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YEAR-END TAX PLANNING

60(1)

Some 2002 year-end tax planning tips include:



1. If the following *expenditures* are made by *individuals* by **December 31, 2002** they will be eligible for 2002 tax deductions: moving expenses, child care expenses, safety deposit box fees, charitable donations, political contributions and medical expenses.
2. **2002 eligible Registered Retirement Savings Plan (RRSP) contribution** amounts are noted on the 2001 *personal income tax return assessment notices*. You have until **March 1, 2003** to make tax deductible RRSP contributions for the 2002 year.

Consider contributing to a *spousal RRSP* to achieve income splitting in the future.

The maximum 2002 addition to deductible *RRSP contribution room* is \$13,500. \$75,000 of **2002 earned income** is needed to reach this maximum.
3. Persons turning **age 69 in 2002** must *mature* their RRSP into cash, an annuity or a Registered Retirement Income Fund by December 31, 2002. Certain 2002 *excess* contributions may be de-

ducted in the year 2003 if *contribution room* is available.

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, 2002.
6. An individual whose **2002 net income** exceeds \$56,966 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 \$27,749.

Individuals facing these problems should contact their professional advisors for assistance in *managing* their 2002 personal income.

7. Consider purchasing assets eligible for *capital cost allowance* before the yearend. For example, *employees* may claim capital cost allowance on *automobiles, aircraft* and *musical instruments* required to be 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 capital gains in the *year*, or in the *three preceding*

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years.

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, 2002**.
10. Individuals may claim a *tax credit* related to the *interest portion* of student loan payments made in 2002.
11. **Registered Education Savings Plan (RESP)**

A *Canada Education Savings Grant* (CESG) for RESP contributions will be permitted equal to 20% of annual contributions for beneficiaries up to and including age 17 (maximum \$400 per child per year).

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However, contributions for 16 and 17 year olds will only qualify for certain previous plans.

12. **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 are actively engaged alone, or as a **partner**, in their business, and either self-employment is their primary source of income or their income from other sources does not exceed \$10,000.

13. **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**.

This includes:

1. Taxable **dividends**, and other **shareholder benefits**, on **unlisted shares** of Canadian and foreign companies (received **directly** or through a **trust** or **partnership**); and
2. Income from a **partnership or trust** where the income is derived from providing goods or services to a business carried on by a **relative** of the child or, of which the relative participates.

Therefore, consider **minimizing** this type of income in **2002**.

14. 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.
15. Canadian resident shareholders **re-**

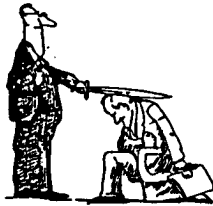
ceiving shares in **foreign tax-free re-organizations** will be able to treat the shares as a reduction in adjusted cost base, as opposed to a taxable dividend.

16. A **refund** of **Employment Insurance** paid for non-arm's length employees **may** be available upon application. (See 60(5).)

2002 REMUNERATION

60(2)

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 \$200,000. Leaving corporate **active business income** over \$200,000 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 \$200,000** 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 effect provincial and federal **capital tax** and certain **provincial clawbacks**.
7. Excessive **personal income** affects receipts subject to **clawbacks**, such as **old age security** and the **age credit**.
8. Salary payments require **source deductions** to be remitted to Revenue Canada 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.

EMPLOYMENT

60(3)

TRUCKERS

In an August 23, 2002 **Tax Court** case, the Court found that this long-distance **truck driver** was entitled to deduct **transport employee meal and lodging** expenses. The taxpayer and his wife worked together driving a transport between **California and Ontario**. The Court noted that the taxpayer's claim for meals based on **U.S. \$40 per day** (subject to the 50% addback for meals and enter-



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tainment) should be allowed, even though *no supporting documents* were submitted, because this was *reasonable* and the evidence was strong that he incurred the meal expense.

NO TAXABLE BENEFIT

Some examples of *non-taxable* employment benefits include:

Example 1

In a recently released *Technical Interpretation*, CCRA note that the following reimbursements and allowances payable to employees who are temporarily working *outside Canada* will be *non-taxable*.

