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## 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.

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

#### Moral

Documentation is important!

# Tax Tips & Traps



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## **BUSINESS/PROPERTY INCOME**

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### **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% addback, 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.

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## **CAPITAL GAINS/LOSSES**

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### **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 notes 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.

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## **OWNER-MANAGER REMUNERATION**

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### **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.

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## **MARRIAGE BREAKDOWN**

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### **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 appealed 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](http://www.cra.gc.ca)).

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## ESTATE PLANNING

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### 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 a 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 2005 income in excess of \$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 0.5% 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 his/her home. 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 does not have 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.

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## GST

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### 72(8)

#### 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".

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