

MacKenzie, George & Company

Certified General Accountants

Certified Consultants in MYOB, Simply Accounting and QuickBooks

#220 Champlain Square, 3150 East 54th Avenue Vancouver, B.C. V5S 1Z1

Tel 604-327-9234

Fax 604-325-3044

www.mackenziegeorge.com

YEAR-END TAX PLANNING

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Some *2004 year-end tax planning tips* follow. Contact us if you need more information.



1. If the following *expenditures* are made by *individuals* by *December 31, 2004* they will be eligible for 2004 tax deductions: moving expenses, child care expenses, safety deposit box fees, charitable donations, political contributions and medical expenses.
2. *2004 eligible Registered Retirement Savings Plan (RRSP) contribution* amounts are noted on the 2003 *personal income tax return assessment notices*. You have until *March 1, 2005* to make tax deductible RRSP contributions for the 2004 year.
Consider contributing to a *spousal RRSP* to achieve income splitting in the future.
3. Persons turning *age 69 in 2004* must *mature* their RRSP into cash, an annuity or a Registered Retirement Income Fund by December 31, 2004.
4. If you own a business, consider paying a *reasonable salary* to family members for their services rendered to the business.
5. Ensure that all deductible *alimony* or

maintenance payments are made by December 31, 2004.

6. An individual whose *2004 net income* exceeds \$59,790 will lose all, or part, of their *old age security*.
Senior citizens will begin to lose their income tax *age credit* if net income exceeds \$29,124.
Contact your professional advisors for assistance in *managing* 2004 personal income.
7. Consider purchasing assets eligible for *capital cost allowance* before the yearend. For example, *employees* may claim capital cost allowance on *automobiles* used in their employment.
8. If you had taxable capital gains in the *year*, or any of the *preceding three years*, consider selling capital properties with an *underlying capital loss* prior to the yearend. This capital loss may be offset against the capital gains.
9. If income in an *inter vivos trust* is to be taxed on a beneficiary's return, the income must be *paid or payable* to the beneficiary by *December 31, 2004*.
10. *Registered Education Savings Plan (RESP)*
A *Canada Education Savings Grant (CESG)* for RESP contributions will be permitted equal to 20% of annual con-

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tributions for children (maximum \$400 per child per year).

The 20% is proposed to be increased to 40% or 30% for lower income families commencing January 1, 2005.

Budget 2004 introduces a new *Canada Learning Bond* from the government totalling \$2,000 for each child born on or after January 1, 2004 (\$500 in the first year and \$100 per year until age 15) if the family net income is under the \$34,000 range. An *RESP* is needed for the deposit.

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11. **Health and dental premiums for the self-employed**

Individuals will be allowed to **deduct** amounts payable in respect of the year for **Private Health Service Plan** coverage in computing **business income** provided they meet certain criteria.

12. **Tax on Split Income**

The Income Tax Act applies the **maximum marginal tax rate** to certain **passive** income of *individuals* under the **age of 18**. Therefore, consider **minimizing** this type of income in **2004**.

13. The tax rate for higher income individuals is now **significantly lower** on **capital gains** than on dividends thereby presenting an incentive to **receive capital gains**.

14. Canadians **receiving shares in foreign tax-free reorganizations** can apply for favourable tax treatment.

15. A **refund of Employment Insurance** paid for non-arm's length employees **may** be available upon application to CRA.

16. **Taxpayer-Requested Adjustments**

Currently an *individual* may request an adjustment to a tax return back to 1985.

It is proposed that **after 2004**, adjustments will be limited to ten years back. Therefore, adjustments for **1985 to 1995** should be requested by **December 31, 2004**.

2004 REMUNERATION

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Some **general guidelines** to follow in **remunerating the owner** of a **Canadian-controlled private corporation** earning "**active business income**" include:



1. In general, **bonus down** active business earnings in excess of the annual business limit - \$250,000 for a December 31, 2004 yearend. Leaving corporate **active business income** over this amount may present a **tax deferral** but there will likely be an **overall higher tax** to pay when dividends are finally paid out. Some companies may find it advantageous to have **greater than , say, \$250,000** of active business income because of other federal and provincial tax incentives.
2. Elect to pay out tax-free "**capital dividend account**" dividends.
3. Consider paying dividends to obtain a refund of "**refundable dividend tax on hand**".
4. Corporate earnings in excess of personal requirements could be left in the company to obtain a **tax deferral**. The effect on the "**Qualified Small Business Corporation**" status should be reviewed before selling the shares.
5. **Dividends**, as opposed to salaries, will reduce an individual's **cumulative net investment loss** balance thereby providing greater access to the **capital gain exemption**.
6. Retaining **income in the corporation** may affect provincial and federal **capital tax** and certain **provincial clawbacks**.
7. Excessive **personal income** affects receipts subject to **clawbacks**, such as **old age security**, the **age credit**, **child tax benefits**, **GST credits**, etcetera.
8. Salary payments require **source deductions** to be remitted to Canada Revenue Agency (CRA) on a timely basis.
9. Individuals that wish to contribute to the Canada Pension Plan or a Registered Retirement Savings Plan may require a salary to create "**earned income**".
10. Salaries paid to family members must

be **reasonable**.