1. *Housing allowance* provided that the individual maintains a self-contained domestic establishment in Canada that is available for his/her use throughout the period of the secondment and is not rented out - a "special worksite".
2. Reimbursement for *transport costs* provided to and from the "special worksite" at the commencement and completion of employment.

Example 2

In a September 5, 2002 *Technical Interpretation*, CCRA notes that where *additional child care expenses* are incurred because an employee is *required* to travel out of town on employment, a reimbursement of these costs by the employer would be a *non-taxable benefit*.

Example 3

In an August 30, 2002 *Technical Interpretation*, CCRA notes that where an employer *reimburses* an employee for the reasonable expenses incurred in *moving the employee*, either because the employee has been transferred from one establishment of the employer to another, or because of having accepted employment at a place other than where the former home

was located, this reimbursement is *not taxable*.

Example 4

In a September 12, 2002 *Technical Interpretation*, CCRA notes that where an employer pays the fees or reimburses an employee for *membership in a fitness club*, the employee is in receipt of a *taxable benefit*.

Editor's Comment

Although this was not mentioned by CCRA in the Technical Interpretation, CCRA's *Interpretation Bulletin 470R*, Paragraph 34, notes that where an employer pays the fees required for an employee to be a member of a social or athletic club, this is *not a taxable benefit* where the membership was principally for the *employer's advantage*.

BUSINESS INCOME

60(4)

EXPENSES DISALLOWED

In a July 30, 2002 *Tax Court* case, the taxpayer carried on a graphic arts business out of a 686 square foot condominium loft apartment which she shared with a friend. CCRA testified that they *audited* the business because of the *large amount of expenses* claimed against a small income. CCRA made a net overall increase to the income by *disallowing a portion* of the insurance, meals, business use of home, motor vehicle, travel and reference material expenses.

The Judge gave considerable weight to the auditor's evidence who spent - *can you believe it*



- upwards of 100 hours on the file, much of

it at the Appellant's premises, reviewing the records, viewing the premises and the equipment.

FINES AND PENALTIES

In a July 31, 2002 *Committee Report*, CCRA note that the *Supreme Court* has ruled that CCRA cannot disallow a deduction for *finances or penalties* incurred to earn income unless they are so "egregious or repulsive" that they could not be justified as being incurred for an income-earning purpose.

However, CCRA did note that *Finance officials are aware* of the Supreme Court decision and the need for an amendment to the Act to reduce its effect.

MEAL AND ENTERTAINMENT EXPENSES

In an August 22, 2002 *Technical Interpretation*, CCRA notes that the *50% add-back rule* does *not apply*, "in respect of one of six or fewer special events held in a calendar year at which the food, beverages or entertainment is *generally available* to all individuals employed by the person at a particular place of business *and* consumed or enjoyed by those individuals".

CCRA notes that an annual Christmas party which is open to *all employees* is eligible for this exemption. However, an "Over-Twenty-Five Years of Service Club" party would not qualify unless the event was available to all employees.

EMPLOYMENT INSURANCE (EI)

60(5)

The *Employment Insurance Act* notes in Subsection 5(2) that insurable employment does *not include*:

- (i) employment if the employer and the employee are *not* dealing with each other at



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arm's length.

However, if the employer is *related* to the employee, they are *deemed* to deal with each other at *arm's length* if the Minister of National Revenue is *satisfied* that, having regard to all the circumstances of the employment, including the remuneration paid, the terms and conditions, the duration and the nature and importance of the work performed, it is *reasonable to conclude* that they would have entered into a *substantially similar contract* of employment if they had been dealing with each other at arm's length.

Refunds

Upon application, EI Premiums paid on the son, parent, brother, sister, spouse, in-laws and common-laws of a person controlling the business *may* be eligible for a *refund*. The process is *not simple* as a *CCRA* Ruling will likely be needed.

