MARTYN, DOOLEY & PARTNERS LLP
CHARTERED ACCOUNTANTS

inbrief

Your Guide to Tax, Accounting & Financial Planning

IN THIS ISSUE

PERSONAL TAX

72(1)

MEDICAL EXPENSE - MEDICATIONS

In a July 29, 2005 ***Tax Court*** of Canada case, the taxpayer purchased ***"over-the-counter" medications***, as advised by his doctor, with respect to throat cancer.

These expenditures were ***denied*** as a ***medical expense*** because they were not "***recorded by a pharmacist***". The Court noted that there are laws throughout Canada that describe the ***records that a pharmacist is required to keep***. Medications purchased ***off the shelf*** do ***not*** meet these requirements.

ADOPTION EXPENSE TAX CREDIT

The Income Tax Act now provides a tax credit for ***eligible adoption expenses*** to a maximum of $10,000 during the adoption period.

An ***eligible child*** means a child under age eighteen at the time the Adoption Order is issued.

DISABILITY TAX CREDIT (DTC)

In a July 7, 2005 ***Tax Court*** of Canada case, the Court permitted a DTC for a taxpayer with a ***number of health problems*** including:

(i) ***rheumatoid arthritis*** which restricted her from performing her daily functions;

(ii) severe ***diabetes***; and

(iii) a ***psoriasis*** skin disorder.

The Court noted that the DTC is also available to a person who has a ***cumulative disability*** creating a severe and prolonged impairment.

EMPLOYMENT INCOME

72(2)

DEDUCTIONS

In an August 5, 2005 ***Tax Court*** of Canada case, an investment advisor represented herself in Tax Court with respect to ***disallowed employment expenses*** for ***compensation*** to clients who lost money, workspace in the ***home***, office ***equipment***, and ***transportation***.

The Court ***disallowed*** the $10,772 and $1,800 in 2000 and 2001 paid to ***unhappy clients*** because she did ***not*** have ***formal recordkeeping*** as to the payments.

The Court accepted CRA's reassessment that only ***8%*** of the ***home*** was used for the ***home office***, rather than the 25% claimed by the taxpayer because the taxpayer ***did not prove*** the 25%.

CRA ***permitted*** all of the claims for the ***equipment leasing*** payments made to her ***husband's company*** in 2000 but, only ***one-half*** in 2001 because of a ***lack of documentation***.

Also, the claim for transportation expenses was ***disallowed*** because of a ***lack of documentation***.

Moral

Documentation is ***important***!

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"Minds are like parachutes. They only function when they are open".
– *Sir James Dewar (1877-1925)*

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BUSINESS/PROPERTY INCOME

72(3)

TRUCKERS

In a June 8, 2005 ***Supreme Court of British Columbia*** class-action suit, the ***truckers*** argued that the ***trucker option*** to claim deductions for ***unreceipted meal expenses*** of $15.00 per meal to a maximum of $45.00 per day; subject to the 50% add-back, should be ***increased*** to the federal ***government travel rate*** ($73.10 per day at the time) without any 50% addback.

Truckers Lose

The taxpayers' ***claim was dismissed*** by the Court on the basis that it had ***no reasonable cause of action***.

Moral

Keep receipts.

CAPITAL GAINS/LOSSES

72(4)

CAPITAL GAIN EXEMPTION - TWO-YEAR HOLDING RULE

In general, an ***individual*** must hold ***shares for two years*** to obtain the $500,000 ***enhanced capital gain exemption*** on the sale of the shares of an active private corporation. However, the Income Tax Act permits an individual to transfer all, or substantially all, of the assets used in a ***proprietorship*** to a corporation and then ***sell the shares immediately*** and still get the capital gain exemption.

In a March 21, 2005 ***External Technical Interpretation***, CRA note that this is also available to an individual who sells all, or part, of a ***partnership interest*** to a corporation.

RESTRICTIVE COVENANTS

On July 18, 2005, a Department of Finance Release introduced ***amendments*** which propose to tax amounts received for signing a "***restrictive covenant***". These rules have a ***very broad definition*** of "***restrictive covenant***" and is not just limited to non-compete arrangements.

Under ***certain circumstances*** the receipt may only be ***half taxed*** if a ***joint election*** is signed between the seller and the purchaser. These new rules are ***complicated*** and require professional assistance.

OWNER-MANAGER REMUNERATION

72(5)

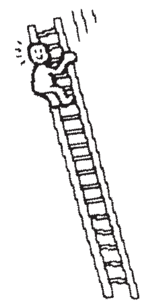
RETIREMENT COMPENSATION ARRANGEMENT (RCA)

The normal procedure when a Canadian-controlled private corporation has active business income in excess of $300,000 is to ***declare a bonus*** to the owner-managers such that the corporate active business income is reduced to, say, ***$300,000*** and the bonus is taxed as ***employment income*** to the owner-managers.

