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## PERSONAL TAX

### 83(1)

#### FITNESS TAX CREDIT

The Fitness Tax Credit is a non-refundable tax credit on eligible amounts of up to \$500 paid to register a child under the age of 16 in an "eligible program of physical activity".

Physical activity means a supervised activity suitable for children (other than an activity where a child rides on or in a motorized vehicle as an essential component of the activity) that contributes to cardio-respiratory endurance and to one or more of the following: muscular strength, muscular endurance, flexibility, and balance.

Programs of physical activity include a weekly program of a duration of eight or more consecutive weeks in which substantially all of the activities include a significant amount of physical activity; a program of a duration of five or more consecutive days of which more than 50% of the daily activities include a significant amount of physical activity; and a program of a duration of eight or more consecutive weeks, offered to children by a club, association or similar organization where a participant may select amongst a variety of activities if more than 50% of those activities include a significant amount of physical activity, or more than 50% of the time scheduled for activities is scheduled

for activities that include a significant amount of physical activity.

The Regulation notes that horseback riding is an activity that contributes to cardio-respiratory endurance and to one or more of muscular strength, muscular endurance, flexibility and balance.

In a May 7, 2008 Technical Interpretation, the Canada Revenue Agency (CRA) notes that bowling meets the physical requirements in the Regulations. (See [www.cra.gc.ca/whatsnew/checklist-e.html](http://www.cra.gc.ca/whatsnew/checklist-e.html))

With respect to children eligible for the Disability Tax Credit, the expression "physical activity" means a supervised activity that results in movement and an observable expenditure of energy in a recreational context. For these children, the expenses incurred up to age 18 will qualify for the credit. Also, children eligible for the Disability Tax Credit are entitled to a separate \$500 amount.

#### CANADA CHILD TAX BENEFITS ("CCTBs")

CCTBs are payable to the parent who primarily fulfills the responsibility for the care, upbringing and place of residence of the children. In cases of marriage breakdowns where there is joint custody, they are generally payable to the parent identified in a Written Agreement or in the Court Order. To qualify, the parents' income must be below a prescribed amount.

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In recent years there has been a marked increase in the number of cases in which there is a dispute between the joint custody parents as to the entitlement to the CCTB. CRA policy generally allows the CCTB to be split between joint custody parents upon agreement of the parents.

In a March 4, 2008 Informal Tax Court of Canada case, the Court was faced with this type of dispute and noted that the best interests of the children concerned could be protected if the parents set up a practice that would prevent any misunderstanding.

In fact, in cases involving minor children where an Order for custody is involved, the parties usually come to an Agreement on these matters.

In this case, the Court noted that both parents, each in their own way contributed to meeting the needs of their three daughters.

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However, upon the divorce, it was negotiated that the mother would initially receive the CCTBs. For that reason, and that reason alone, the Court found that the mother was the eligible individual to receive the CCTBs.

For more information see the Canada Child Tax Benefit section at [www.cra.gc.ca](http://www.cra.gc.ca).

In a March 6, 2008 Informal Tax Court of Canada case, the Court found that where the father obtained a special access right for the summer period (i.e., 41 days of a total of 61 days) the father, not the mother, was the parent who primarily fulfilled the care and upbringing of the child for July and August and, therefore, the father is entitled to the CCTB for that period.

In another Informal Tax Court of Canada case, the female Appellant admitted that even though she had legal custody, her son did attend school in Quebec City where he resided with his father.

The Court permitted the CCTB to the father (for the months that the child was in school and living with the father) and to the mother (during the months in which the child was not in school).

#### Editor's Comment

For information on "shared eligibility" in joint-custody arrangements do a Google search on "Canada Child Tax Benefit" and then click on "frequently asked questions - application and eligibility" and then "shared eligibility".

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## EMPLOYMENT INCOME

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### 83(2)

#### SCHOLARSHIP

The 2006 and 2007 Federal Budgets fully exempt from taxable income scholarships, fellowships, bursaries and prizes with respect to post-secondary education and elementary or secondary school educational programs.

