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### PERSONAL TAX

#### 71(1)

##### **COSMETIC SURGERY**

The Income Tax Act permits a medical expense credit for an amount paid to a medical practitioner in respect of medical services - this could include items such as cosmetic surgery, botox injections, calf implants, hair transplants, rhinoplasty and breast augmentation, facelifts, liposuction and tooth bleaching.

##### **PERSONAL CARE HOMES**

In a May 5, 2005 External Technical Interpretation, Canada Revenue Agency (CRA) notes that if an individual is certified as suffering from a physical or mental handicap and, as a result, receives care, or the care and training at a particular place which has the required equipment, facilities or specially trained personnel, the expenditures may qualify as a medical expense.

For example, fees paid to an institution which has staff specially trained to deal with Alzheimer's disease will usually qualify as a medical expense.

##### **TUITION FEES**

In a June 7, 2005 External Technical Interpretation, CRA notes that tuition fees may be eligible for a medical expense tax credit if the student is suffering from a physical or mental handicap, the severity of which is such that the student "requires" (not merely "benefits from") the

equipment, facilities or personnel specially provided by the school and, which is not available in the public school system.

An appropriately qualified person must certify this.

##### **PARENTS**

In a May 31, 2005 Internal Technical Interpretation, CRA confirms that where a parent is dependent on more than one child, each child could claim their portion of the permissible medical expense such as nursing home fees.

### EMPLOYMENT INCOME

#### 71(2)

##### **MOTOR VEHICLE LOG BOOK**

In a March 14, 2005 External Technical Interpretation, CRA reminds employers that they are required to maintain records so that the employee's total employment income can be reported. This includes making every reasonable effort to ensure that an employee maintains a logbook in respect of the use of an employer-provided motor vehicle.

##### **OVERSEAS EMPLOYMENT TAX CREDIT**

A Canadian resident employee may receive an income tax credit if employed throughout at least six consecutive months with a specified employer for the performance of services outside Canada in connection with a contract related to,

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among other things, engineering activities.

##### **SPECIAL WORKSITE**

The Income Tax Act excludes from income, allowances for board, lodging and transportation paid to employees at temporary special worksites.

In an Internal Technical Interpretation, CRA notes that even though a contract may extend beyond two years, the duties could still be of a "temporary" nature, thereby resulting in a tax-free allowance.

##### **TRUCKERS**

In a May 19, 2005 Tax Court of Canada case, the taxpayers were married and employed to drive the employer's trucks on long distance trucking routes in Canada

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and the United States.

CRA disallowed their deduction for meals, showers and incidental expenses on the basis that the Income Tax Act only permits a travel expense deduction if the taxpayer must make disbursements for meals and lodging. In this case, most of the time the taxpayers slept in the truck cab.

#### **Some Good News!**

The Court noted that CRA's objection is incorrect.

#### **Now Some Bad News**

The taxpayers deducted \$61.50 per day for meals, without receipts, on the basis that these were the rates established by the Treasury Board at that time to be paid as a non-taxable travel allowances to employees of the Government of Canada.

The Court noted that this is not relevant. However, the Court permitted \$40.00 per day with a 50% addback because of Section 67.1.

Also, the cost of the showers was deductible as a component of lodging.

#### **Editor's Comment**

CRA now permits, without receipts under the Simplified Method, \$15.00 per meal times three meals for a total of \$45.00 per day, subject to a 50% addback.

#### **HOME OFFICES**

In a May 26, 2005 External Technical Interpretation, CRA was asked for guidance as to whether an employer should complete Form T2200 where there is no contract of employment but the employee does incur home office expenses.

CRA notes that where it is tacitly understood by the employer and the employee that the office in the home be provided and that the required conditions are met, the employer should issue a

T2200 and the employee should be able to deduct expenses.

