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## PERSONAL TAX

### 67(1)

#### DISABILITY TAX CREDIT (DTC) - DIABETES

In a June 14, 2004 and a September 11, 2003 *Tax Court* of Canada case, the Court *permitted* a *DTC* for parents who had a seven year old daughter and a six year old son respectively who suffered from *Type 1 Insulin Dependent Diabetes*. A *positive medical certificate* noted that the children needed assistance due to age.

In a May 3, 2004 *Tax Court* of Canada case, the *Court disallowed* the *DTC* for a parent who had a five year old child with *Type 1 Insulin Dependent Diabetes* because a *positive medical certificate* was *not provided* by the taxpayer.

#### TUITION FEES - FOREIGN INTERNET STUDIES

In an April 21, 2004 *Tax Court* of Canada case, the *Court disallowed* the *tuition fee tax credit* for *foreign*

*university Internet studies*. The Court noted that completing courses through the Internet is not the same as physically travelling back and forth between Canada and the U.S. as permitted under the Income Tax Act.



#### MEDICAL EXPENSE - DEPENDANT

In a May 3, 2004 *External Technical Interpretation*, Canada Revenue Agency (*CRA*) notes that an individual may *claim medical expenses* in respect of specified persons such as a *dependent parent* (including in-laws). This requires that the individual has supplied necessary maintenance, or the necessities of life, to the person on a regular and consistent basis.

#### MEDICAL EXPENSE - AUTISTIC CHILD

In a May 6, 2004 *External Technical Interpretation*, *CRA* notes that the cost of sending an *autistic child* to an integrated daycare could *qualify* as a medical expense if there was a *medical certificate* which *clearly indicates* that the daycare/facility has specialized equipment, facilities, or trained personnel to provide care, or care and training, for *this child*.

## EMPLOYMENT INCOME

### 67(2)

#### PRIVATE HEALTH SERVICE PLAN (PHSP)

*CRA* noted in an *External Technical Interpretation* that a *PHSP* is a *contract of insurance* to pay eligible medical expenses which are *deductible* to the employer and *not taxable* to the employee.

A Plan where a *corporate* employer *reim-*

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DID YOU KNOW...

*burses its employees* for medical expenses may qualify as a *PHSP*.

However, where an individual, who is *both a shareholder and an employee*, receives a benefit under a *PHSP* and *equivalent benefits* are *not available* to



other non-shareholder *employees*, the individual is generally considered to be in receipt of a *taxable shareholder benefit* and contributions may *not be deductible* by the corporate employer.

On the other hand, when *equivalent coverage* is *extended* to all employees, the benefits are *non-taxable* to the employee and *deductible*



# Tax Tips & Traps

to the employer. This also applies when all employees of a corporation are shareholders and it is reasonable to conclude, based on the particular facts, that the PHSP coverage has been provided as part of a *reasonable remuneration package*.

### LUMP-SUM LEASE PAYMENT

In an April 26, 2004 *External Technical Interpretation*, CRA notes that *employees* may *deduct up-front lease payments* for leased vehicles used in employment provided that the total amount deducted does not exceed the allowable *\$800 per month*.

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## BUSINESS/PROPERTY INCOME

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### 67(3)

#### STOCK OPTIONS

In a May 14, 2004 *External Technical Interpretation*, CRA reviewed a situation where an *independent contractor* is granted a *stock option* as payment for his *consulting services*.



The fair market *value* of the option on the *grant date*, less any amount paid, will be included in *business income*. (*Editor's Comment* - For example, if the option price is \$10 and the fair market value of the share is \$17, the business income is \$7.)

When the *option* is *exercised*, the *incremental value* realized on the *acquisition* of the *shares* may be a "business income" or a "capital gain".

(*Editor's Comment* - Example, if the fair market value is \$27 at the exercise date the additional amount included in income/capital gain is \$10 - (\$27 - \$17).)

CRA notes where the \$10 is for services rendered it would be *business income*. However, where the option is held as a *capital property*, the \$10 may be a *capital gain* - only half of which is taxable.

### RESERVE FOR UNPAID AMOUNTS

In a May 12, 2004 *External Technical Interpretation*, CRA note that where a *business sells inventory* and all or part of the selling price was not due for at least two years after the sale, a reasonable *Reserve* for the *unpaid amount* may be claimed.

### RESTRICTIVE COVENANTS

New rules propose to *fully tax* receipts for signing *restrictive covenants*.

The Income Tax Act broadly defines a "*restrictive covenant*". For example, over and above the normal situations, where a parent corporation sells shares of a subsidiary and undertakes that its *other subsidiaries* will *not compete* with the target corporation, this is considered to be a "*restrictive covenant*". Also, included is where a parent corporation sells a subsidiary corporation and, after the sale, its other subsidiaries will carry certain quantities of the sold subsidiary's products.

