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### PERSONAL TAX

#### 75(1)

#### TUITION FEES - ONLINE COURSE AT FOREIGN UNIVERSITY

The Income Tax Act requires a student to be in full-time attendance at a university outside Canada to claim a tax credit for tuition fees.

In a March 9, 2006 Tax Court of Canada case, the taxpayer took a post-graduate degree on an online basis from Open University in England. Although there are no lectures, visual presentations are provided in CD format. Students are given access to a dedicated online connection similar to a "chat room" so that issues can be discussed among the students and with the tutors.

Exams were written at the University of British Columbia.

#### Taxpayer Wins!

The Judge found that the Income Tax Act does not necessarily require physical presence at a university. The expression "full-time attendance" is ambiguous and should be interpreted literally to include programs that require the "attention" of the student on a full-time basis, such as the online program taken here.

#### MOVING EXPENSES AS A MEDICAL EXPENSE TAX CREDIT

In an April 11, 2006 External Technical

Interpretation, Canada Revenue Agency ("CRA") notes that the Income Tax Act permits "reasonable moving expenses" of up to \$2,000 as a medical expense tax credit for a person who lacks normal physical development or has a severe and prolonged mobility impairment, where the move is to a dwelling that is more accessible by that person or in which the person is more mobile or functional.

For example, this may apply to a person who has to move because they have Multiple Sclerosis if the new dwelling is more accessible or you are more mobile or functional within the new dwelling.

### EMPLOYMENT INCOME

#### 75(2)

#### HEALTH CARE EXPENSE ACCOUNT ("HCEA") - BONUSES

In a 2005 Advance Income Tax Ruling, CRA ruled that when part of a bonus allocation is credited to the HCEA, this will not be taxable income.

Unused balances in the HCEA at the end of the year may be carried over and used to reimburse eligible medical expenses in the subsequent year. Unused balances will not be payable in cash.

#### HEALTH SPENDING ACCOUNT ("HAS")

In a 2006 Advance Income Tax Ruling, CRA noted that a company compensates

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its management employees with a base salary and incentive pay.

The company permits the employee to elect to allocate the incentive pay to an HSA which qualifies as a Private Health Services Plan (PHSP).

CRA ruled that the allocation of credits to the HSA will not be considered taxable income.

#### PAYROLL DEDUCTIONS ON TIPS

In an April 18, 2006 External Technical Interpretation, CRA notes that where tips are controlled by the employer, payroll deductions must be met and the amounts reported on the employee's T4.

Controlled tips include tips the employer pays or that pass through the employer's books before the employee receives them.

# Tax Tips & Traps



## TRUCKERS

In a May 12, 2006 British Columbia Court of Appeal case, the Court found that this class-action suit that truck drivers should be allowed deductions for meals, without receipts, at the rates the Federal government pays its employees when they travel on business was not allowed by the Court.

### Editor's Comment

Truck driver employees are required to keep receipts for travel expenses unless they use CRA's simplified method of claiming \$15 per meal to a maximum of \$45 per day. However, deductions are subject to a 50% limitation under the Income Tax Act.

## OVERTIME MEAL ALLOWANCES

In a May 29, 2006 External Technical Interpretation, CRA notes that where an employer pays for reasonable meal expenses incurred while the employee is required to work overtime, a taxable benefit does not result where:

- (a) the employee works three or more hours of overtime right after his/her regularly scheduled hours of work, and
- (b) the overtime is infrequent and occasional in nature (less than three times a week).

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## BUSINESS/PROPERTY INCOME

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### 75(3)

#### EMPLOYEE VS. INDEPENDENT CONTRACTOR

In a March 2, 2006 Federal Court of Appeal case (The Royal Winnipeg Ballet ("RWB") vs. M.N.R.), the Court found that dancers with the RWB are independent contractors - not employees.

The Federal Court noted that the

uncontradicted evidence of the parties as to their common understanding of the legal relationship as being that of an independent contractor should have been considered. This common understanding is borne out by the contractual terms and the other relevant factors.

## REPLACEMENT PROPERTY

In an April 18, 2006 External Technical Interpretation, CRA reviewed the replacement property rules whereby a motel business is sold and the funds used to acquire a recreational vehicle park to defer the capital gain on the sale of the motel.

