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PERSONAL TAX

77(1)

ON-LINE TUITION FEES

In a November 10, 2006 Tax Court of Canada case, the taxpayer was enrolled in an on-line Master of Science postgraduate degree at the University of Liverpool, England. The taxpayer claimed tuition fees of \$16,278. The Program was taken exclusively over the Internet while the taxpayer was physically in Canada.

Taxpayer Wins!

The Court noted that full-time attendance at a foreign university can include attendance through the Internet or on-line, as is the case here.

TRANSIT PASS CREDIT

In an October 3, 2006 Technical Interpretation, CRA notes that the pass must provide the individual with the right to use public commuter transit services on an unlimited number of occasions and on any day on which the public commuter transit services are offered during an uninterrupted period of at least twenty-eight days.

CHILDREN'S FITNESS TAX CREDIT

The Government proposes to allow, starting in 2007, a non-refundable tax credit on eligible amounts of up to \$500

paid by parents to register a child, who is under 16 at any time during the year, in an eligible program of physical activity.

To qualify, a program must be ongoing (either a minimum of eight weeks duration with a minimum of one session per week or, in the case of children's camps, five consecutive days) and substantially all of the activities must include a significant amount of physical activity that contributes to cardio-respiratory endurance plus one or more of: muscular strength, muscular endurance, flexibility, or balance.

Registration and membership costs can include the costs of administration, instruction, and the rental of facilities. If the fees charged to parents include a part for accommodation, travel, food, or beverages (for example, room and board at a fitness camp), this part must be deducted when calculating the fees that qualify for the tax credit.

EMPLOYMENT INCOME

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EMPLOYMENT BENEFITS

IN THIS ISSUE

The October 18, 2006 issue of the National Post listed the top one hundred employers for 2006. Some employment benefits provided to employees may

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include: fitness facilities, memberships to fitness clubs, maternity/paternity top-up of salaries, tuition subsidies, scholarship programs for employees' children, health care spending accounts, private pension plan contributions, referral bonuses, on-site daycare facilities, and discounts on the firm's products.

REWARD POINTS

In a September 12, 2006 External Technical Interpretation, CRA notes that an employee may receive tax-free from an employer, two non-cash gifts per year and two non-cash awards per year (not more than \$500 per year for the gifts and the awards respectively).

However, CRA has a number of provisos including "reward points" received by an employee which do not qualify.

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BUSINESS/PROPERTY INCOME

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APPRENTICESHIP JOB CREATION TAX CREDIT

For the 2006 and subsequent taxation years, a business will be allowed an investment tax credit in respect of each eligible apprentice employed after May 2, 2006 equal to the lesser of \$2,000 and 10% of eligible salary payable.

An eligible apprentice is an individual who is working in a prescribed trade in the first two years of the individual's provincially registered apprenticeship contract. A prescribed trade is a trade that is one of the 45 Red Seal Trades. The 45 Red Seal Trades are listed on www.red-seal.ca and include trades such as bakers, carpenters, electricians, hairstylists, mechanics, machinists, plumbers, welders, etc.

The Budget also proposes a new \$1,000 grant for first and second year apprentices effective January 1, 2007.

INTEREST DEDUCTION

In a September 20, 2006 External Technical Interpretation, CRA notes that where a taxpayer had a personal line of credit of \$60,000 which was increased by \$40,000 to \$100,000 because \$40,000 was invested in securities, the interest that can be deducted for income tax purposes is 40% of the total interest paid. When the taxpayer reduces the line of credit to \$80,000, the interest that can be deducted would be 50% of the interest paid or payable. If the taxpayer further reduces the personal line of credit by paying down the balance to \$40,000, the taxpayer is allowed to deduct 100% of the interest paid or payable.

MANAGEMENT FEE

In a June 26, 2006 Tax Court of Canada case, the Court disallowed a deduction for management fees paid by BCO to two related corporations on the basis that the management fees were not incurred to earn income and were unreasonable.

CONSTRUCTION REPORTING

The Income Tax Act requires construction contractors to report payments to subcontractors (along with the subcontractor's Business Number or Social Insurance Number) on Form T5018 on either a calendar or fiscal period basis within six months after the end of the reporting period to which it pertains.

Payments of less than \$500 for services per year per subcontractor do not have to be reported. Failure to file Form T5018 could result in a penalty equal to the greater of \$100 and \$25 times the number days, not exceeding 100 days, during which the failure continues in respect of each such failure (maximum \$2,500).

"Construction activities" includes the erection, excavation, installation, alteration, modification, repair, improvement, demolition, destruction, dismantling or removal of all, or any part, of a building, structure, surface or sub-surface construction, or any similar property if the person's business income for that reporting period is derived primarily from those activities.

