) notes that where an employer pays for a *defensive driving course* for an employee whose duties involve a lot of driving, this likely will *not* be a *taxable benefit* to the employee but will

be *deductible* to the employer.

### Editor's Comment

In *owner-manager* situations, this beneficial treatment may only apply to *Employment* rather than *Ashareholder* based benefits. *Documentation* is important.

### RETIRING ALLOWANCE

In a March 20, 2003 *Technical Interpretation*, CCRA notes that where *employment* has *ceased* and the former employees go into business and some of their *business income* is earned from their former employer, the severance payments paid to the former employees would qualify as *retiring allowances* eligible to be rolled over to an *RRSP*.

The maximum amount that may be rolled over is \$2,000 for each year employed prior to 1996 and an additional \$1,500 for each year prior to 1989 for which the employer's contributions to a pension plan or deferred profit sharing plan had *not vested* at the time the retiring allowance is paid.

### EXPENSES

In a February 5, 2003 *Tax Court* of Canada case, the taxpayer was an *investment advisor* for Wood Gundy and incurred expenses in earning his commission employment income. The Court *permitted a deduction* for out-of-pocket costs - such as *donuts* that he purchased by the dozen and dropped off in various lunch rooms of clients. Also, he was permitted to deduct *small tools*.

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Unfortunately, *computer* capital cost allowance (CCA) was *not allowed* as the Income Tax Act only permits employees to claim CCA on automobiles, aircraft and musical instruments.

### Editor's Comment

Alternatively, *leasing* computers is deductible.

### SHORT-TERM DISABILITY INSURANCE

In a May 21, 2003 *Technical Interpretation*, CCRA notes that when an employer provides a *short-term disability insurance plan* or a *paid sick leave plan* for its employees that meets certain conditions, the employer can *apply* for a *reduction* of employment insurance (EI) premiums. If this is approved, *5/12* of the reduction *must* be given to the employees.

# Tax Tips & Traps

## Editor's Comment

For details, see website [www.hrdc-drhc.gc.ca/prp-prtc](http://www.hrdc-drhc.gc.ca/prp-prtc).

## TEACHERS

In a May 29, 2003 *Correspondence*, CCRA remind *teachers* that they may *deduct supplies* required to be purchased in their employment. This *requirement* could be through a *written contract* with the employer or be *understood* that the employee was to make such payments. Therefore, a teacher may deduct the cost of supplies, whether there is an express or an implied requirement to provide the supplies, *if the employer has certified* that the employee qualifies for the deduction by completing *Form T2200*.

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## BUSINESS/PROPERTY INCOME

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### 63(3)

#### REASONABLE EXPECTATION OF PROFIT (REOP) - RENTAL PROPERTY

In a May 26, 2003 *Federal Court of Appeal* case, the Tax Court had previously disallowed the losses on a rental house in Edmonton, Alberta on the basis that there was no REOP because there was a non-deductible *personal element*. The property had formerly been the Appellant's *home*, the Appellant used the property as collateral for a line of credit for his realty business, and the Appellant acknowledged *retaining pride* in maintaining the home as an asset to the neighbourhood.

#### Good News!

The *Federal Court* overturned the Tax Court decision and found that these *elements are not* sufficient to make the property something *other than a commercial activity*.

## HAWAIIAN CONDOMINIUM

In a May 20, 2003



*Tax Court* of Canada case, a corporation acquired a *Hawaiian condominium* in 1985 and rented it out until 1992 at which time it was *simply used* by the owner and employees and clients for promotional purposes.

The Court *disallowed* the owner's *travel expenses* to the Hawaiian Condominium as *personal* in nature. However, with respect to the *costs related to the condo*, such as *interest expense, utilities and condo fees*, the Court found that 20% of the days used were by the owner and the balance were by customers or employees. Therefore, 20% of the expenses were disallowed as an expense to the company and were taxable to the owner.