11. Some provinces have "**payroll taxes**" thereby increasing the costs of paying salaries versus dividends.

PERSONAL TAX RETURNS

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DISABILITY TAX CREDIT (DTC)

Type I Insulin Dependent Diabetes - O.K.

In a June 14, 2004 **Tax Court** of Canada case, the taxpayer successfully claimed a DTC for his **seven year old daughter** who has **Type I Insulin Dependent Diabetes**.



Epilepsy - O.K.

In a December 12, 2003 **Tax Court** of Canada case, the taxpayer has **epileptic seizures** in which she loses complete physical control.

The Court **permitted** the **DTC**.

STRUCTURED SETTLEMENT

In a 2004 **Advance Income Tax Ruling**, the taxpayer was injured in a **motor vehicle accident** and reached an out-of-court settlement with the Defendant's Insurers to receive **tax-free** payments for life.

MEDICAL EXPENSES

In a June 29, 2004 **Technical Interpretation**, CRA notes that an amount **paid to a medical doctor** normally qualifies as a **medical expense** even if it is for **cosmetic or elective surgery**.

This includes **cosmetic eyelid surgery**, **botox** and **artecoll injections**.

EMPLOYMENT INCOME

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EMPLOYER-PAID PROFESSIONAL MEMBERSHIP INITIATION FEES

In an April 14, 2004 **Techni-**



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cal Interpretation, CRA notes that the payment of *annual professional membership fees* by an employer on behalf of an employee is *not a taxable benefit IF* the employer is the *primary beneficiary* of the payment.

Also, the amount is a *deductible business expense*.

TUITION FEES REIMBURSED

In a June 7, 2004 *Technical Interpretation*, CRA notes that *employer-paid tuition* (and related costs) may *not* be a *taxable benefit* to the employee. This includes courses in a field *related* to the employee's *responsibilities* as well as courses *not directly related* to the employer's business such as stress management, employment equity, first aid and language skills.

MOTOR VEHICLE EXPENSE DEDUCTION

In a July 15, 2004 *Technical Interpretation*, CRA notes that where an employee receives a reasonable *per kilometre reimbursement* for the use of his/her personal motor vehicle in connection with employment duties, the reimbursement is generally *excluded* from *employment income*.

BUSINESS/PROPERTY INCOME

68(5)

LOSSES ON SHARE SALE

In a June 25, 2004 French *Tax Court* of Canada case, the taxpayer was permitted a *business loss*, not a capital loss, on the *sale of shares* which were *speculative* in nature.



SALARIES PAID TO CHILDREN - DISALLOWED

In a June 23, 2004 *Tax Court* of Canada case, the Court disallowed a *deduction for salaries* to his *sixteen* and *twelve* year old

children against his self-employed business income for reasons including:

- (i) The amounts were either *not paid* to them or, upon being paid, were *immediately redeposited* in bank accounts of either the business or the parents.
- (ii) There was *not sufficient documentation* and,
- (iii) The children *did not declare* any amounts on their tax returns.

PRIVATE HEALTH SERVICES PLAN (PHSP)

Where an employer enters into a *PHSP* for an employee, the expenses are generally *deductible* to the employer and *not taxable* to the employee. This *deductible/non-taxable* status may *not apply* if the PHSP is *only* available to *shareholders*.

In a June 24, 2004 *Tax Court* of Canada case, CRA *disallowed* the *deduction* to the company and *taxed the shareholder* on the basis that this was a *benefit* given to him in his *capacity* as a *shareholder*, not an *employee*.

CAPITAL GAINS AND LOSSES

68(6)

PRINCIPAL RESIDENCE

In a June 3, 2004 *Technical Interpretation*, CRA notes that when a taxpayer *converts a principal residence* to an *income-producing* use, the taxpayer may, within limits, elect to *defer recognition* of any gain to a later year.



RETIRING ALLOWANCE

68(7)

In a 2004 *Advance Income Tax Ruling*, *six non-arm's length individuals* were em-



ployee/shareholders of a *corporation*. The corporation wishes to sell all of the assets and then *wind up*.

CRA Ruled that a *retiring allowance* paid to each employee within *prescribed limits* is *deductible* to the corporation and *eligible for a rollover* by the employees to a *Registered Retirement Savings Plan*.

CAPITAL COST ALLOWANCE (CCA)

68(8)

In a June 21, 2004 *Federal Court of Appeal* case, the taxpayer had an *October 31 yearend* and, *purchased a "new fleet" of cars* to replace the "old fleet" *as at October 31*.



However, the "*old fleet*" remained in the *ownership* of the taxpayer until *November 1*. Therefore, CCA was allowed on both the "old fleet" and the "new fleet" at the October 31 yearend.

MARRIAGE BREAKDOWN

68(9)

LIVING SEPARATE AND APART

In a January 5, 2004 *Tax Court* of Canada case, the Court considered the taxpayers to be *living separate and apart* because of a breakdown in their relationship even though they *continued to live in the same house*. Therefore, their *incomes* were *not combined* for purposes of the *GST credit*.



