



McGovern, Hurley, Cunningham, LLP Chartered Accountants

2005 Sheppard Avenue East, Suite 300, Toronto, Ontario, Canada M2J 5B4

Telephone: (416) 496-1234 -- Fax: (416) 496-0125

E-Mail: info@mhc-ca.com -- Website: www.mhc-ca.com

PERSONAL TAX

81(1)

STUDENTS

Some claims that may be made by students include:

- (i) tuition and ancillary fee tax credit,
- (ii) a textbook credit of \$65 per month in school,
- (iii) an education amount of \$400 per month.

If the student cannot use the tuition, education and textbook amounts, these can be transferred to a parent or grandparent up to \$5,000. Amounts not used by the student and not transferred may be carried forward and used by the student in a subsequent year.

Also, the student may claim a public transit pass credit. If the student is under age nineteen, the unclaimed amount may be claimed by the parent.

Scholarships, fellowships or bursaries are tax-free.

A student may deduct moving expenses against employment income or research grants. These may be carried forward to the next year if not deductible in the current year.

Also, a tax credit is available on interest on loans made under the Canada Student

Loans Act and the Canada Student Financial Assistance Act, or similar provincial law. This cannot be transferred to a parent but can be carried forward for up to five years.

MEDICAL EXPENSE - ATTENDING A PRIVATE SCHOOL

In a June 26, 2007 Tax Court of Canada case, the taxpayer paid tuition fees of \$12,900 on behalf of her son to attend a private school (Rothesay Collegiate School in Saint John, New Brunswick). The son had been diagnosed with severe learning disabilities and behavioral problems.

The Court permitted the tuition fees as a medical expense and noted that:

1. The Income Tax Act permits a medical expense for the care, or the care and training, at a school, institution or other place that the patient, who has been certified by an appropriately qualified person to be a person who, by reason of a physical or mental handicap requires the equipment, facilities or personnel specifically provided by that school, institution or other place for the care, or the care and training, of individuals suffering the handicap suffered by the patient.
2. Even though Rothesay was not a school exclusively for the learning disabled, the school's programs were

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able to adapt to and accommodate such individuals. The programs were progressive enough that they could accommodate those with Attention Deficit Disorder and learning and organizational disabilities.

COMMON-LAW PARTNER

In a September 27, 2007 External Technical Interpretation, CRA noted that a common-law partner is a person who, at that time, co-habits in a conjugal relationship with the taxpayer and has done so throughout the twelve-month period that ends at that particular time. Common-law partners are considered to be spouses for income tax purposes.

The duration test is not satisfied where the person simply "stays" with the taxpayer. Rather, the test requires a conjugal relationship. Where a person who lives with the taxpayer is routinely absent from the home for part of a week, that fact, in

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and of itself, would not preclude a finding that throughout each such week the person was living in a conjugal relationship with the taxpayer.

CHARITABLE DONATIONS

Administratively, CRA usually permits either spouse to claim a charitable donation tax credit even though the donation receipt may be in the other spouse's name. However, if there is a large donation it would be advisable to ensure that the receipt is in the name of the person who wishes to claim the tax credit.

CHILD CARE EXPENSE ("CCE")

In a November 21, 2007 External Technical Interpretation, CRA notes that only the portion of the fees paid to an educational institution relating to child care (i.e., supervision before and after classes or during the lunch period) may qualify as a CCE. However, when the payment is for a child who is under the compulsory school age, the services are generally considered to be for child care (rather than education), unless the facts indicate otherwise.

EMPLOYMENT INCOME

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TELEPHONE AND LODGING EXPENSES

In a July 24, 2007 Tax Court of Canada case, the taxpayer was a commissioned sales employee who agreed to work on a temporary basis in a location which was three hours from his home base. He rented a motel from Monday to Friday at that location and deducted the expenses.

The Court permitted the \$4,800 for the motel expenses on the basis that this was not personal because it was a temporary employment location.

Also, the employee incurred cellular telephone charges which were partly reimbursed. He successfully deducted the business portion of the amounts that were not reimbursed.