However, where a *joint election* is made between the grantor and the grantee on a disposition of an *eligible capital property*, a *partnership interest* or a *share* of a corporation the gain may only be *half taxed*.

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## CAPITAL GAINS AND LOSSES

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### 67(4)

#### SMALL-BUSINESS SHARE ROLLOVER

In a May 6, 2004 *External Technical Interpretation*, CRA notes that an *individual* that has a *capital gain* from a *qualifying disposition of shares* may claim a *deferral* on the capital gain if qualifying *replacement shares* are bought.

There are *many restrictions and conditions* to be met. For example, the share must usually be a common share issued by an active business corporation to the individual (treasury share).


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## MARRIAGE BREAKDOWN

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### 67(5)

#### CHILD SUPPORT - AMENDMENT

In a May 3, 2004 *Tax Court of Canada* case, the taxpayer  signed a Child Support Payment Agreement on *April 24, 1997*. Because it was signed *prior to May, 1997* the *child support* amounts were *deductible/taxable*. Unfortunately for the payor, the Agreement was *amended* on January 3, 2000 and the child support payments then became *non-deductible/non-taxable* because they were now under a post-April, 1997 Agreement.

#### CHILD SUPPORT - DEEMED INCOME

The May 6, 2004 issue of the *National Post* noted that Mr. A was a *farmer* whose income in 2002 was *\$12,692* when he had custody of his sixteen year old son. His former spouse had custody of their thirteen year old daughter and held down three jobs in earning *\$28,000* a year.

Mr. A *claimed child support* from Mrs. A on the basis that her income was higher than his.

The Court concluded that Mr. A is *under-employed* and could also be earning \$28,000 per annum. Therefore, *neither parent* was entitled to receive *child support payments* from the other.

#### PENSION INCOME

In an April 30, 2004 *External Technical Interpretation*, CRA notes that if there is a *division of pension benefits* on a *marriage breakdown* under the *Pension Benefits Legislation of a province*, the portion received by each former *spouse* is included in the income of *that spouse*.

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## CHARITIES

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### 67(6)

#### GIFT AND LEASEBACK

In a nine-page 2004 *Advance Income Tax Ruling*, CRA reviewed a proposed *donation of commercial property* to a charity with a *leaseback* of the property to the donor. The donor received a *tax credit* for the value of the commercial property.

#### NON-PROFIT ORGANIZATION (NPO)

In a 2004 *Advance Income Tax Ruling*, CRA Ruled that a change to the bylaws of the NPO to *permit a distribution of profits* to its members will cause it to *lose its NPO status*. Therefore, it will become subject to *tax*.



The purpose of the amendment was to allow the NPO to distribute excess funds to its members.

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## FARMING

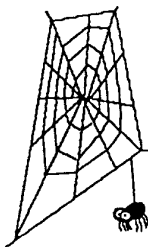
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### 67(7)

#### TRANSFER OF FARM PROPERTY TO CHILD

In a May 7, 2004 *External Technical Interpretation*, CRA approved a situation where Father (Mr. A) owned farmland for sixty years - the first fifty of which he *farmed on a principal basis*. The last ten years were rented. Mr. A dies and bequeaths on a *non-taxable basis* the farmland to his *spouse* who then transfers the farmland to their children, also on a *non-taxable basis*.

(*Editor's Comment* - If one of the *main purposes* of the transfer to the children is to obtain a tax benefit, and a subsequent disposition occurs by the children *before three*



*years*, the taxpayer (Mrs. A) may have to pay tax based on a disposition of the property at *fair market value* to the children.)

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## ESTATE PLANNING

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### 67(8)

#### WITHHOLDING TAX RATES

The *withholding tax rates* when withdrawing funds out of an *RRSP or RRIF* are:

- (i) less than \$5,001 - 10%
- (ii) \$5,001 - \$15,000 - 20%
- (iii) more than \$15,000 - 30%.

For example, if Mr. A withdraws \$20,000 from his RRSP he would be subject to a 30% withholding tax. Alternatively, if he took the funds out in four \$5,000 increments, the withholding tax would only be 10%. Of course, when he files his tax return he will still have to report the \$20,000 in income and pay tax at marginal rates.

Therefore, he will likely owe tax upon filing his tax return, however, he will have had the use of the money in the interim period without interest.

#### RRSP TRANSFER TO A CHILD

In a 2004 *Head Office Memo*, CRA notes that an amount paid out of an RRSP as a *consequence of the death* of the annuitant to a *child or a grandchild* of the annuitant who was *financially dependent* on the annuitant for support may be included on the *child's Tax Return*. This could be achieved by designating the *child as the beneficiary* of the RRSP.