The replacement property rules generally allow a taxpayer to defer recognition of capital gains and recaptured capital cost allowance on the disposition of a capital property when the replacement property is acquired by the end of the following fiscal period (voluntary dispositions) or the second fiscal period (involuntary dispositions).

## RENTAL LOSS

In a May 5, 2006 Tax Court of Canada case, the taxpayer purchased a house in Toronto. From 1981 to 1994 the house was rented out to family members. From 1994 on, it was rented out to arm's-length persons. The taxpayer claimed losses from 1987 through to the year 2000 ranging from \$4,000 to \$14,000 each year.

CRA disallowed losses in the years 2001, 2002, 2003 of \$14,655, \$14,865, and \$16,385 on the basis that there was a personal aspect to the house.

### Taxpayer Wins on this Point!

The Court noted that there was no sentimental attachment to the premises nor was there any evidence that the taxpayer might put the property to some non-commercial use in the future.

### Taxpayer Loses on this Point!

CRA successfully argued that many of the expenses were not deductible because they were not supported by receipts.

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## OWNER-MANAGER REMUNERATION

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### 75(4)

#### FAMILY MEMBERS AS DIRECTORS

A common issue in private corporations is the remuneration which can be paid to family members who are not active in the day-to-day operations of the business. Such salaries are deductible only to the extent they are reasonable in relation to the services provided.

Some family members are made Directors of the corporation to support payment of higher salaries. A recent case indicates that the additional remuneration a Directorship may support is fairly small. In that case, the Tax Court denied the deduction of a large portion of Directors' fees paid to adult children who were Directors of the corporation, but provided no other services. The Tax Court allowed a deduction of only \$1,500 per child per year. A greater deduction (\$11,600) was allowed for one child who was more active in the business.

### Caution!

Prospective Directors should carefully consider the legal ramifications and risks of Directorship, and consult with their legal counsel. Directors can be held personally liable for unremitted GST and source deductions and can also be at risk of liability for items such as environmental damages, improperly issued shares, improper payments to shareholders and wages not paid to employees.

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# Tax Tips & Traps

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## ESTATE PLANNING

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### 75(5)

#### ART FLIP DONATIONS

In a Tax Court of Canada case, the taxpayer claimed charitable donations of \$9,000, \$9,500, \$10,100 and \$10,000 for the years 1990 to 1993 on the basis that art was purchased and donated to charities. However, evidence indicates that the taxpayer never saw the paintings, never had them in his possession and did not choose the charitable organizations that were to receive the donations.

#### Taxpayer Loses

CRA was successful in disallowing the charitable donation tax credits for all the years, including the years thought to be statute-barred because the Court found that there was a "misrepresentation attributable to neglect, carelessness or willful default".

#### ESTATE FREEZE

When a parent owns the shares of a corporation, he/she may wish to freeze the value of their shares in favour of children who will subscribe for future growth common shares, perhaps through a Trust. This could reduce tax on the death of the parents.

CRA Ruled positively on an Estate Freeze in a 2006 Advance Income Tax Ruling.

#### DESIGNATED BENEFICIARIES

In a May 4, 2004 Ontario Superior Court case, the issue involved who was entitled to the life insurance and assets in the deceased person's RRSP - the designated beneficiary or the Estate.

In this case, Mr. and Ms. G entered into a Separation Agreement in 2004 in which Ms. G released her entitlement to all assets as part of the settlement of all claims between them. However, Mr. G died

before he changed the designated beneficiary on his RRSP and life insurance policy.

The Court determined that Ms. G was entitled to receive the assets in the RRSP and the life insurance proceeds on the basis that the Separation Agreement did not revoke Ms. G's rights as the named beneficiary in both the RRSP and the insurance policy.

There have been other cases where the rights of a named beneficiary have been revoked because of a proven intention of the deceased, but this did not occur in this case. Therefore, if the intention is to have the RRSP and insurance not go to your former spouse, it is important to change the beneficiary.

#### LOANS FOR VALUE

The marginal tax rate system permits taxpayers who can redirect income to lower income family members to enjoy considerable tax benefits as a family unit. Unfortunately, the attribution rules often frustrate income splitting with spouses and minor children or grandchildren.

However, the attribution rules do not apply to transfers where the recipients of investment capital pay fair value for the funds they receive such as through properly structured loans.

The loan must bear interest at a rate no lower than the CRA prescribed rate at the date the loan is advanced (4% until September 30, 2006); and the interest for every year must be paid no later than January 30 of the following year.