TRAVEL FROM HOME TO A POINT OF CALL

In an October 29, 2007 External Technical Interpretation, CRA notes that the use of an employer-provided motor vehicle by an employee to travel between his/her home and regular place of employment is generally considered personal and not deductible.

However, where the employee proceeds directly from home to a point of call, other than the employer's place of business to which the employee regularly reports, or returns home from such a point, use of the vehicle is not considered personal and is deductible.

Some Good News for a Taxpayer!

In an October 30, 2007 Tax Court of Canada case, Mr. H was required to travel for employment purposes and received 31.5 cents per kilometre and a fixed allowance for travel which he included in income and then deducted expenses.

Included in the expenses deducted by Mr. H was the daily 30-kilometre drive between his residence and his office for which he did not receive an allowance. His justification was that the only reason he took the motor vehicle to work was his employer's requirement that he do so. He had alternate and less expensive means of transport of which, but for the employment requirement, he would have availed himself.

The Court concluded that these commute kilometres are allowable motor vehicle expenses and noted that:

1. The employee was required to have his motor vehicle available at the

office.

2. The only way that requirement could be satisfied was to drive it there each day.
3. The Court accepted the taxpayer's argument that, except for the requirement that he have his vehicle at work, he would have relied on the cheaper alternate transportation that was available to him - catching a ride with his son who lived at home, carpooling or taking the bus. Instead, he had to take his car back and forth and was responsible for the expenses incurred in doing so.

Editor's Comment

CRA does not always follow these Tax Court Informal decisions in their assessing practices.

THE AUTO LOG

In a September 26, 2007 Tax Court of Canada case, the employer supplied a minivan (a 1998 Chevrolet Astro) which was used for both business and personal trips by the employee. CRA assessed a standby charge and an operating benefit to the employee.

Employee Loses

The Court confirmed CRA's reassessment and noted that to successfully rebut the taxable benefit assessment, the employee must provide clear, explicit evidence of the actual employment use of the automobile in terms of kilometres. The Appellant did not provide such evidence.

BUSINESS/PROPERTY INCOME

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INTEREST DEDUCTIBILITY - MUTUAL FUND UNITS

In an August 21, 2007 Technical

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Interpretation, CRA notes that where funds are borrowed to acquire a mutual fund unit and, there is a return of capital to the unit holder without any disposition of the property, if the funds received are not used for an income-earning purpose, the interest on that portion of the borrowed money that relates to the return of capital would not be deductible since its current use is personal.

PERSONAL SERVICE BUSINESS CORPORATION

In a January 19, 2006 Tax Court of Canada case, a computer technician formed a corporation that received subcontracts from only one person. CRA successfully determined that the corporation was a personal services business and denied the small business deduction.

The Court agreed with CRA that there was an employment relationship resulting in a personal service business status.

Editor's Comment

The corporation would have had a *better* chance of success had there been a signed bona fide independent contractor contract, and related performance, in accordance with the independent contractor criteria in CRA Guide RC4110.

MUTUAL FUNDS FOR INDIVIDUALS

CRA's Guide RC4169 explains the tax treatment of mutual funds for individuals including:

1. A mutual fund trust will issue a T3 Slip and a mutual fund corporation a T5 Slip to report capital gains, dividends, foreign income, interest, other amounts, returns of capital, or a combination of these amounts.
2. When an investor redeems or cashes in the units or shares, you are taxed on the capital gain. The individual

will receive a T5008 Slip from the mutual fund.

The Guide also includes example calculations.

OWNER-MANAGER REMUNERATION

81(4)

APPROPRIATION OF PROPERTY

In an August 8, 2007 Tax Court of Canada case, Mr. and Mrs. D each owned 50% of the shares of CANCO. Mr. and Mrs. D transferred \$96,000 of CANCO funds into an investment account held jointly by them to produce better returns on the combined funds. Approximately three years later, all the funds were returned to CANCO to restore the status quo.

CRA successfully assessed Mr. and Mrs. D for appropriating corporate property even though the funds were returned to the company.