ESTATE PLANNING

60(6)

LEAVING ASSETS TO CHILDREN

Where *Mr. A* owns the shares of *OPCO* (which owns business assets valued at \$100,000 and investments valued at \$50,000) and *Mr. A* wishes to leave the *investment assets* to *Child 2* and the business assets to *Child 1* but, also wishes to have an *equal* distribution of *\$75,000* each, *Mr. A* could transfer the \$50,000 investments to *INVESTCO*, along with a \$25,000 receivable from *OPCO* such that *Child 1* receives *INVESTCO* worth \$75,000. *Child 2* will receive *OPCO* worth \$75,000 (business assets of \$100,000 minus \$25,000 payable to *INVESTCO*).



This requires specific *procedures, agreements and tax elections.*

CHARITIES

60(7)

REGISTERED CHARITIES NEWSLETTER NO. 13

On August 29, 2002, *CCRA* released *Registered Charities Newsletter No.*



13 and noted that:

1. A new Form *T3010*, reduced from thirteen pages to four, will be used for fiscal periods that end on, or after, *January 1, 2003.*
2. Charities are *subject to audit*, similar to other taxpayers, on a purely *random* basis or to follow up on *non-compliance* or *tips* or other information gathered from third parties.

(See www.ccradrc.gc.ca/tax/charities/disclaimer-e.html and Guide T4118, "Auditing Charities".)

3. In a recent *Federal Court of Appeal* case, the charity had its *registration revoked* because of improper documentation, lack of control over fund disbursement, payroll issues, and a problem with reconciling donation receipts to the Form *T3010.*

The Court noted that the *onus of proof* is on the *charity* to show that its status should not be revoked.

4. Guidelines describing *business activities* which a charity may, and may not, legally engage in can be found at Website www.ccradrc.gc.ca/tax/charities/consultation_policy-e.html.

DONATION OF REWARD POINTS

In an August 8, 2002 *Technical Interpretation*, *CCRA* notes that most, if not all, *reward point plans* do *not permit* the transfer of points. Only the person who is a member of the reward points plan, and who earned the points, can redeem the reward points.

However, if a particular reward points program *does permit* the transfer of reward points from a plan member to a charity, such that the charity could redeem the reward points, the *fair market value* of the reward points on the date that they are transferred to the charity would have to be determined so that a *tax receipt* could be *issued.*

PARTNERSHIPS

60(8)

INCORPORATION OF MEDICAL PARTNERSHIP

In a 2002 *Advance Income Tax Ruling*, *CCRA* ruled *positively* on the *incorporation of a medical partnership*



and the use of *separate corporations* by the doctors to provide services to the new corporation.

The *purposes* of the incorporation include eliminating joint and several liability, permitting independent contractor status and increased control for each individual, better congruence between effort and financial return, provide a vehicle for the partner to provide professional services external to the practice, provide increased efficiency through individual management of personal practice preferences and expenses, control over expenditures reflecting personal practice preferences, estate planning and ease of entry to the practice.

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Caveat

Not all provinces permit the incorporation of professionals.

FARMING

60(9)

CHECKOFFS - RESEARCH TAX CREDITS

An *investment tax credit* may be claimed on the portion of *checkoff contributions* used for *research and development* at a rate of **20%** for individuals and **35%** for Canadian-controlled private corporations.

For 2001, a total of **41%** of the *wheat* checkoff and **61%** of the *barley* checkoff administered by Western Grains Research Foundation (WGRF) is eligible to earn the investment tax credit.

For more information see the WGRF website at www.westerngrains.com or the CCRA website at www.ccradrc.gc.ca/sred/.

NET INCOME STABILIZATION ACCOUNT (NISA)

NISA is a voluntary program developed jointly between producers, the Government of Canada and participating provinces. Producers deposit money annually into their *NISA* account and receive matching government contributions. For more information, see www.agr.ca/nisa/.

Fund 1 holds the *participant's* matchable and non-matchable deposits under the *NISA* program. *Fund 2* holds *government* contributions (federal and provincial) and all interest earned on both funds, including bonus interest.

Withdrawals are first taken from *Fund 2* and are *taxable*. Once *Fund 2* is depleted, withdrawals come from *Fund 1* on a *non-taxable* basis.