In an October 30, 2007 External Technical Interpretation, CRA discussed the income tax treatment of a scholarship program where scholarships are paid by a corporation to children of the corporation's shareholders or directors. They noted that in general, these amounts would be deductible to the corporation and non-taxable to the child if they constituted a bona fide scholarship program.

#### Court Cases

Two Court cases have now been rendered in favour of the taxpayer with respect to children of arm's length employees.

For example, in a March 7, 2008 General Tax Court of Canada case, the Appellant is an employee of Dow Chemical Canada Inc. and his 21 year old son received a tax-free award of \$3,000 from Dow's "Higher Education Award Program" ("HEAP") at the University of Waterloo in partial reimbursement of his tuition fees.

#### Another Taxpayer Wins!

In a March 7, 2008 Informal Tax Court of Canada case, the issues were the same only in this situation the taxpayer, an employee of Dow, had three qualifying children each of whom received the \$3,000 resulting in a \$9,000 employment assessment against the taxpayer.

Again, the amounts were considered to be tax-free scholarship income, not employment income, and not taxable to the employee/parent.

#### Another Taxpayer Wins!

In a March 7, 2008 Informal Tax Court of Canada case, the parent is an employee of the University of Western Ontario (UWO) and in 2004, the taxpayer's daughter qualified for an award of \$1,200 from the UWO which was to be used towards her tuition. The award was paid to the parent who in turn gave the award to her daughter to put towards her tuition. CRA incorrectly included the \$1,200 in the income of the parent on the basis that the

award was a taxable employment benefit.

#### GIFTS AND AWARDS

In a March 13, 2008 External Technical Interpretation, CRA notes that an employer can provide an employee, on a tax-free basis, up to two non-cash gifts per year for special occasions, such as Christmas, birth of a child, or marriage, where the total cost of the gifts (including all taxes) is less than \$500.

Similarly, employers are able to give employees up to two non-cash awards per year, on a tax-free basis, in recognition of special achievements, such as reaching a set number of years of service, meeting or exceeding safety standards, or reaching similar milestones where the total cost of the awards (including all taxes) is less than \$500. The employer may deduct the cost of gifts and awards.

CRA notes that cash or near-cash gifts are not covered by the Policy and the value of such gifts is considered a taxable employment benefit. CRA considers near-cash gifts to mean any items that can readily be converted to cash, or essentially equivalent to cash, such as securities, gold nuggets, or gift certificates. Also, where an employee is permitted to select a gift or award from a store or from a restaurant, they are essentially in the same position as employees receiving gift certificates. Accordingly, such gifts or awards received by the employees would be considered near-cash gifts and would be taxable employment benefits.

#### EMPLOYEE INCENTIVE PROGRAM - NOT TAXABLE

In an April 4, 2008 External Technical Interpretation, CRA reviewed a situation where a company is implementing a new incentive program (Program) where the employee may purchase one of the Company's appliances at retail cost from a dealer and will then be partially rebated by the Company in cash.

The Program is available to all employees

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of the Company as well as their immediate families. The net cost to the employee will be higher than the Company's cost, plus delivery.

#### **Good News!**

CRA noted that these rebate payments would likely be non-taxable.

#### **SUPPLEMENTAL EMPLOYEE RETIREMENT PLANS ("SERPs")**

Even though a corporation may provide a retirement package for an employee through a Registered Pension Plan based on salaries of up to \$117,000, persons earning more than that could also receive a SERP.

If the SERP is funded by the employer, this will likely be a Retirement Compensation Arrangement (RCA) and the employer will be entitled to a tax deduction however, there will be a 50% refundable tax liability. When the funds are paid and taxed to the employee, the 50% is refunded.

If the SERP is unfunded, there are no tax implications other than a deduction to the payor and taxable income to the recipient when paid.

