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### PERSONAL TAX

#### 73(1)

#### MEDICAL EXPENSE - OUTSIDE CANADA

In an October 3, 2005 article in the Globe and Mail it was noted that an Ontario taxpayer was reimbursed for her medical expenses by the Ontario Hospital Insurance Plan ("OHIP") under a decision of the Ontario Health Services Appeal and Review Board for a hip operation done in Florida. It was noted that the 18 to 24 month wait that she faced would have caused "medically significant irreversible tissue damage". This follows a similar Ruling for a London, Ontario man who went to Port Huron, Michigan for a hip replacement.

If foreign medical expenses are not reimbursed by government authorities, they are usually allowed as a medical expense credit on the Canadian personal tax return. Also, the transportation costs for the taxpayer and a required attendant may qualify but CRA may request from the taxpayer a letter provided by a medical practitioner in Canada that equivalent medical services were not available at their Canadian location.

#### MEDICAL EXPENSE - SPECIAL SCHOOL

In a November 25, 2005 Tax Court of Canada case, the taxpayer's daughter had learning disabilities and attended a special

school in Hamilton, Ontario to assist her in overcoming these disabilities.

CRA allowed the tuition fees as a medical expense. The Tax Court also allowed the travel expenses incurred in driving the daughter to the school from her home in Simcoe each day.

#### DISABILITY TAX CREDIT

In a November 7, 2005 Tax Court of Canada case, the taxpayer was allowed a Disability Tax Credit ("DTC") in respect of her son who suffered from Attention Deficit Hyperactivity Disorder.

### EMPLOYMENT INCOME

#### 73(2)

#### TREASURY BOARD NON-TAXABLE TRAVEL ALLOWANCES

Effective October 1, 2005, the Treasury Board increased non-taxable government travelling allowances by 5 cents per kilometre as follows:

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Effective	10/1/05	4/1/05	7/1/04
Alberta	49.0	44.0	43.5
British Columbia	49.0	44.0	43.0
Manitoba	47.0	42.0	40.5
New Brunswick	49.5	44.5	43.5
Newfoundland and Labrador	52.5	47.5	47.5
Northwest Territories	54.5	49.5	49.0
Nova Scotia	49.5	44.5	44.0
Nunavut	54.5	49.5	49.0
Ontario	50.5	45.5	45.5
Prince Edward Island	49.0	44.0	44.0
Quebec	53.5	48.5	47.5
Saskatchewan	46.0	41.0	40.0
Yukon	57.0	52.0	50.5

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Also, the total meal and incidental allowance increased from \$73.90 to \$74.65 per day.

For details see website [http://www.tbs-sct.gc.ca/pubs\\_pol/hrpubs/TBM\\_113/tb-dv-c\\_e.asp](http://www.tbs-sct.gc.ca/pubs_pol/hrpubs/TBM_113/tb-dv-c_e.asp).

This could be a starting point for providing non-taxable travel allowances to employees.

**SELF-ADMINISTERED SUPPLEMENTARY UNEMPLOYMENT BENEFIT (“SUB”) PROGRAMS**

The basic Employment Insurance (“EI”) program can be enhanced with an employer top-up plan called Supplementary Unemployment Benefit (“SUB”) Programs.

Employer payments go on top of the \$413/week EI pays, bringing the employee closer to his/her pre-disability earnings.

All plans are registered with HRSDC (Human Resources and Skills Development Canada). Reference material can be found on the HRSDC website “Guide to SUB Plans”. ([www.hrsdc.gc.ca](http://www.hrsdc.gc.ca)).

**TOP ONE HUNDRED EMPLOYERS**

The October 22, 2005 issue of the National Post included an article on the top one hundred employers and provided information on benefits provided to their employees such as:

1. Maternity and compassionate leave Employment Insurance top-ups
2. Tuition subsidies
3. Fitness plans
4. Health Plans
5. Product discounts
6. Scholarships to employees

**PROFESSIONAL DEVELOPMENT PAYMENTS**

In an October 17, 2005 External Technical Interpretation, CRA notes that when an employee takes employer-paid training primarily for the benefit of the employer, there is no taxable benefit to the employee whether or not the training leads to a degree, diploma or certificate.

For example, it was noted that the Ontario Ministry of Education provides School Boards with grant monies for “Teacher and Support Staff Development” (“TSSD”). \$512 (maximum) is paid tax free to each employee for professional development.

**GIFT CERTIFICATES**

In an October 20, 2005 External Technical Interpretation, CRA notes that cash or near-cash gifts and awards are not covered by their policy to permit tax-free gifts and awards of up to \$500 per year to an employee. CRA considers near-cash gifts and awards to include securities, gold nuggets, and gift certificates.

