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## YEAR-END TAX PLANNING

### 76(1)

Some 2006 year-end tax planning tips include:

1. The following expenditures will be eligible for 2006 tax deductions if made by individuals by December 31, 2006: moving expenses, child care expenses, safety deposit box fees, charitable donations, political contributions, medical expenses, and alimony.
2. 2006 eligible Registered Retirement Savings Plan ("RRSP") contribution amounts are noted on the 2005 personal income tax return assessment notices. You have until March 1, 2007 to make tax deductible RRSP contributions for the 2006 year. Consider contributing to a spousal RRSP to achieve income splitting in the future.
3. Persons turning age 69 in 2006 must mature their RRSP into cash, an annuity or a Registered Retirement Income Fund by December 31, 2006.
4. If you own a business, consider paying a reasonable salary to family members for services rendered to the business.
5. An individual whose 2006 net income exceeds \$62,144 will lose all, or part, of their old age security. Senior citizens will begin to lose their income tax age credit if net income exceeds \$30,270. Contact your professional advisors for

assistance in managing 2006 personal income.

6. Consider purchasing assets eligible for capital cost allowance before the year-end. For example, employees may claim capital cost allowance on automobiles used in their employment.
7. If you had taxable capital gains in the year, or any of the preceding three years, consider selling capital properties with an underlying capital loss prior to the year-end. This capital loss may be offset against the capital gains.
8. Registered Education Savings Plan ("RESP")  
A Canada Education Savings Grant ("CESG") for RESP contributions equal to 20% of annual contributions for children (maximum \$400 per child per year) will be permitted.
9. Health and dental premiums for the self-employed  
Individuals will be allowed to deduct amounts payable in respect of the year for Private Health Service Plan coverage in computing business income provided they meet certain criteria.
10. Tax on Split Income  
The Income Tax Act applies the maximum marginal tax rate to certain passive income of individuals under the age of 18. Therefore, consider minimizing this type of income in 2006.
11. A refund of Employment Insurance

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paid for non-arm's length employees may be available upon application to CRA.

12. Taxpayers that receive "eligible" dividends from private and public corporations will have a significantly lower tax rate on the dividends.
13. Eligible tools acquired after May 2, 2006 in excess of \$1,000 will be entitled to a tax deduction to a maximum of \$500.
14. Eligible public transit passes acquired after July 1, 2006 will be entitled to a tax credit.

## 2006 REMUNERATION

### 76(2)

Some general guidelines to follow in remunerating the owner of a Canadian-controlled private corporation earning

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“active business income” include:

1. In general, bonus down active business earnings in excess of the annual business limit. However, leaving corporate active business income over this amount presents a tax deferral. The disadvantage of the additional tax on dividends has been significantly reduced with the new lower tax rates on “eligible” dividends.
2. Elect to pay out tax-free “capital dividend account” dividends.
3. Consider paying dividends to obtain a refund of “refundable dividend tax on hand”.
4. Corporate earnings in excess of personal requirements could be left in the company to obtain a tax deferral. The effect on the “Qualified Small Business Corporation” status should be reviewed before selling the shares.
5. Dividends, as opposed to salaries, will reduce an individual’s cumulative net investment loss balance thereby providing greater access to the capital gain exemption.
6. Excessive personal income affects receipts subject to clawbacks, such as old age security, the age credit, child tax benefits, and GST credits.
7. Salary payments require source deductions to be remitted to Canada Revenue Agency (“CRA”) on a timely basis.
8. Individuals that wish to contribute to the Canada Pension Plan or a Registered Retirement Savings Plan may require a salary to create “earned income”.
9. Salaries paid to family members must be reasonable.
10. Some provinces have “payroll taxes” thereby increasing the costs of paying salaries versus dividends.

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## PERSONAL TAX RETURNS

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### 76(3)

#### PENSION TAX CREDIT

The 2006 Federal Budget increased the Federal Tax Credit to pension income of \$2,000 commencing January 1, 2006. With the Provincial Tax Credit this could be in the 25% range.

Pensions that qualify include:

1. An annuity from a pension plan,
2. For persons aged 65 or older, annuity payments from an RRSP, a RRIF, or a deferred profit-sharing plan.
3. For persons aged 65 or older, the taxable portion of annuities purchased from an insurance company.

However, a person under age 65 would also get the pension credit if they were receiving annuity payments inherited from a deceased spouse.

#### AFTER-SCHOOL RECREATIONAL PROGRAM - CHILD CARE EXPENSE

In a September 8, 2006 Tax Court of Canada case, the taxpayer paid fees to a gymnastics club of \$984 for after-school classes and \$431 for summer and spring break gymnastics camps for her 12 year old daughter.