Some employers/employees have taken advantage of the RCA rules by paying the amounts to the individual when they become a non-resident and subject to a much lower tax. CRA are reviewing RCAs which are considered to be tax avoidance schemes.

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#### **BUSINESS/PROPERTY INCOME**

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##### **83(3)**

#### **GREENHOUSE GAS (GHG) EMISSIONS**

In a 2008 Government Release, CRA notes that given that taxpayers may be required to reduce their GHG emissions relating to their business operations, CRA expects that contributions to provincial and federal government funds due to

regulatory requirements will normally be tax deductible. However, if the expenditure provides the taxpayer with ongoing benefits with a view to bringing into existence an asset of enduring benefit, the amount may be a depreciable property or, an eligible capital property.

However, where the payment is a fine or penalty imposed by a provincial or federal government, the amount would not be deductible. See CRA's Income Tax Technical News No. 34 ([www.cra.gc.ca](http://www.cra.gc.ca)) for general comments regarding GHG credits.

#### **CELL PHONE CHARGES**

In a May 28, 2008 Informal Tax Court of Canada case, the taxpayer was a Rural Route mail carrier under contract with Canada Post and spent approximately 4 1/2 hour days on country roads twelve months a year. The Court found that it would be reasonable to be equipped with a cell phone and permitted a tax deduction of \$50 per month to reflect basic service availability even though there was limited evidence of actual use.

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#### **OWNER-MANAGER REMUNERATION**

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##### **83(4)**

#### **DIRECTOR LIABILITY**

##### **Case 1 - Not Liable**

In a December 21, 2007 General Tax Court of Canada case, the directors were assessed for the outstanding liability for GST, plus interest and penalties, at the time the company was struck from the Registrar of Companies for failure to file returns.

The taxpayers successfully argued that they could not be assessed as they ceased to be directors of the company more than two years before the assessment was issued.

##### **Case 2 - Not Liable**

In a February 11, 2005 Informal Tax Court of Canada case, the taxpayers/directors were found not to be liable for the unremitted GST/HST at the time the company became bankrupt on the basis that they signed a document resigning their directorships more than two years before CRA assessed them in 2002. Therefore, the two-year statute of limitations was applied.

##### **Case 3 - Not Liable**

In a May 22, 2008 Informal Tax Court of Canada case, the director was found not to be liable for the unremitted source deductions because he exercised due diligence.

##### **Case 4 - Not Liable**

In a May 26, 2008 General Tax Court of Canada case, the taxpayer/director was held not to be liable for the unremitted GST because of the due diligence defence including he had entrusted the day-to-day operations to a person in whom he had total confidence and he had no reason to suspect that the GST/HST returns were not being properly made as the company was making its GST remittances.

In the absence of doubt it appears reasonable to rely on the manager, particularly when the company is not experiencing financial difficulties.

The point at which the due diligence is expected from a director is when he/she has knowledge, or ought to have knowledge, of the failure to remit, or that the remittances may not be correct. At that point, a director must take a meaningful positive step toward preventing the failure.

##### **Case 5 - Not Liable**

In a June 2, 2008 General Tax Court of Canada case, Ms. R was an administrator of a Non-Profit Organization and was assessed by CRA for personal liability for the unremitted GST for the Organization.

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The Court accepted that Ms. R exercised the degree of care, diligence and skill that a reasonably prudent person would have exercised in comparable circumstances to prevent the Organization's failure to remit the net tax owed.

### Case 6 - Liable

In a May 22, 2008 Tax Court of Canada case, the Court found that the taxpayer was personally liable as a director for the unremitted source deductions of his company.

The Court noted that:

1. The taxpayer was an inside director. He did not establish that he acted in a reasonable and prudent manner in attempting to prevent the failure with respect to the source deduction remittances.
2. He was the sole shareholder and director of the corporation. Money that was paid out to other creditors or employees could have been available to reduce the balances owing to CRA. It was a conscious decision to keep the business running in hopes that things would improve and that the amounts outstanding to CRA would somehow be paid in the future. These actions do not satisfy the due diligence duty.