**AUTOMOBILE BENEFITS**

Employer-owned automobiles made available to employees require reporting of a taxable benefit on the employees’ T4s for the standby charge and the operating benefit. This may be a complicated calculation. For example, if the personal kilometres are less than 20,000 and the automobile is used more than 50% for business, the standby charge and operating benefits are reduced accordingly.

CRA provides a valuable online tool to assist in calculating taxable benefits at [www.cra.gc.ca/autobenefits-calculator](http://www.cra.gc.ca/autobenefits-calculator).

**CRITICAL ILLNESS INSURANCE**

An employer may provide “group critical illness insurance” for employees which provide tax deductible premiums to the employer, without a taxable benefit to the employee. Also, when cash is paid to the employee under a Direction to Pay, it may

be non-taxable to the employee.

**BUSINESS/PROPERTY INCOME**

**73(3)**

**SCIENTIFIC RESEARCH AND EXPERIMENTAL DEVELOPMENT (SR&ED)**

Some things to consider when determining eligibility for SR&ED investment tax credits include:

1. A scientist working in a laboratory is not required in order to qualify. The business owner and staff may be carrying on SR&ED activities.
2. A claim does not normally result in a CRA audit of other matters in the business. CRA will simply send a science consultant to determine if the claim qualifies as SR&ED. Next, they will send a financial reviewer to check the amount of the claim.
3. The claim process includes writing a technical report for each SR&ED project and compiling the data (labour, materials, and overhead costs).
4. Capital equipment, as well as labour, is eligible for the SR&ED investment tax credit.
5. CRA is looking for evidence of technological advancement. Therefore, it is important to emphasize technological goals, not business objectives.
6. Some CRA Guides with respect to SR&ED claims include Guide RC4290 (Refunds for Small Business SR&ED), Guide RC4270 (Introducing the SR&ED Program’s Account Executive Service), Guide RC4271 (Pre-Claim Project Review Service), Interpretation Bulletin IT-151R5, Form T661, Information Circulars 86-4R2 and 3, and 94-1 and

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2, and 97-1, Income Tax Technical News 23 (List of Approved SR&ED entities), and the CRA website [www.cra.gc.ca/sred](http://www.cra.gc.ca/sred).

7. Most provinces also have tax credits for SR&ED expenditures.

### **DIRECTOR FEES PAID TO ADULT CHILDREN**

In a September 27, 2005 Tax Court of Canada case, CRA disallowed directors' fees paid to adult children in 1997, 1998 and 1999 as being unreasonable.

The taxpayer admitted that the appointment of the children as directors was largely tax driven so that income earned in excess of the annual small business deduction limit could be expensed to the adult children. The disallowed expense to the company resulted in double tax as the amounts had been included in income by the adult children.

The taxpayer argued that one motive to have the children as directors was to expose them to the business in the hopes that one day they would become more active in the business and ensure its continuity. However, when the children were first appointed they were all in school and none of the children were employed during the subject period with the taxpayer, other than in their capacity as directors. They did not participate in the day-to-day operations or management of the corporation.

The directors' fees were determined based on the draws of the children and bore no relationship between the amount declared and the performance of duties.

### **CRA and the Taxpayer Both Lose/Win**

The Court found that director fees of \$11,600 paid to one child who did have a possible interest in the business, signed documents, and had liability risks were

allowed.

With respect to the other children, only \$1,500 per child per year was allowed on the basis that they did have some liability risks as directors.

### **RETIREMENT COMPENSATION ARRANGEMENTS**

A corporation may consider declaring a deductible payment to a Retirement Compensation Arrangement ("RCA") rather than a bonus payable to the shareholders. This is because, even though a 50% refundable tax is payable to CRA on the amount allocated to the RCA, it may be possible to borrow funds against this 50% and the amounts in the RCA. Therefore, funds may be available to the business which would not be available if the bonus had been declared and income tax paid to CRA.

### **THEFTS**

In an October 13, 2005 Tax Court of Canada case, Mr. G carried on a proprietorship grocery store. His spouse, who did much of the work, allegedly stole funds from the proprietorship. The taxpayer argued that this should be a deduction to the proprietorship.

### **Taxpayer Loses!**

The Court noted that this was likely a partnership and thefts made by a partner are not deductible to the business. Even if it was a proprietorship, thefts made by senior employees in a position to control or act as an owner are likely not deductible.

### **MUTUAL FUNDS**

CRA Guide RC4169 provides information on the "Tax Treatment of Mutual Funds for Individuals" including what is a mutual fund, how income from mutual funds is taxed, how to report income from information slips, calculating capital gains on redemption and sale, adjusted cost base calculations and examples.

## **CAPITAL GAINS/LOSSES**

### **73(4)**

### **PRINCIPAL RESIDENCE EXEMPTION ("P.R.E.")**

In a November 9, 2005 Tax Court of Canada case, the taxpayer was a contractor who acquired land and constructed a home in Niagara Falls which was sold two and one-half years later at a gain of \$32,000 for which the taxpayer claimed the P.R.E. and the GST new housing rebate.