#### **CRITICAL ILLNESS INSURANCE (CII)**

A June, 2005 Supreme Court of Canada case in Quebec struck down a law prohibiting private health coverage in Canada. This has made CII coverage a more attractive option by introducing the possibility of private health coverage in Canada. Currently, private health coverage is mostly accessed through the United States or, more recently, Asia.

CII policies are a hedge against the public medical system deteriorating, or not being available on a timely basis.

In a December 9, 2003 External Technical Interpretation, CRA notes that if the CII policy is provided by the corporation to the owner-manager in his/her capacity as a employee, and not a shareholder, the premiums will be deductible to the employer. Assuming that the premiums only provide for group CII and do not contain any return of premium, there would be no taxable benefit.

Also, a lump-sum payment received under a CII policy may be non-taxable.

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### **BUSINESS/PROPERTY INCOME**

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#### **71(3)**

##### **OFFICE IN THE HOME**

In a Tax Court of Canada case, the Court accepted the deductions for the office in the home on the basis that it was used on a regular and continuous basis for meeting clients.

The fact that this doctor met most of his patients at the Clinic or at nursing homes, and only had about one or two appointments per week at his own home did not prohibit the deduction.

The Court noted that meeting with patients may occur by telephone. Patients and staff telephoned the doctor often and regularly at his home office for consultation, advice and to discuss cases.

#### **LEASES**

The Income Tax Act permits a lessee and a lessor to jointly elect to treat a lease as a capital lease in computing the income of the lessee such that the rental payments made by the lessee will be treated as blended payments of principal and interest. The lessee will be able to claim capital cost allowance and deduct the interest portion of each rental payment.

This only applies for leases of more than one year and does not apply on "prescribed property" including property that has a value less than \$25,000, intangible property, and exempt property - office furniture or office equipment, electronic data processing equipment, motor vehicles, trucks or tractors and certain buildings.

#### **INTERNET FEES**

In a May 30, 2005 Internal Technical Interpretation, CRA notes that internet connection fees paid by a self-employed person to earn income may be allowed under the Income Tax Act. However, if the fees are related to a home office and contain varying degrees of personal and business elements, a pro-ration must be made.

#### **MANAGEMENT FEES PAID TO A SPOUSE**

In a May 24, 2005 Tax Court of Canada case, Mrs. W deducted a \$32,000 management fee to her husband from her self-employed real estate business income.

No record was kept for the services performed.

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### **Taxpayer Loses**

CRA successfully argued that for an expense to be deductible there must be a "legal obligation to pay".

### **IMPORTANCE OF RECORDKEEPING**

In a June 17, 2005 Tax Court of Canada case, the taxpayer carried out a discount store as a proprietorship in which many of the expenditures and revenues were on a cash basis.

### **Taxpayer Loses**

The Court noted that because of the CRA auditor's methodical and thorough examination of the records available, the taxpayer was unable to rebut the Minister's assumptions. The taxpayer's difficulties stemmed from inadequate recordkeeping.

### **INDEPENDENT CONTRACTOR VS. EMPLOYEE STATUS**

CRA is aggressively reassessing in this area and have revisited same companies over and over again - for example, in one case, the workers were found to be independent contractors in 1995 and 2000 and are again being attacked by CRA in 2005.

There are a number of important issues such as liability for Employment Insurance (EI), Canada Pension Plan (CPP), withholding taxes at source, preparation of T4s, and deductibility of expenses by the workers. Important side issues include the worker's entitlement to employment-related benefits such as vacation pay and wrongful dismissal settlements.

The Courts are now looking at the joint intention of the worker and the payer as one of the important factors in determining the status.

In certain industries (ex; entertainment), workers/performers may wish to be

classified as employees so that they can claim EI benefits when they are not working. However, other workers want independent-contractor status to increase deductions against business income and to access corporate tax advantages such as lower tax rates, non-taxable employment benefits, and income splitting (National Post, June 28, 2005, FP12).