THE BONUS DOWN DECISION

In the past, Canadian-controlled private corporations ("CCPCs") ordinarily bonused down their active business income to the small business deduction amount. This approach has been complicated through the reduction of tax on eligible dividends paid out of the General Rate Income Pool ("GRIP"). In all provinces, there is a significant deferral in leaving income in the corporation at the top corporate rate versus the top personal rate. However, there is an overall cost when the amounts are taken out even though they are eligible dividends.

An additional complication is that by not bonusing down, the corporation must make its final corporate tax installment payment two months after the year-end (not three months) and have much higher monthly corporate tax installments. Also,

quarterly, rather than monthly, tax installments would not apply.

Other considerations include the shareholders' current or future cash needs, the effect on any scientific research and experimental development claim, the effect on the small business corporation status through the buildup of surplus inactive assets, the loss of the small business deduction as taxable capital in the corporation exceeds \$10 million, and the accelerated payment of corporate tax installments.

There are also provincial tax implications to consider.

REFUNDABLE DIVIDEND TAX ON HAND ("RDTOH")

A corporation may pay an "eligible dividend" and still receive the 33 1/3% refund of RDTOH. As the tax rate on "eligible dividends" is significantly less than this 33 1/3%, having General Rate Income Pool income and investment income in the same corporation permits the RDTOH to be refunded through the payment of "eligible dividends".

Making a Dividend Eligible

A dividend is made "eligible" by advising all recipients that it is an eligible dividend when it is paid including:

- CRA has indicated that directors minutes could designate the dividend, if all shareholders are directors.
- Otherwise companies may want to have letters dated on the date of dividend payment specifying that the dividend is "eligible".

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MARRIAGE BREAKDOWN

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ARREARS

In a September 24, 2007 Tax Court of Canada case, the Appellant was required to pay monthly support payments of \$2,000 and fell behind after losing his job. A February, 2003 Final Court Order noted that the spousal support payments in arrears were \$25,000; however, the total arrears were reset at \$7,500 which was paid by the taxpayer. CRA argued that the payment was a settlement of arrears and, therefore, was a non-deductible capital payment.

Taxpayer Wins!

The Court noted that the intention of the Court Order was that the \$7,500 was to be paid as deductible arrears.

Editor's Comment

If this was a settlement between the spouses without a Court Order, the payment would likely be non-deductible/non-taxable. See the following case.

ARREARS - SETTLEMENT

In an English translation of a French March 29, 2006 Tax Court of Canada case, the taxpayer paid \$11,680 as a final settlement for unpaid support arrears under the 1993 Divorce Judgment. It was the Tax Court's view that the payments were made to release the Appellant from the obligations in the 1993 Divorce Judgment and, therefore, were capital in nature and not deductible.

THIRD PARTY PAYMENTS

In a September 27, 2007 Tax Court of Canada case, the former spouse, Mrs. T, was concerned with respect to collecting

the annual alimony payments of \$30,800. Therefore, to allay Mrs. T's concerns, it was agreed that the support payments would be paid by way of an annuity which was to be bought by Mr. T from Manulife Financial for \$136,679.

The Court reluctantly dismissed the Appeal because the agreement to provide the annuity to the former spouse constituted a fundamental modification of the Separation Agreement.

Editor's Comment

It appears significant that this annuity purchase was not part of a Court Ordered Separation Agreement.

HOUSE/COTTAGE

In a September 4, 2007 External Technical Interpretation, CRA reviewed a scenario where, as part of a divorce settlement, Husband ("H") transfers his 50% interest in the house to Wife ("W") and W transfers her 50% interest in the cottage to H. CRA noted that these transfers will be on a tax-deferred basis assuming they do not elect-out of the automatic rollover.

Also, provided that the spouses jointly elect, future gains or losses on the properties will accrue to the recipients as opposed to the transferors.

Editor's Comment

These Principal Residence Exemption issues should be considered in the separation proceedings.

ALIMONY

It was noted in the November 7, 2007 issue of the National Post that CRA has requested of the payer of spousal support, a receipt from the recipient spouse before allowing the deduction.

Editor's Comment

Consider having the provision of a receipt

as a requirement in the Agreement.

PENSION SPLITTING

In a November 7, 2007 Tax Court of Canada case, Mr. L entered into a Separation Agreement with his spouse in 2005 including an equal division of the pension from his employer. Therefore, Mr. L did not include in income the \$13,802 paid by him to his wife on the pension division. The wife argued that this should not be taxable to her, or deductible to him.