Both were disallowed by CRA on the basis that the property was inventory acquired with the intention of resale.

### **Taxpayer Wins!**

The Court noted that, even though the individual was a contractor, the primary intention was to build a residence for his family which was very specific to their individual taste and needs.

Therefore, the P.R.E. and the GST new housing rebate were allowed.

### **AGRICULTURAL LAND RESERVE**

In an October 25, 2005 External Technical Interpretation, CRA notes that where a residence is on an agricultural land reserve which cannot be subdivided and has been used on a continuous basis for the home, these are very strong factors to indicate that the entire property is eligible for the principal residence exemption even though it is in excess of one-half hectare.

### **SHARE OF BANKRUPT/INSOLVENT CORPORATION**

In a November 24, 2005 External Technical Interpretation, CRA notes that a taxpayer may elect to claim a loss on shares where the corporation:

- (i) becomes bankrupt during the year;
- (ii) is under a Winding-Up Order; or
- (iii) is insolvent,

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and neither the corporation nor a corporation controlled by it carries on business, the fair market value of the shares is nil and it is reasonable to expect that the corporation will be dissolved or wound-up.

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## ESTATE PLANNING/CHARITIES

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### 73(5)

#### NON-PROFIT ORGANIZATIONS ("NPO")

In a September 22, 2005 External Technical Interpretation, CRA notes that for a club, society or association to receive non-taxable treatment the NPO must be operated exclusively for social welfare, civic improvement, pleasure or recreation or for any other purposes except profit.

However, if an association happens to realize incidental profits from their non-profit activities, it may still qualify as a NPO unless the primary purpose is "for profit".

#### DIRECTOR LIABILITY

Directors of non-profit organizations may be sued because of actual, or alleged, errors such as wrongful employee termination, discrimination, unpaid salaries, environmental damage, unpaid GST and employee source deductions, etc. Lawsuits could come from many sources such as government, creditors, members of the public, employees, and even fellow directors.

Therefore, it may be important to have director and officer liability insurance that covers directors, officers, volunteers, staff and employees.

#### DISCRETIONARY FAMILY TRUST

It may be advantageous to have a Discretionary Family Trust ("DFT") own a class of shares of a family corporation so that dividends may be paid on the class for income splitting purposes. (Caution -

dividends allocated to minor children may be subject to the Kiddy Tax.)

Also, upon a *sale* of the shares, the capital gain can be allocated to a number of beneficiaries of the DFT thereby multiplying the capital gain exemption.

It may also be advisable to have another class of shares of the family corporation owned by another corporation so that dividends may be paid tax free on that class for creditor proofing and to maintain the qualified small business corporation status of the operating company.

#### Caution!

Specialized legal and tax advice is needed in dealing with a DFT.

#### CHARITABLE DONATIONS

A number of charitable donation tax shelters were again offered by promoters in 2005. For example, a donation of \$10,000 may provide two donation receipts, one for \$10,000 and, another for, say, \$30,000. The \$30,000 typically relates to an asset received from a Trust which is in return donated to a charity for the \$30,000 receipt.

CRA warned taxpayers of the pitfalls and risks of these plans in a November 22, 2005 Release.

#### ART FLIPS - A LOSER

In a September 24, 2004 Tax Court of Canada case, the Court allowed the taxpayer's appeal where \$8,571 of art prints were purchased and donated. A receipt for \$29,400 was claimed as a donation tax credit based on individual retail values for each of the prints.

#### Taxpayer Loses - in the Federal Court of Appeal ("FCA")

In this November 21, 2005 FCA case, the taxpayer made purchases and donations through CVI Art Management Inc.

The Federal Court noted that the evidence provided by the taxpayer on the individual

retail values for each print was not acceptable because there was a normal market for the "group" of prints. The evidence was that CVI only sold groups of prints. Therefore, the highest price paid for the "group" of prints is the correct value for donation purposes. This is approximately equal to the \$8,571 paid by the taxpayer for the prints.

#### Editor's Comment

CRA will likely proceed against thousands of taxpayers involved in art flip donations as these cases were put on hold pending this FCA decision.

#### OFFICIAL DONATION RECEIPTS

In a December 2, 2005 Registered Charity CRA Release, it was noted that registered charities have to include the name and website address of CRA on official donation receipts as of January 1, 2006.

## GST

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### 73(6)

#### DUE DILIGENCE DEFENSE FOR A GST PENALTY

CRA's seven-page GST/HST Policy Statement P-237 discusses the due diligence defense for penalties imposed under the Excise Tax Act for failure to remit or pay GST.