### Case 7 - Liable

In a May 2, 2008 General Tax Court of Canada case, the taxpayer/director was found to be personally liable for the unremitted source deductions on the basis that he was a "de facto director". Where a corporation operates without having been properly organized and the only director of record plays no part in running the corporation, those persons who direct the affairs of the company may be held to be de facto directors, whether or not they had explicitly represented themselves as directors to any third party. The essential question is whether those individuals have, in fact, taken on the role of director of the

corporation.

In this case, the taxpayer was aware of the unremitted source deductions and, therefore, was personally liable as a de facto director.

### THE FIGHT IS ON

In an April 25, 2008 General Tax Court of Canada case, Mr. F was given 40% of the equity, and all of the voting shares, of his father's corporation (H). His two sisters were each given 30% of the equity by way of non-voting shares.

The two sisters commenced litigation against their brother (Mr. F) for a lack of financial disclosure, and excessive draws and remuneration taken from the company. Mr. F incurred legal fees of \$636,949 which he attempted to deduct as legal expenses incurred for the purpose of either collecting or establishing salary or wages owed.

### Taxpayer Loses

The Court found that the legal fees were not deductible because they were not incurred to collect or establish a right to remuneration from H.

The Statement of Claim alleged that most, or all, of the funds inappropriately paid out were received by Mr. F's spouse, which is not surprising because Mr. F testified that he personally had very significant legal exposure as a result of H's business operation.

However, the Court did agree with Mr. F's request to seal the confidential settlement agreements.

### INDIVIDUAL PENSION PLAN ("IPP")

An IPP is a retirement plan designed to provide greater immediate tax deductions and retirement benefits than the RRSP. An IPP is usually an employer-sponsored defined benefit pension plan created for the benefit of one employee. However, if the spouse or child is an employee, they may be beneficiaries of the IPP.

The IPP may be funded up to 100% by the employer and is regulated under either provincial or federal pension legislation and must be registered with CRA.

The ideal candidate for an IPP is a person over 40 years of age with T4 earnings of over \$100,000 and the owner of an incorporated business or, a senior executive in an employment relationship.

At retirement, the benefits can be paid directly from the IPP or can be transferred to a Life Income Fund, a Locked-In Retirement Fund, a Locked-In Retirement Income Account, or an Annuity.

Employer contributions are deductible if made in accordance with actuarial valuations.

Contributions to an IPP affect the amount that can be contributed to an RRSP since they create a "pension adjustment".

The benefits of an IPP include:

1. Tax deductions for current and past service contributions. Also, interest and other expenses are deductible.
2. Contributions may be made for past service for years back to 1991. However, if the person contributed to an RRSP during that time, the amounts must be transferred from the RRSP to the IPP and the employer may pay the balance to reach the maximum amount allowed.
3. An employer may make a catch-up contribution to make up for contributions that were not maximized in an earlier year.
4. Under pension benefits legislation, IPP assets cannot be seized by creditors of the business, or creditors of the member, presuming the IPP was established in good faith with the primary purpose to provide retirement benefits and, not in anticipation of a bankruptcy.
5. As the age and income of the employee increases, the contributions

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are higher than that of an RRSP leading to a larger pool of accumulated retirement funds.

6. At retirement a catch-up contribution may be made to the IPP to allow for all benefits possible including full consumer price indexing, early retirement pension, and bridge benefits to compensate for CPP and OAS that will not be received until age 65.
7. An eligible spouse may be entitled to a payment in the event of death of the member as a spousal benefit.

Disadvantages include:

1. IPP funds are locked-in until retirement.
2. There are significant setup costs as well as costly registration requirements to meet both CRA and provincial or federal pension regulations. Also, there are triennial actuarial valuations to be filed with the regulators. An annual filing is also required with CRA.
3. The employer is required to make the IPP contributions according to the actuarial calculations regardless of the employer's ability to pay.