Also, when an amount is paid out of the RRSP to the *Estate* in which a *child is a beneficiary, a joint designation* for all or a part of the payment may be made. The amount so designated is *deemed* to be *received* by the *beneficiary*. This amount may be used to acquire an *eligible annuity* payable until *age 18* or included in *income* immediately.

If the child has a *physical or mental infir-*

*mity* the amount may be *rolled over* to their RRSP.

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## WEB TIPS

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### 67(9)

#### CALCULATORS

##### Small Business Banking -



If you want to know which *bank in Canada offers the best plan/rate for your company*, take a look at this calculator. By answering a series of questions about the company's banking activities, this calculator can give you the rates under different plans that *10 of the largest banks* in Canada offer. After *comparing rates* you can click on links that give specific *details about that specific plan*. This tool is ideal for comparing different types of accounts either within one bank or amongst several.

##### Buy vs. Lease -

This calculator compares *the costs involved in buying versus leasing assets*. The tool *requires eleven pieces of information* and can be completed with relative ease and speed.

To use either of these *calculators* go to:

<http://strategis.ic.gc.ca/epic/internet/insof-sdf.nsf/en/Home>

As this is the *Industry Canada* website, it is relatively reliable. The calculators are the seventh and eighth items in the left hand menu.

#### FUND COMPANIES: PRICES AND DISTRIBUTIONS

[www.fundlibrary.com](http://www.fundlibrary.com)

If you are looking for fund *prices, distributions*, graphs or company news for any day, or series of days, this site has the information you need. This website contains information for *hundreds of fund companies* and their respective funds.

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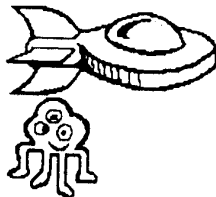
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67(10)

**INPUT TAX CREDIT FOR TRAVEL ALLOWANCES**

An *employer* may claim *input tax credits* for *non-taxable allowances* paid to *employees* for motor vehicles.



This was confirmed in a July 22, 2003 *Tax Court* of Canada case.

**INTER-CORPORATE CHARGES**

Where two corporations are engaged in *commercial* activities, *inter-corporate charges* may not cause GST problems as GST may be avoided if the parties qualify for the *election under Section 156* of the Excise Tax Act. Otherwise, the GST paid will be eligible for an *input tax credit*.

However, corporations that are *not involved in commercial activities* may trigger *extra costs* with *inter-corporate fees* because the GST paid is either not eligible for exemption under Section 156 or, is not eligible for an input tax credit.

*One solution* is to have one corporation acting as the *“agent”* for the other corporation. However, it is a *very fine line* as to whether a corporation is an *“agent”* for another corporation and professional advice is needed.

For example, in a March 12, 2004 *Tax Court* of Canada case approximately thirty corporations that owned *residential real property* paid fees to KPMC for *superintendents* and *maintenance* workers.

The Court found that the payments made for the *superintendents* were of an *“agency”* relationship and, therefore, were *not* subject to GST as the superintendents were in fact *employed* by the owner corporations.

However, with respect to the *maintenance workers* that went from apartment to apartment, the *“agency”* argument *did not work*. They were considered to be *employees* of the *management company*, not the owner companies. Therefore, GST was successfully charged.

Because of the *complexity* in this area, it may be advisable to obtain a *Ruling* from CRA on cost-sharing or agency agreements.

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**DID YOU KNOW...**

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67(11)

**INVESTMENT CLUBS**

*Investors may elect* to report their income under a *simplified basis* as if the investment club was a *partnership*. However, this method is *only available* where, among other things, *all* of the club members are *individuals*.

In an April 28, 2004 *External Technical Interpretation*, CRA note that an *investment club* which includes *corporate members* may *not elect* to use this *modified partnership method* to report the income.

**CANADA PENSION PLAN/EMPLOYMENT INSURANCE (CPP/EI)**

In an April 28, 2004 *External Technical Interpretation*, CRA notes that where an *employer* makes *contributions to an employee’s RRSP*, these payments are *taxable* and are generally subject to *CPP* and *EI*.

However, the contributions will *not be EI insurable* if the employee *cannot withdraw* the amounts from a group RRSP until the employee retires or ceases to be an employee of the employer.

**RRSP - ARTIFICIAL ARRANGEMENT**

In a May 28, 2004 *Tax Court* of Canada case, the Appellant acquired through her *self-directed RRSP* shares of a *corporation* and then obtained a loan, guaranteed by her RRSP, from a *related corporation* of the first corporation.

**Taxpayer Loses**

The Court found that the shares acquired were *not qualified investments* and that the whole arrangement was an *artificial financial arrangement* to obtain liquid assets from an RRSP without having to pay income tax.



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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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