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### **OWNER-MANAGER REMUNERATION**

#### **71(4)**

#### **SOURCE DEDUCTIONS**

If a corporation declares a bonus payable to an employee, the bonus must be paid within 179 days after the year end. Therefore, the income tax, CPP and, if applicable, employment insurance must be paid in the following month, either on the 3rd, the 10th or the 15th, depending on the remittance period.

If the source deductions are not paid on time, the corporation may be assessed a late filing penalty.

#### **SALARIES TO ADULT CHILDREN**

In an April 15, 2004 Tax Court of Canada case, Mr. F owned all the shares of a corporation which employed his adult children as key significant employees. In bonusing down to the annual business limit, bonuses of \$136,639 and \$50,000 were declared to the children, respectively. CRA disallowed as a deduction most of the bonuses on the basis they were not incurred to earn income.

#### **Taxpayer Wins!**

The Court permitted the bonuses and noted that the services provided by the adult children played a material role in the financial success of the business.

### **DIRECTOR LIABILITY**

In a May 19, 2005 Tax Court of Canada case, Mr. M bought a flower shop from Mr. C and left Mr. C to manage the corporation.

The corporation was "run extremely poorly" and was deficient in GST remittances by \$61,216. Mr. M, the sole director, was assessed with personal liability for the \$61,216.

### **Taxpayer Loses**

The Court noted that Mr. M was a knowledgeable director with a strong business background. This was not a case of a naive or unaware director. Under these circumstances, the duty to take reasonable care to prevent ongoing defaults requires significant effort on the director's part. The efforts need not guarantee success but, must be immediate, forceful and have some reasonable likelihood of success.

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### **MARRIAGE BREAKDOWN**

#### **71(5)**

#### **THIRD PARTY PAYMENTS**

In a March 24, 2003 Tax Court of Canada case, the taxpayer paid \$19,828 to third parties in respect of the family residence including mortgage, insurance, taxes, electricity, telephone, cable service, repairs and maintenance as stipulated in the Marriage Separation Agreement.

The Income Tax Act permits a deduction for third party payments if the Court Order or Agreement specifically refers to these tax implications. The purpose is to ensure that the parties in question are fully aware of the fiscal consequences resulting from the payments.

### **Taxpayer Loses**

The Court disallowed the deduction

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because there was no written document confirming the tax consequences.

### **RETROACTIVE CHILD SUPPORT AWARDS**

An Alberta Court of Appeal case ruled that when the income of a person paying child support goes up, the obligation to pay higher child support would generally commence at that time. Therefore, a child support payor could owe substantial amounts for retroactive child support if his/her income has increased since the original settlement date.

#### **Ontario Disagrees**

On May 19, 2005, the Ontario Court of Appeal repudiated the Alberta Ruling by directing Judges not to routinely order payor parents to pay retroactive child support to custodial parents.

The Ontario Court Ruled that Trial Judges should only "sparingly" order child support for the months prior to the date on which a custodial parent formally applies for support.

### **ARREARS**

In a February 25, 2005 Supreme Court of Canada case, the Court found that a lump-sum "disability payment" for arrears was taxable.

Even though there have been a number of alimony arrears cases that found that an arrears settlement was non-taxable/non-deductible, this status may change in the future because of this finding.

CRA is in the process of reviewing its policies because of this case. This makes settlements of arrears quite risky as the tax implications to both the payor and the recipient are uncertain.

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## **CHARITIES**

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### **71(6)**

#### **FORM T3010A**

Persons filing a Charitable Organization return for a fiscal period that begins after March 22, 2004 should use new Form T3010A(05).

#### **NEW FUNDING PROGRAM**

On May 17, 2005, the Minister of National Revenue launched the Charities Partnership and Outreach Program to support compliance-related education and training projects for charities.

Up to \$3 million in funds will be available to the voluntary sector annually for education and training on charities regulations to a maximum of \$500,000 per year per project.