The borrower (commonly a Trust for minor children or grandchildren) can then invest the borrowed funds and earn income. Because the borrowed funds are used to earn income, the borrower is entitled to deduct the interest incurred as a carrying charge. To the extent the return on their investments exceeds the interest,

the difference will be taxable to the lower-income borrower. Of course, the lender must report the interest received each year.

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## MARRIAGE BREAKDOWN

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### 75(6)

#### LEGAL FEES - CHILD SUPPORT

In a March 9, 2006 Tax Court of Canada case, the taxpayer had custody of the younger child and, his former spouse had custody of the older child after the marriage separation. Upon applying the Federal Child Support Guidelines, the amount that he had to pay her based on his income exceeded the amount that she had to pay him. Therefore, the net amount payable by him for child support was \$185 per month. CRA disallowed his legal fees related to the child support.

#### Taxpayer Wins!

The \$8,265 of legal fees paid by the taxpayer with respect to his claim for child support from his former spouse was considered deductible even though, he had to pay a net amount to her. The Court noted that the purpose in incurring the legal fees was in part to establish his entitlement to support for one child. Legal fees incurred to establish entitlement to child support are deductible.

#### COMMENCEMENT DATE - CHILD SUPPORT

Child Support Orders made after April, 1997 do not permit a deduction to the payor, or income to the recipient because the "Commencement Day" is after April, 1997. Also, pre-May, 1997 Agreements that are changed after that date may also have a "Commencement Day" after April, 1997 thereby converting the status of the child support from deductible/taxable to non-deductible/non-taxable.

In a March 16, 2006 Tax Court of Canada

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case, Daniel was required to pay child support in a marriage breakdown situation to his former spouse under a July 14, 1993 Agreement. Therefore, this was a pre-May, 1997 Agreement and the child support payments were deductible.

However, on November 23, 1998 the Agreement was changed with respect to overall custody and child support amounts. The Court found that Amendment was a new Agreement. Therefore, it had a Commencement Day after April, 1997 and the child support payments were no longer deductible.

## GST

### 75(7)

#### GST/HST WEB REGISTRY

As part of their obligations under the GST/HST, Registrants are required to ensure that Input Tax Credits are claimed only where suppliers are registered for GST/HST. Previously, the sole means available to verify this was to contact Canada Revenue Agency.

The February 23, 2005 Federal Budget proposed a publicly accessible web-based GST/HST Registry. This has now been activated and the link is:

<https://www.businessregistration-inscriptionentreprise.gc.ca/ebci/brom/regi>

#### [stry/registryPrompt.en.jsp](#)

This could also be valuable for real property transactions where a vendor needs to confirm that the purchaser is registered so that the vendor will not be required to collect GST/HST on the sale.

#### EXPORTS

Most exported services are subject to a GST rate of 0%. However, the taxpayer may claim Input Tax Credits as the supplies are zero-rated, not tax exempt.

GST/HST Memoranda Series 4.5.1 Exports - Determining Residence Status - includes a sample declaration that may be provided by a purchaser to a vendor with respect to their non-resident status.

#### LAWYERS' DISBURSEMENTS

In May, 2006, CRA released Policy Statement P-209R which addresses lawyers' disbursements for GST/HST purposes.

## DID YOU KNOW...

### 75(8)

#### U.S. REAL ESTATE SALES BY CANADIANS

Canadians that sell U.S. real estate at a profit will be subject to U.S. Federal and, perhaps, U.S. State tax.

From the proceeds of disposition you are entitled to deduct your cost base which includes any permanent improvements. You also may deduct sale expenses such as real estate taxes, interest, insurance and maintenance.

Some other things to consider include:

1. There is a 10% U.S. withholding tax that applies at the time of sale as a prepayment of the income tax.  
A vendor may be exempt from the withholding tax (but not the income tax) if the buyer certifies that they will use the property as a residence and the selling price does not exceed \$300,000. Also, a Form 8288-B may be submitted to the IRS to authorize a reduction in the withholding tax below 10%.
2. A U.S. income tax return to report the sale is due by June 15 of the following year (April 15 if you had wages subject to U.S. withholding). The U.S. withholding tax is shown as a payment on that return.
3. State taxes also must be considered.
4. A United States Taxpayer Identification Number will be needed.

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