Mr. L Wins!

The Court noted that it was the intention of the parties at the time the Separation Agreement was executed that each would receive 50% of the pension.

Therefore, the \$13,802 paid by Mr. L to his spouse should not have been included in Mr. L's income.

Editor's Comment

There may be fewer arguments if the pension is divided at source.

ESTATE PLANNING

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RDSP

A new Registered Disability Savings Plan ("RDSP") with a Canada Disability Savings Grant ("CDSG") Program and Canada Disability Savings Bond ("CDSB") Program is applicable in 2008. There will be a lifetime limit of \$70,000 on CDSGs and \$20,000 on CDSBs.

Eligibility

Generally, any person eligible for the Disability Tax Credit ("DTC") and resident in Canada, or their parent or other legal representative, will be eligible to establish an RDSP.

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CLEARANCE CERTIFICATE

In a July 10, 2007 External Technical Interpretation, CRA notes that the distribution of property to a non-resident beneficiary in satisfaction of their rights under the Trust or the Estate is subject to a withholding tax unless a Clearance Certificate is obtained.

Taxpayers should also be aware that every non-resident person who in a taxation year disposes of any Taxable Canadian Property shall send to CRA a Notice.

Failure to comply may result in a penalty of \$25 per day to a maximum of 100 days for a total of \$2,500.

If this has been missed, a "Voluntary Disclosure" to CRA should be considered.

WARNING

In a November 29, 2007 Release, CRA warned investors about questionable RRSP and RRIF tax-free withdrawal schemes. To date, CRA has reassessed over 3,100 taxpayers, commenced audits on another 1,800 taxpayers and, audits on other arrangements are about to begin.

CRA advises that taxpayers should avoid schemes that promise withdrawal of funds from an RRSP or RRIF without paying tax, immediate access to assets in "locked in" RRSPs or RRIFs, or income tax deductions of three or more times the amount invested.

The Problem

CRA notes that the full amount of any

withdrawal or ineligible investment is included in income.

Also, in many cases taxpayers have lost all, or part, of their retirement savings. These schemes are usually promoted either over the internet, newspaper ads, or promotional meetings.

DID YOU KNOW...

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eBAY

It was reported in the Globe and Mail that CRA won a Federal Court Order requiring eBay Canada Ltd. to turn over the names, addresses, phone numbers and e-mail addresses of all high volume sellers on its website.

CRA is checking to see if the sales were reported on 2004 and 2005 tax returns. CRA noted that it is targeting people who qualified for eBay's Power Seller Program in 2004 and 2005.

REBATE/GREEN LEVY - VEHICLES

The 2007 Federal Budget introduces a vehicle efficiency incentive rebate of up to \$2,000 for highly fuel-efficient vehicles (6.5 litres or less/100 kms - see www.tc.gc.ca) and a new Green Levy on fuel-inefficient vehicles (13 litres or more/100 kms) of up to \$4,000.

The rebate applies to eligible new vehicle purchases or leases after March 19, 2007. See www.ecoaction.gc.ca for information and forms.

The Green Levy will apply to new vehicles delivered or imported after March 19, 2007.

CRA PENALTIES

CRA notes that starting January 1, 2006 penalties are being applied to all late-filed foreign reporting forms such as Forms T106, T1134, T1135, T1141 and T1142. To avoid being assessed a penalty, consider going through the Voluntary Disclosure Program at the local Taxation Service Office.

Editor's Comment

We have heard of a number of \$2,500 penalty assessments for late/unfiled T1135 Forms (foreign property costing \$100,000 or more) - even if the income is reported.

Some of the assessments have been related to foreign investments held in brokerage accounts.

NIGERIA SCAMS

In a November 2, 2007 Tax Court of Canada case, the taxpayer lost approximately \$300,000 from a fraud emanating from Nigeria (Nigerian Advance Fee Fraud).

CRA successfully disallowed a deduction for tax purposes on the basis that the losses had no connection with an actual business.

See www.phonebusters.com for information on scams.

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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