#### Taxpayer Wins!

The essential question is what is the primary reason for enrolling the child in the activity. In this case, the primary reason was to provide childcare so that the taxpayer was able to perform duties of employment. Therefore, the taxpayer’s deduction for childcare expenses was allowed.

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## EMPLOYMENT INCOME

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### 76(4)

#### SPECIAL WORKSITE

In a July 17, 2006 External Technical Interpretation, CRA notes that where an employee is assigned to a location other than the normal employment location for a temporary period, payments made by the employer in respect of the employee’s eligible relocation and living expenses are deductible to the employer and not taxable to the employee.

The requirement that the duties be of a “temporary nature” will occur if the period is less than two years. However, CRA notes that there are situations where the employment period extends beyond two years which will also be considered of a “temporary” nature.

In a June 14, 2006 External Technical Interpretation, CRA notes that where a company which is taking on temporary logging work on a six-month renewable contract pays for the board, meals and travel of its employees to carry out the work, this will likely qualify as a special worksite. The value of board, lodging and other benefits related to it would be tax-free to the employee.

#### LEGAL EXPENSES

In an August 11, 2006 External Technical Interpretation, CRA notes that the Income Tax Act permits a deduction in computing income from employment for legal expenses paid in the year to collect, or to establish a right to, employment income.

Therefore, if the income received from a disability claim is taxable, legal expenses incurred would be deductible.

#### REIMBURSEMENT OF HEALTH PREMIUMS BY EMPLOYER

In a July 25, 2006 External Technical Interpretation, CRA notes that medical and hospital insurance plans covered by Blue

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Cross and various other medical insurers would be considered Private Health Service Plans (“PHSPs”). Therefore, the reimbursement of premiums for health and dental benefits by an employer for employees would be excluded from employment income.

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## **BUSINESS/PROPERTY INCOME**

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### **76(5)**

#### **PRIVATE HEALTH SERVICE PLAN (“PHSP”)**

In a July 14, 2006 Technical Interpretation, CRA notes that when a sole proprietor implements a Cost-Plus Plan, it must provide coverage for at least one employee other than the sole proprietor. Otherwise, it is not in the nature of insurance as the proprietor has not undertaken to indemnify another person.

#### **ASSOCIATION - DE FACTO CONTROL**

In a February 28, 2006 English translation of a French Tax Court of Canada case, the Court concluded that the spouse of the sole shareholder of Company A exercised de facto control over Company A thereby associating Company A with the spouse’s corporations which had already been allocated the annual business limit. This resulted in no small business deduction for Company A.

The Tax Court felt that Company A’s sole shareholder, Mrs. S, was not involved in the daily decisions of the Company. Also, Company A was economically dependent on Mr. S’s Corporations.

#### **LANDSCAPING**

The Income Tax Act permits a deduction for amounts paid by a taxpayer for landscaping grounds around the building or other structure of the taxpayer that is used primarily for the purpose of gaining or producing income from a business.

Therefore, prepaid landscaping costs may

be eligible for a deduction even if the actual work has not been started. Alternatively, work that has been done, but not paid (just payable), will not be deductible until it is paid.

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## **ESTATE PLANNING**

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### **76(6)**

#### **AIRPLANE TICKETS**

In a June 2, 2006 External Technical Interpretation, CRA notes that where an individual redeems reward points to acquire an airplane ticket and then donates the airplane ticket to a Registered Canadian Charity, the individual will be considered to have made a gift for Income Tax Act purposes.

#### **PRIVATE FOUNDATION**

In a June 27, 2006 Internal Technical Interpretation, CRA notes a revocation of charitable status could occur if the charity acquires a limited partnership interest because it is now considered to be carrying on a business.

#### **FLOW-THROUGH SHARES**

Taxpayers that donate publicly listed securities after May 1, 2006 do not have to report the capital gain if the securities are donated to a registered charity, but not to a private foundation. As the tax cost of a flow-through share is usually nominal or nil because of the immediate write-off of deductions, the donation for a tax credit based on fair market value is advantageous because the otherwise large capital gain is not taxable.

#### **REGISTERED EDUCATION SAVINGS PLAN (RESP)**

A person may contribute up to \$42,000 to an RESP in the lifetime of a beneficiary at a maximum of \$4,000 per year. Also, a Canada Education Savings Grant (“CESG”) is available at \$400 per year at a rate of 20% per contribution to a maximum of \$7,200 (18 years times \$400

per year). Therefore, a \$2,000 RESP contribution will net the maximum \$400 CESG for the year.