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## CAPITAL GAINS

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### 63(4)

#### QSBC SHARE

In an April 23, 2003 *Technical Interpretation*, CCRA notes that for the capital gain on the sale of a qualified small business corporation share (*QSBC*) to be eligible for the *capital gain exemption*, criteria must be met including that the share must not have been owned by anyone other than the individual, or a related person, throughout the twenty-four months immediately preceding the disposition. Also, the Income Tax Act *deems* shares that were issued after June 13, 1988 to have *been owned immediately before* their issue by a non-related person *unless* they meet specific circumstances, such as being issued as part of a transaction in which the person disposes of *all or substantially all* of the assets used in an active business.

In this Technical Interpretation, the taxpayer carried on a *trucking proprietorship*. He had two different buyers for his trucks and, therefore, wished to transfer some trucks on a rollover basis to *one cor-*

*poration* and the other trucks to the *other corporation* and then sell the shares of each corporation and claim the capital gain exemption.

Not surprisingly, CCRA concluded that the shares would *not be eligible* for the capital gain exemption because *all or substantially all* of the assets used in active business proprietorship were not transferred to each corporation.

## REPLACEMENT PROPERTY

In a May 22, 2003 *Technical Interpretation*, CCRA notes that a taxpayer may *elect* to *defer* the income or capital gains where a "*former property*" is *involuntarily* disposed of or, a "*former business property*" is *voluntarily* disposed of, and "*replacement property*" is acquired.

## NON-COMPETITION PAYMENTS

The *Federal Court* recently found that amounts received for signing a *non-competition agreement* were tax-free. Consider this:

1. Until there is *future legislative or jurisprudential developments*, the seller of shares of a corporation may receive a *tax-free receipt* for signing a *reasonable non-competition* agreement.
2. The result may be *different* for a person receiving the payments who *carried on the business*, such as a sole proprietor, partner, or corporation.
3. It may be prudent to engage an *expert* to determine the *value* to be assigned to the non-competition amount.

## Editor's Comment

*Caution* - If a current, former, or future employer of the recipient makes the payment, it could be considered *employment income*.

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# Tax Tips & Traps

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## TRANSFER OF CAPITAL LOSS TO A SPOUSE

In a May 27, 2003 *Technical Interpretation*, CCRA reviewed a situation where Mr. X owns shares with an adjusted cost base of \$100,000 and a fair market value of \$5,000. As Mr. X has never had any capital gains, the capital loss will be of little value to him. However, Mr. X's wife had substantial capital gains and would like to use Mr. X's accrued capital losses.



The Technical Interpretation discusses how the losses could be transferred to Mrs. X.

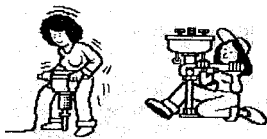
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## CORPORATE TAX

### 63(5)

#### THE SMALL BUSINESS DEDUCTION

The federal small business deduction for a Canadian-



controlled private corporation (CCPC) is 16% times the lesser of the active business income, taxable income - modified by foreign tax credits, and the corporation's "business limit". The "business limit" is proposed to increase in 2003 from \$200,000 to \$225,000, to \$250,000 in 2004, to \$275,000 in 2005 and to \$300,000 in 2006.

Also, these limits must be allocated among associated corporations.

#### SCIENTIFIC RESEARCH (SR&ED)

CCPCs are also eligible to earn investment tax credits at an enhanced rate of 35% on up to \$2 million of SR&ED expenditures. As a consequence of the proposal to increase the "business limit", the Budget

also proposes that the \$2 million expenditure limit be phased out where taxable income in the previous year is between \$300,000 and \$500,000.

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## CCRA

### 63(6)

#### DIRECTOR LIABILITY

In a December 31, 2002 *Tax Court* of Canada case, the taxpayer was the sole director of T Inc., and was held personally liable by CCRA for unremitted source deductions and GST.

The taxpayer argued that he was statute-barred as he was unable to act as a director due to a severe computer failure which resulted in the termination of the company's business and the appointment of a receiver manager. Two years expired from this date to the date of the issuance of the assessment.