CAPITAL GAINS/LOSSES

77(4)

IDENTICAL PROPERTIES

Taxpayers that buy identical properties must average their cost base. For example, if Mr. A acquired 1 Class A share for \$10 and then another Class A share for \$20, he would own 2 Class A

shares with a total cost of \$30 but, each Class A share would have a cost of \$15. Therefore, if one share was sold for \$20, it would have a capital gain of \$5.

One solution is to have a different person buy the other share (for example, your corporation, your spouse, a Trust, your child) such that one taxpayer would have a cost base of \$10 on the share and the other a cost base of \$20. If you do not want to trigger a capital gain, you could have the person with the \$20 cost base sell the share.

COTTAGES

Selling cottages, or any asset for that matter, to children for less than fair market value can result in double taxation because the transferor will have proceeds equal to fair market value and the recipient will have an adjusted cost base ("ACB") equal to what they paid.

Alternatives include:

- (i) a gift to the child which would be a disposition at fair market value to the transferor and an ACB of fair market value to the transferee or,
- (ii) a sale, for example, for a promissory note equal to fair market value which may be forgiven on death. This would also give a fair market value disposition and a fair market value ACB. If the note is forgiven on death there may be no adverse tax consequences. Also, if the note cannot be demanded earlier than a period of five years, a reserve could be claimed on the capital gain for five years. The cottage may qualify for a principal residence exemption.

TRANSFERRING A LOSS TO A SPOUSE

If Mr. A has an underlying capital loss on publicly traded securities, but has no capital gain for which to offset the loss, he

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may wish to transfer the loss to a spouse who has had capital gains.

For example, if Mr. A has a share with a cost base of \$30 and a fair market value of \$10, he could sell the share for \$10 and trigger a capital loss of \$20. If his spouse acquires the same share on the open market 30 days before or 30 days after Mr. A's disposition, Mr. A's capital loss will be denied under the Superficial Loss Rules. Mrs. A's cost base of \$10 will be increased to \$30, assuming that Mrs. A does not sell the shares within this period. Mrs. A could then sell the share for a \$20 capital loss to be offset against her capital gains.

A similar result could occur if Mr. A sold the share to Mrs. A and, after 30 days, she sold the share. Mrs. A will have to elect out of the rollover provisions.

This area is complicated and needs professional advice.

ESTATE PLANNING

77(5)

CLEARANCE CERTIFICATE

In an October, 2006 Technical Interpretation, CRA notes that a payment to a non-resident beneficiary of an Estate may require a Clearance Certificate from CRA. Where the non-resident beneficiary can show that no capital gain arises, the

beneficiary will not be required to remit or post any amount as security.

If a Clearance Certificate is not obtained, the Estate may be liable to pay CRA 25% of the payment.

TRUSTS - TWENTY-ONE YEAR DEEMED DISPOSITION

The Income Tax Act has a "twenty-one year deemed realization rule" to prevent the use of Trusts to defer indefinitely gains accruing on properties. For example, a Trust established in 1986 would have a deemed disposition in 2007.

Therefore, many Trusts have provisions that require them to be wound up on a tax-free basis before twenty-one years to avoid the deemed disposition at fair market value.

However, in certain instances this may not be possible. For example, where a non-resident is a beneficiary additional planning is required.

This is a complicated area and needs professional advice.

SPOUSAL RRSP

Even though the government has announced that pensions may be split, effective January 1, 2007, between spouses, this applies mostly to persons age 65 or over.

Therefore, the Spousal RRSP is still a

useful tool. For example, if a person made a Spousal RRSP contribution by December 31, 2007, those amounts can be taken out on or after January 1, 2010 by the transferee spouse without attribution back to the contributor.

CHARITABLE DONATION SCHEMES

A February 9, 2006 Federal Court of Appeal case denied the taxpayer's charitable donation credits because the donations made were not truly for the amount appearing on the receipts. Also, gross negligence penalties were upheld by the Federal Court of Appeal.

On October 31, 2006, CRA warned taxpayers about the risks of charitable donation schemes. (www.cra.gc.ca; click on "what's new")

DID YOU KNOW...

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REFUNDS AND REBATES

The May 2, 2006 Federal Budget notes that income tax and GST/HST refunds will only be paid to a person if all returns under the Excise Tax Act, the Income Tax Act, the Excise Act and the Air Travellers Security Charge Act have been filed. This takes effect as of April 1, 2007.

An online version of this Newsletter/Article and other information on McGovern, Hurley, Cunningham, LLP can also be accessed on the internet at www.mhc-ca.com

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