The Release has examples including one where the due diligence defense was accepted because the taxpayer researched product information, compared the product to similarly classified items, consulted CRA publications and the Excise Tax Act, and questioned the distributor of the product. Also, the registrant sought formal advice from an accountant, and unknowingly provided incomplete information to obtain advice from CRA officials.

#### DIRECTOR LIABILITY

In a November 22, 2005 Tax Court of

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Canada case, the director was assessed with personal liability for unremitted GST.

### Taxpayer Wins!

The Court noted that the taxpayer had resigned as a director on April 21, 1997 well over two years before the date of the June 3, 2002 assessment. Therefore, the assessment was statute-barred.

### AGENTS

In a seven-page GST/HST Info Sheet G1-012, CRA discusses agents and the GST implications related thereto.

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## DID YOU KNOW...

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### 73(7)

#### ENERGY COSTS

On October 6, 2005 - 2005-066 - The Department of Finance introduced Federal measures to offset higher energy costs including payment of \$250 to families entitled to receive the National Child Benefit in January, 2006; \$250 to senior couples where both spouses are entitled to receive the Guaranteed Income Supplement ("GIS") in January, 2006; and \$125 to single seniors entitled to receive the GIS in January, 2006.

A person must have filed a 2004 income tax return before they qualify for the Energy Cost Benefit. Also, if you have never applied for the Canada Child Tax Benefit ("CCTB"), you must complete the CCTB application (RC66) to register your children.

For more information call 1-800-OCANADA.

#### Editor's Comment

The Alberta Resource Rebate of \$400 will be paid to every Albertan 18 years of age or over at December 31, 2005.

Children under age 18 get the rebate via

the primary caregiver listed for the Canada Child Tax Benefit.

The 2004 Personal Tax Return must be filed by December 31, 2006.

#### NATURAL RESOURCES CANADA

Canada Mortgage and Housing Corporation ("CMHC") will provide assistance through the Residential Rehabilitation Assistance Program ("RRAP"). Single, row and semi-detached housing may be eligible for financial assistance of between \$3,500 and \$5,000 for energy retrofits such as draft-proofing, heating system upgrades and window replacements if the house was built prior to 1980.

To qualify, the household must meet certain household income requirements. For example, a four-person household with two children residing in Hamilton with a household income of \$44,500 or less would be eligible for assistance. The same household would have to earn \$34,000 or less if they resided in Kamloops because of the lower cost of housing in that market.

Funding will also be provided for multiple-unit buildings and rooming houses of between \$1,000 and \$1,500 per unit.

The program will be available in January, 2006.

For details contact Grace Thrasher, CMHC, 1-613-748-2375 or see

[http://www.nrcan-rncan.gc.ca/media/newsreleases/2005/200577a\\_e.htm](http://www.nrcan-rncan.gc.ca/media/newsreleases/2005/200577a_e.htm).

#### SALE TO U.S. PURCHASER

Where a Canadian individual is about to sell shares of a Canadian corporation to a U.S. person, if the corporation is converted to an Unlimited Liability Corporation ("ULC") before the sale, the sale may be viewed as an asset acquisition for U.S. purposes even though it is a share sale for Canadian purposes. Therefore, the U.S. purchaser would receive flow-through advantages while the Canadian vendor would still be eligible for capital gains treatment.

Alberta and Nova Scotia Corporation Acts currently provide for ULCs. We understand that other provinces (including British Columbia and Ontario) are considering similar legislation.

**Caution:** Specialized expertise is needed.

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## **GUARANTEED INCOME SUPPLEMENTS**

In the past, over 200,000 elderly taxpayers missed out on claiming approximately \$300 million in Supplemental Old Age Security benefits because they have not applied for them. This information comes from Statistics Canada.

Since 2002, Social Development Canada has been using tax returns to identify and contact persons who may have not claimed the low-income supplement, even though they qualify.

First-time applicants and those wishing to be reconsidered after losing eligibility and those not filing a tax return must submit an application directly to Social Development

Canada.

## **CAREGIVERS**

The Federal Government mentioned that it will be announcing the expansion of the Employment Insurance ("EI") program for caregivers of dying persons.

Currently, persons caring for dying persons must be a direct kin, such as a spouse, child or parent to qualify for EI payments.

## **CHILD SUPPORT - THE 40% RULE**

In a November 10, 2005 Supreme Court case, the Court ruled that a divorced father cannot automatically reduce his child support if he spends greater than 40% of the time with his child.

In this case, the Supreme Court noted that increased time spent with the child does not necessarily mean that there has to be lower child support payments.

## **ARREARS**

In a November 1, 2005 Tax Court of Canada case, the taxpayer was in arrears on spousal and child support and made a lump-sum payment of \$25,000 which released him from any past and future obligations arising from the arrears.

## **Taxpayer Loses**

The Court found that this was a capital payment in settlement of all amounts payable. It is not deductible to the payor.

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