Alternatively, the corporation may bonus down to the ***provincial small business deduction amount*** which is $400,000 in some provinces.

An alternative to the "***bonus***" is to pay that amount to a pension vehicle - an ***RCA***. The payment is subject to a ***50% refundable tax to CRA***. When funds are distributed from the RCA, the 50% is refunded and the amounts are taxable to the individual. The ***advantage*** is that the corporation may use the ***assets of the RCA*** and the ***refundable tax*** as ***collateral*** to obtain a ***bank loan*** thereby increasing the capital available to the company.

The ***RCA*** may make sense to owner-managers that already have personal income taxed at top rates.



Caution: This is ***complicated***, requires special ***professional advice***, and is ***not for everybody***.

MARRIAGE BREAKDOWN

72(6)

RETROACTIVE SUPPORT

An article in the ***Globe and Mail*** notes that the ***Supreme Court*** of Canada ***will hear an appeal*** from four Alberta fathers about the fairness of having to make ***large retroactive child-support*** payments.

Also, an Ontario taxpayer ***has appealled*** an Ontario Court of Appeals decision to the ***Supreme Court*** of Canada where his ***former wife successfully applied*** to reinstate her spousal support payments that were terminated by the Manitoba Courts in 1992. The taxpayer faces the prospect of paying hundreds of thousands of dollars of retroactive support.

LUMP-SUM RETROACTIVE SUPPORT PAYMENTS DEDUCTIBILITY

In a July 12, 2005 ***CRA Release***, CRA notes that their position in respect of the ***deductibility*** to the payor and ***income inclusion*** to the recipient of a lump-sum retroactive support payment is set out in Paragraphs 21 and 22 of their Interpretation Bulletin ***IT-530R*** which is available on the CRA website (www.cra.gc.ca).

ESTATE PLANNING

72(7)

CLAWBACKS ON SENIORS

Taxpayers age 65 or over who have higher income on their ***personal tax returns*** are subject to a ***clawback*** of the ***Old Age Security***. For example, the clawback rate in 2005 is 15% of the excess when the person's income reaches $60,806. The ***clawback*** is based on ***individual*** income. Therefore, if each spouse has, say, $55,000 of income there will be ***no clawback***.

Also, the ***age credit*** for persons reaching age 65 is ***reduced*** by 15% of the excess income in 2005 over ***$29,619***.

Also, there are ***clawbacks*** of the ***GST credit*** and other ***low income*** entitlements.

Consider this

If a taxpayer dies and leaves assets to a spouse, it may be advantageous if those amounts were ***left in trust*** so that the ***income*** is on a ***Trust Return*** and, ***not*** on the ***personal tax return*** of the beneficiary. Another option is to have a ***corporation***, not the individual, earn income such as business income.

DONATION TO MUNICIPAL GOVERNMENTS

In a July 28, 2005 ***External Technical Interpretation***, CRA notes that amendments to the Income Tax Act will permit gifts made after May 8, 2000 to a "***municipal or public body*** performing a function of government in Canada" as ***charitable donations***.

RECEIVING CANADA PENSION PLAN (CPP) EARLY

If a person qualifies, and takes ***CPP early*** (for example, at age 60), rather than age 65, the CPP is ***reduced*** by ***.5% a month*** for each month under the age of 65. Therefore, the CPP received at age 60 would be ***30%*** lower than the age 65 amount.

If the individual has a ***private pension plan*** which will be ***reduced*** by CPP received at ***age 65***, it may make sense to start receiving CPP at age 60.

REGISTERED EDUCATION SAVINGS PLANS (RESP)

For the first $2,000 contributed to an RESP in a year for a child, the federal government will contribute 20%, or $400, as a ***Canada Education Savings Grant*** (***CESG***) (to a total maximum of $7,200 per child).

The money contributed to the RESP grows on a ***tax-deferred basis*** although the ***initial contribution*** is ***not*** tax deductible. The ***investment income*** is taxed to the student when withdrawn for ***educational purposes***. The RESP investments are the same as for RRSPs.

A ***Family RESP Plan*** may be established so that the funds could be used by any of the children. Also, a RESP may be established such that if the child does ***not attend*** a post-secondary institution, the ***funds may be rolled*** into the ***contributor's RRSP***, assuming the contributor has contribution room. If contribution room is not available, the contributor may withdraw the funds but is subject to a ***20% penalty tax***. In both cases, the ***CESG*** must be ***paid back***.

Other ways to provide funds for a ***child's education*** include ***Trusts*** where ***one parent contributes*** the funds and the ***other parent*** acts as the ***Trustee***. However, these Plans miss out on the ***CESG***.