NEW FEDERAL PLAN

The Federal Government will distribute approximately **\$600 million** in risk management funding in October, 2002 through *NISA accounts*. Farmers will receive a payment into their *NISA* accounts equal to **4.25%** of their five-year average eligible net sales (*ENS*).

However, once the funds are in *NISA*, they may be stuck there until the funding *formula* triggers a payment.

EXPENSES RELATING TO PETS

In an August 13, 2002 *Tax Court* case, the farmer testified that wild animals, such as deer, rats and mice, *love to eat* his *blueberry* crop. Therefore, a cat and dog were acquired to, and were able to, keep them away. The Court believed this and permitted deductions with respect to the dog and cat for veterinary bills, pet food, etc.



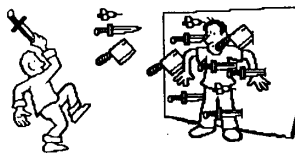
CCRA questioned why the taxpayer had to acquire pet food - "*can't they eat the mice and the rats?*". The Court *did not swallow* this argument and noted that the "frightening" aspect of the animals on a small berry acreage warranted their business use to help preserve the berry crop.

GST

60(10)

GROSS NEGLIGENCE PENALTIES

CCRA appears to be applying the **25% gross negligence penalty** under the *Excise Tax Act* if



after making a mistake and being warned, the taxpayer makes the *same mistake again*.

Even though the Court may throw out the penalties on an appeal by the taxpayer, there is still a time and money cost involved. Therefore, it is usually best to be diligent *to avoid* making the *same GST mistake twice*.

GST NOT IN THE CONTRACT

In a British Columbia Court case, a construction contract *did not refer to GST*.

Even though there have been cases *going both ways* on this issue, the majority of the cases, and this case as well, concluded that when a contract does not refer to *GST*, *GST* should still be considered to be an *addition to the purchase price*.

SELF-SUPPLY RULES

Where a taxpayer acquires a newly constructed *residential property* for lease to others, *GST applies* on the purchase price.

Therefore, when a property is *constructed* by the owner, the property is deemed to have been acquired at *fair market value* and the builder is, therefore, subject to *GST* on the *fair market value* of the property at the time it is put into rental use. However, the builder may claim input tax credits for the *GST* paid on his/her input costs.

DID YOU KNOW...

60(11)

NIGERIAN FRAUD

This fraud, which usually *originates in Nigeria*, generally involves a taxpayer *receiving a letter* which requests assistance



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in helping a person to extract large sums of money from a foreign country. The letter usually implies that there is a crooked element to this and that the Government of Nigeria would not approve if it knew. The taxpayer is asked to send their banking information so that a massive sum can be moved into their bank account. The fraudsters then claim that they need a *small amount* for *administration purposes* - and these requests continue and continue.

For more information about the *Nigerian Fraud* mechanics see the National Post, Wednesday, August 21, 2002, for a full-page analysis, including a discussion with Paul B who admits he has thrown away \$500,000, lost his life savings, his marriage and his tile business, is in trouble with

Revenue Canada and still, over coffee in a Calgary hotel, dials his cell phone and sends off another \$2,500. According to police, the Nigerian scam has taken \$10 million from Westerners, including \$2 million from a dozen people in Moose Jaw, Saskatchewan.

In another case, Mr. D had sent over \$1.9 million for items such as “chemical decoding of cash funds” and bail for a participant who had allegedly been detained in Germany. In fact, he had to *steal from his employer* to finance these expenditures for which he was told he would eventually get over \$10 million U.S.

With respect to the *theft* from the *employer*, the Court of Appeal in Ontario noted that persons in positions of trust,

who breach that trust (such as employees), will receive jail terms in the range of three to five years even if it is a first offence and even if there were personal circumstances involved. The main purpose is to deter, not sympathize.

A NEW TWIST

Some ads promise a *guaranteed loan* for persons with a poor credit history or no credit rating. Once contacted, the *fraudsters* request an up front *processing fee*. If paid, it will be gone, along with the company, forever.

The *RCMP* advise you to call *1-888-495-8501* (toll free) for more information or to report a possible fraud.

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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