Any registered charity or non-profit organization serving the charitable sector can apply to CRA for funding.

#### **PRIVATE GIVING FOUNDATION**

For a list of Community Foundations that provide a structure for tax deductible charitable giving see [www.community-fdn.ca](http://www.community-fdn.ca).

#### **DONATION THROUGH THE WILL**

The Income Tax Act permits a donation made through the Will to be claimed on the Terminal Return of the deceased taxpayer. CRA usually considers that a gift by the Will of a specific percentage of the residual will be eligible.

However, if the residue of the Estate is dependent on decisions to be made by the Executor (for example, amounts to be paid to grandchildren) then the donation is in the Estate, not the Terminal Return of the deceased.

## **ETHNOCULTURAL COMMUNITIES**

In a June 30, 2005 Release, CRA notes that a group that provides assistance to an ethnocultural community, or that educates the public about a particular culture, may be eligible for charitable registration. This 14-page Release discusses the options for such groups.

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## **ESTATE PLANNING**

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### **71(7)**

#### **ROLLOVER TO FINANCIALLY DEPENDENT CHILDREN**

Where a financially dependent child or grandchild receives, on the death of a person, a distribution from the deceased's RRSP or RRIF, the child, not the deceased taxpayer, includes the amount in income. However, an offsetting deduction is permitted if the amount is used to acquire a specific type of annuity, including a life annuity where the child or grandchild is dependent by reason of physical or mental infirmity or, an annuity payable up to the age of 18 for other dependent children or grandchildren.

In an April 6, 2005 External Technical Interpretation, CRA noted that a "Henson" style Trust could be used to safeguard a disabled beneficiary's entitlement to social assistance.

#### **U.S. DIVIDENDS AND INTEREST**

Where a Registered Retirement Savings Plan receives U.S. dividends or interest, there should be no U.S. withholding tax.

#### **REGISTERED RETIREMENT INCOME FUND (RRIF) BENEFICIARY**

An article in the National Post noted that because the spouse was not designated as the direct beneficiary of the RRIF, the RRIF proceeds went into the Estate and

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they were forced to obtain probate which cost more than \$1,000 and took about six weeks (June 11, 2005, FW6).

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## GST

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### 71(8)

#### VENDOR DOES NOT REMIT GST

In an Excise Tax Act case, the taxpayer bought vehicles and paid GST to the vendor but the vendor did not remit the GST to CRA. CRA argued that the purchaser must then remit the GST for which they claimed an input tax credit.

The Court concluded that this is ludicrous as long as the purchaser can prove that they have paid the GST, because the vendor is acting as the agent of CRA (The Bottom Line, January 2004, Page 20).

#### CARRYING ON BUSINESS IN CANADA

Every non-resident person who carries on business in Canada, other than a small supplier, must register for GST/HST if the non-resident person makes a taxable

supply in Canada.

#### GST/HST REGISTRATION CANCELLATION

GST/HST Memoranda Series 2.7 discusses Cancellation of Registration including the required conditions, responsibilities and obligations upon GST/HST cancellation.

#### COMPUTERIZED RECORDS

In June, 2005, CRA introduced GST/HST Memoranda 15.2 Computerized Records.

The 11-page Guide discusses electronic records, retention of records, inspections, audits and examinations, and lost, damaged or inadequate records.

Also, in June, 2005, CRA introduced GST/HST Memoranda 15.1 General Requirements for Books and Records.

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## DID YOU KNOW...

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### 71(9)

#### CANPASS AIR - BORDER CLEARANCE

On March 24, 2005 CRA introduced Guide RC4344 which discusses the CANPASS Air Service for pre-approved commercial airline travellers.

Members are allowed to use the self-service kiosk when entering Canada to avoid the regular customs and immigration line-ups. For more information call 1-800-461-9999 or see website [www.cbsa.gc.ca/canpass](http://www.cbsa.gc.ca/canpass).

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