EQUIVALENT-TO-SPOUSE CREDIT (ETSC)

In a January 8, 2004 *Tax Court* of Canada case, the Court noted that it is *impossible* for a taxpayer to claim an *ETSC* for a child where the individual is *required* to pay a *support amount* for that person.

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FORM RC 65(04)

Taxpayers may use this Form to advise CRA of a *change in marital status*. This could affect the Canada Child Tax Benefit and GST/HST payments.

RRSP/RESP/SBIT

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RRSP - HOME BUYERS' PLAN (HBP)



The *HBP* permits an individual to *borrow* up to **\$20,000** from his/her *RRSP* to purchase a *home in Canada*. To qualify, the borrower, or his/her spouse, *cannot have an owner-occupied home* in the four preceding years. Each spouse may withdraw up to **\$20,000** from their *RRSPs* to *jointly purchase* a home.

REGISTERED EDUCATION SAVINGS PLANS (RESP)

An *RESP* permits an individual to put funds with a Trust Company for the post-secondary education of one or more beneficiaries. The Trust is *exempt* from income tax.

Contributions to a *RESP* may also be eligible for a *Canada Educational Savings Grant* (CESG).

SMALL BUSINESS INVESTMENT TRUST (SBIT)

In a 2004 *Advance Income Tax Ruling*, CRA Ruled that the *arm's length employees* of a construction company may have their *RRSPs* invest in a *SBIT* which will provide *loans to developers*.

ESTATE PLANNING

68(11)

GIFT FROM AN ESTATE

In a June 11, 2004 *Technical Interpretation*, CRA reviewed a situation where, prior to the death of Brother



A, *Brother B took care* of his personal needs and managed his finances. Brothers C, D and E agreed that the Estate should pay Brother B for the care provided to Brother A.

This is a *non-taxable gift* to Brother B from the Estate.

ELDERLY TAXPAYERS

Some considerations for *elderly taxpayers* follow. Contact your professional advisors for details.

1. Sign a *Power of Attorney* for management of property and *personal care matters*.
2. *Avoid probate fees* by naming *beneficiaries* to life insurance policies and pension plans, *joint ownership* and by *multiple wills*.

Also, assets could be rolled over to an *Alter Ego Trust* or a *Joint-Spousal or Common-Law Partner Trust*.

3. A *Will* may be used to *defer gains* by transferring assets to a spouse or a Spousal Trust, to deem a *charitable donation* to have been made in the year of death, to establish a *Testamentary Trust* eligible for a separate yearend and graduated tax rates, to provide for a *windup* of a holding company, and to gift *publicly traded securities* to a charity to take advantage of the 25% taxable capital gain.

FARMING

68(12)

TRANSFER OF FARMLAND BETWEEN SPOUSES

In a June 25, 2004 *Technical Interpretation*, CRA confirmed that where *Mr. A transferred* farm property to his *spouse* on a rollover basis, the *subsequent capital gain* on the sale of the property by the spouse would be *attrib-*



uted back to Mr. A and would be eligible for a *capital gain exemption* if it met the criteria for qualified farm property.

FARM LOSSES

In a July 9, 2004 *Tax Court* of Canada case, the taxpayers were eligible for a *full deduction* for all their farm losses, rather than the restricted farm loss treatment provided by CRA.

WEB TIPS

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BUSINESS VALUATION CALCULATOR

This website has a *seven step calculator* that allows you to make a *quick business valuation*.



<http://www.cdnbx.com/valuations/quickValuation1.asp>

This website also contains a *market comparison section*, *rules of thumb for valuing Canadian businesses*, and a *search tool to find brokers, advisors* and other related professionals throughout Canada.

POST-SECONDARY INFORMATION

If you are looking for information on *student financing, scholarships or awards*, take a look at the following websites:

www.canlearn.ca (is an excellent starting point for anybody thinking about pursuing a post-secondary education)

www.scholarshipscanada.com

www.studentawards.com

GST

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LAWYERS' DISBURSEMENTS

In a July 7, 2004 *Policy Statement*, CRA provided eleven pages of information with respect to how a



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lawyers' disbursements are taxed for *GST/HST purposes*.

SALES BY INDIVIDUALS OF OWNER-OCCUPIED HOMES

A *GST Guide* provides information on the GST/HST implications on the *sale of owner-occupied homes by individuals*.

DID YOU KNOW...

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CREDITOR PROOFING

Some *creditor*



proofing strategies for owner-managed business follow. For details contact your professional advisor.

1. *Transferring assets out of a company*
 - By placing capital assets in a *separate holding company*, subsequent legal claims arising in the operating company may not affect these assets.
 - Paying *tax-free dividends* to a holding company may protect assets from future claims.
2. *Securitizing the position of the business owner*

- Shareholder loans may be secured by a *general security arrangement* to give the shareholder priority over all unsecured creditors.
- Consider an *estate freeze* such that the future growth will go to other family members.
- Transfer assets into a *Discretionary Family Trust*.

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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