REVERSE MORTGAGES

A ***Reverse Mortgage*** permits an elderly person ***to borrow*** a ***percentage*** of the ***equity*** in their homes. The ***money borrowed*** plus interest does ***not*** have to be ***repaid*** until the homeowner ***sells*** the home, ***moves***, or ***dies***. Since 1986, these mortgages have largely been provided by a company called Canadian Home Income Plan Corp. (***CHIP***).

In July, 2005, Canada Mortgage and Housing Corporation (***CMHC***) noted that they will be providing ***Reverse Mortgages***. However, the CMHC ***website*** warns that Reverse Mortgages can be ***expensive*** because of high fees and higher interest rates and will deplete the equity in the home. The ***main benefactor*** is the ***homeowner*** while the ***main loser*** is the ***beneficiary*** who will now be inheriting a home which is not clear title.

The proceeds are ***tax-free*** as they represent loans. Therefore, they will not affect income-related plans available to seniors such as the Guaranteed Income Supplement, Old Age Security, the age credit, and GST credits.

FARMING

72(8)

CANADIAN AGRICULTURAL INCOME STABILIZATION (CAIS) PROGRAM

One of the issues discussed at the July 6, 2005 Ministers of Agriculture Conference was for ***disaster relief*** to be made more available to farmers. For example, Manitoba farmers hit by ***flooding*** were encouraged to file for ***interim 2005 payments*** from the ***CAIS Program*** by Federal Agriculture Minister Andy Mitchell. It is planned that farmers should be able to receive interim benefits by Fall 2005.

The Ministers also agreed to develop a ***formula*** for ***covering negative margins***.

Also, it was noted that farmers will now have to pay an annual, non-refundable ***fee of .45%*** of their ***reference margins*** to get into the CAIS Program. For example, a farmer with a $100,000 reference margin will have a fee of $450. This fee replaces the CAIS deposit.

CAIS generally covers ***70% of a farmer's losses*** based on his/her ***reference margins***. Therefore, CAIS simply stabilizes falling margins. A suggestion was made that CAIS should also cover reduced cash incomes and not just financial reference margins such as the ***United States Loan Deficiency Program*** (LDP) which provides a payment for certain commodities through a floor price.

Federal Agriculture Minister ***Andy Mitchell*** noted that the CAIS program would ***not follow*** the ***U.S. model***.

Another problem with CAIS is that farmers ***do not know in advance*** the amount they will be receiving from CAIS. Therefore, they cannot use it as collateral for a bank loan - such as is available under the U.S. LDP program. Apparently, there will be ***no changes*** in this area either.

Mr. Mitchell noted that in the first fourteen months of operation, CAIS paid out $1.9 billion and also released over $.6 billion in CAIS deposit money back to the farmers.

TAX-DEFERRED COOPERATIVE SHARES

The Income Tax Act proposes that a member of an ***agricultural cooperative*** corporation may ***defer*** the ***income*** inclusion of all or a portion of a patronage dividend in the form of a ***tax-deferred cooperative share***. The deferral lasts until the disposition of the share and, generally will ***apply after 2005***.

WEB TIPS

72(9)

GOOGLE EARTH

Have you ever taken a ***look at your house from space***? It is now possible with Google Earth. This newly released ***free program*** from Google allows users to view a collage of satellite photos. One starts off by looking at a ***view of the globe*** (the view can be rotated around to view from any angle). From a macroscopic view of whole continents and ocean fissures, one can narrow down the view to ***focus on a single dwelling or possibly even a tree or vehicle***. In general, the views become more clear and accurate in areas that are more densely populated.

One handy feature of the program is the ***ability to measure distances***. If you like to ***jog, walk or bike on paths*** of which the distances are not easily measurable, one could use the program to find out ***exactly how far you have gone***.

A ***second*** feature is the ability to ***tilt the view*** so that one can gain a ***height perception of buildings and natural features***. Check out the Rocky Mountains or the Eiffel Tower to examine these features.

A ***third*** useful feature is the ability to ***send a selected location or picture to a friend or colleague via email***. If you have a meeting at a location that is either difficult to get to or is difficult to locate based simply on the address, one could send a photo which details the streets leading to the final destination.

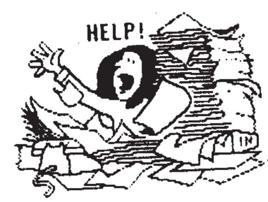
In order to download this program, go to:

http://earth.google.com/

GST

72(10)

PROCUREMENT CARDS



In a nine-page ***CRA Notice***, CRA notes that to qualify for an ***input tax credit*** (ITC) on ***procurement card*** purchases, the Registrant must have data for four months of transactions and one month of each quarter.

CHARITIES

In July, 2005, CRA released 23-page ***Guide RC4082*** which discusses the ***GST/HST rules*** for ***charities***.

DAMAGE PAYMENTS

On August 30, 2005, CRA released ***Notice 202*** which discusses "Draft GST/HST Policy Statement, Tax Status of ***Damage Payments***".