#### Good News!

The Court noted that the two year limitation period runs from the time when an individual ceases to be in a position in law and in fact to exercise the powers of a director. The taxpayer could do nothing after the receiver-manager was appointed and, therefore, he had ceased to be able to act as a director.

#### Editor's Comment

A legal resignation as a director more than two years before CCRA issues the assessment is the best evidence.



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## MARRIAGE BREAKDOWN

### 63(7)

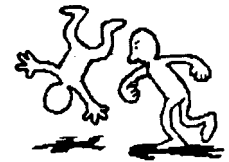
#### ARREARS

In a January 30, 2003 *Tax Court* of Canada

case, the taxpayer was in arrears on periodic spousal support amounts. A Court found that the taxpayer must pay \$23,595, being \$7,500 of costs and \$16,095 for arrears as a final payment due under the said Judgment. There shall be no obligation of the husband to pay any other spousal support to the wife.

#### Bad News!

The Tax Court found that the payment was not deductible even



though it is generally accepted that periodic payments which have fallen into arrears and subsequently paid in lump-sum are deductible in the hands of the payer and taxable to the recipient.

However, in this case, the payment did not represent the full amount of the arrears due and, more importantly, the amount paid released the taxpayer from any future obligations.

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## CHARITIES

### 63(8)

#### CHARITABLE GIFT ANNUITIES

In a February 17, 2003 *Technical Interpretation*, CCRA reviewed a situation where an eighty-year old taxpayer contributes \$100,000 to a charity and the charity agrees to make annual annuity payments to the taxpayer of \$7,700 as long as the taxpayer lives.

CCRA notes that the Income Tax Act permits the charity to issue a donation receipt for the excess of the fair market value of the property transferred (\$100,000) over the advantage provided to the donor. Assuming that \$52,300 would be required to acquire an annuity paying \$7,700 for the life of the donor, the donation receipt could be for \$47,700 (\$100,000 - \$52,300).

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# Tax Tips & Traps

## ART FLIPS

CCRA has *reassessed* over 3,000 Canadians who claimed a



*charitable donation tax credit* on the *donation of art* - adding up to about \$7 million in unpaid taxes. CCRA looks at several aspects when it suspects an “*art flip*”:

1. **How long** the art was held. If it is purchased and sold in the same year, CCRA will be suspicious.
2. **The art’s value** - is there a significant difference between the amount it was bought for and the amount sold for?
3. Is there an **appraisal** on the art by an independent qualified appraiser?

Taxpayers that have been reassessed have the option of filing a *Notice of Objection* within the prescribed time.

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## FARMING

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### 63(9)

#### QUALIFIED FARM PROPERTY

In a March 28, 2003 *District Office Memo*, CCRA



reviewed a situation where Mr. and Mrs. X bought farmland from *Mrs. X’s father* (Mr. A) who had *previously farmed* the land. Mr. and Mrs. X only farmed the land on a marginal basis. Mr. X and Mrs. X divorced and now wish to *sell the farm*, which they still *own jointly*.

CCRA confirmed that Mr. and Mrs. X’s share of the land would still be *qualified farm property (QFP)* eligible for the \$500,000 capital gain exemption since an *individual’s parent* may satisfy the *use tests*.

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## WEB TIPS

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### 63(10)

#### COMPUTER VIRUSES

Not all anti-virus protection software packages detect viruses and solve and update systems at the same time or speed. Therefore, it may be a good idea to check your system with a secondary virus scanner either periodically or if your system feels sluggish. For a *free virus scan* go to:



<http://housecall.trendmicro.com/>

Click the link in the middle of the page ‘SCAN WITHOUT REGISTERING’ and follow the instructions.

## RETIREMENT INCOME

See Canadian Retirement Income Calculator - <https://srv260.hrdc-drhc.gc.ca/> or go to [www.hrdc.gc.ca](http://www.hrdc.gc.ca) and search for ACANADIAN 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 *amounts*. Once the 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.

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