#### **RRSP SCAMS**

In a December 9, 2005 Tax Court of Canada case, a lady who needed money to finance her return to school responded to a newspaper advertisement that proposed to allow her to withdraw her RRSP tax-free through an investment of \$48,200 in Company 3563545 which would be used to guarantee a loan back for a similar amount, net of 36% in fees (\$17,360). CRA included in her income the \$48,200 on the basis that this was a non-qualified investment.

#### **Taxpayer Loses**

The Court found that these shares were not “qualifying investments” as the transaction was a sham since the perpetrators never genuinely intended for the taxpayer’s RRSP to hold an investment.

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## **MARRIAGE BREAKDOWN**

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### **76(7)**

#### **CHILD SUPPORT**

In an August 24, 2006 Tax Court of Canada case, Mr. P paid child support under a 1993 Ontario Court Divorce Judgment of \$650 per month per child.

On August 31, 1998, the Appellant and former Spouse signed an Agreement varying the child support payable to \$500 per month in compliance with the May, 1997 Child Support Guidelines.

#### **Taxpayer Loses**

The Court noted that this new agreement changed the status of the child support payments from deductible/taxable to non-deductible/non-taxable.

#### **DIVISION OF A PENSION**

In an April 6, 2006 External Technical Interpretation, CRA notes that if there is a division of pension benefits on a marriage

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breakdown, the portion received by each spouse is the income of that spouse even if the administrator issues one cheque to the Plan member. The intention of the parties in the Separation Agreement is the key when determining the income tax treatment.

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## GST

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### 76(8)

#### NON-PROFIT ORGANIZATIONS

20-page Guide RC4081 discusses the GST/HST implications for non-profit organizations including Registering, exemptions, input tax credits, public service body rebates, simplified accounting, and real property issues.

#### GST/HST REFUNDS AND REBATES

The May 2, 2006 Federal Budget notes that GST/HST refunds will only be paid if all returns required under the Excise Tax Act, the Income Tax Act, and the Excise Act have been filed.

These changes commence April 1, 2007.

#### INPUT TAX CREDITS - REFUSED

In a March 17, 2006 Tax Court of Canada case, the taxpayer claimed Input Tax Credits on purchases for which the invoices did not include a valid GST Registration Number.

#### Taxpayer Loses

The Court noted that a Registrant may not

claim an Input Tax Credit unless he/she has obtained prescribed information which includes the valid GST Registration Number of the supplier.

#### Editor's Comment - GST/HST Web Registry

A person's GST/HST Registration status may be checked at [www.cra-arc.gc.ca/eservices/tax/business/gsthregistry/menu-e.html](http://www.cra-arc.gc.ca/eservices/tax/business/gsthregistry/menu-e.html).

After entering a GST/HST number, business name and date of transaction, the system will tell you whether the person was registered for GST/HST on that particular date. Keeping this confirmation for receipt purposes is a good idea.

#### RESIDENTIAL RENTAL PROPERTY REBATE

In August, 2006, CRA introduced 18-page Guide RC4231 which discusses the GST/HST New Residential Rental Property Rebate including Forms GST524 and 525.

#### DENTISTS

Most dental services are "exempt" supplies. Therefore, purchases related thereto are not eligible for Input Tax Credits. However, cosmetic dental services (GST rate 6%) and sales and installation of artificial teeth and orthodontic appliances (zero-rated) are eligible for Input Tax Credits on purchases related thereto.

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## DID YOU KNOW...

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### 76(9)

#### CORRECTION

Re: Tax Tips and Traps Issue 75(6) (2006 Third Quarter) LOANS FOR VALUE - third paragraph.

The CRA prescribed rate until September 30, 2006 should be 4% - not 9%.

#### RRSP - CREDITOR PROOF

Currently, RRSPs are subject to creditor attacks with the exception of certain life insurance RRSPs. Also, Registered Pension Plans are creditor proof.

New Federal Bill C-55 (Royal Assent - November 25, 2005) puts RRSPs and RRIFs on a similar basis as life insurance RRSPs and Registered Pension Plans. However, RRSP/RRIF contributions in the last twelve months will not be exempt from seizure.

Also, this exemption will only apply where an individual "locks in" the RRSPs. There will also be a cap on the exempt RRSP portion based on the bankrupt person's age and the maximum RRSP contribution limit in the year of bankruptcy.

#### The Problem

Bill C-55 has not yet been proclaimed.

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