## ESTATE PLANNING

**83(5)**

### FUNDRAISING ACTIVITIES

5-page CRA Guide RC4456 provides information concerning fundraising activities of registered charities including prohibitions on fundraising through an unrelated business. Also included is a checklist for small charities to assess their fundraising activities.

### AUDITING CHARITIES

5-page CRA Guide T4118 provides information on why a charity is audited including random selection, review of specific legal obligations, follow-up on

possible non-compliance or complaints, and to confirm that assets have been distributed after revocation.

The Release also discusses how an audit is conducted and what happens after the audit is concluded.

Also discussed are objection and appeal processes and the charity's responsibilities such as filing the annual T3010A Information Return, meeting annual disbursement quotas, keeping adequate books and records, issuing accurate donation receipts, engaging only in allowable activities, informing the Charities Directorate of any changes to the structure, and maintaining the charity's status as a legal entity.

### INCOME SPLITTING

There are many advantages of legally transferring income/properties to family members such as multiple use of the \$750,000 capital gain exemption, use of the lower marginal income tax brackets of family members, asset protection, reduction in probate fees, reduction of taxes on death, and disassociating corporations for purposes of the small business deduction.

Some other examples include:

1. Underlying capital losses in shares can be transferred to a spouse who may offset these capital losses against their capital gains using a series of steps.
2. A parent could trigger a capital loss on a transfer of shares to a child or a Trust for the child.
3. Up to 50% of eligible pension income may be transferred to a spouse or common-law partner. Also, an application may be made to transfer up to one-half of the Canada Pension Plan ("CPP") receipts to a spouse, or common-law partner, once both are age 60.
4. Where a parent or grandparent

transfers funds to a child, there is no attribution on a capital gain earned with the transferred funds.

Also, income earned on cash gifted to a child is not attributed back to the parent or grandparent if the child is aged 18 or over.

5. Dividends may be paid to eligible shareholders of a family corporation to achieve income splitting. However, dividends paid to minor children may be subject to the "kiddie tax".
6. An interest-free loan may be made to a spouse or a child to acquire a proprietorship or a general partnership. The business income will not attribute back to the lender.

## GST

**83(6)**

### INPUT TAX CREDITS ("ITCs")

In a July 12, 2006 General Tax Court of Canada case, CRA disallowed ITCs of \$736,525 on invoices paid by the taxpayer to subcontractors. The taxpayer had obtained the corporate subcontractors' certificates of incorporation, as well as each subcontractor's declarations of registration. In addition, every month, it checked that each subcontractor had a GST and Quebec Sales Tax Registration Number. All of this was shown by supporting documents.

### Taxpayer Wins!

The fact that the subcontractors did not remit the GST to CRA did not prevent the taxpayer from obtaining the ITCs. CRA did not allege fraud or collusion and simply reassessed on the basis that they did not collect the GST from the supplier.

The taxpayer showed on a balance of probabilities that it paid the GST in good faith to the twenty-six subcontractors, just as it did with all eighty subcontractors, with which it did business. Therefore, it is

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entitled to the ITCs.

### **SORRY - NO INPUT TAX CREDIT**

In a December 2, 2005 Tax Court of Canada case, the Court denied an input tax credit for the GST paid for the preparation of financial statements and income tax returns of five management companies that were related to the Appellant.

The Court noted that the management companies should pay their own expenses.

The purpose and context of the expenditures are not related to the Appellant's commercial activities.

### **DID YOU KNOW...**

#### **83(7)**

#### **JOINT AND SEVERAL LIABILITY - SECTION 160**

In a March 7, 2008 Federal Court of Appeal case, Ms. L, the taxpayer and Ms. D were friends when Ms. D owed CRA \$80,000 in taxes. Ms. D then transferred funds to an account in Ms. L's name.

The Tax Court had previously determined that Ms. L did not have to pay Ms. D's taxes because adequate consideration had been made because Ms. D could take the funds out of the account when she wished.

### **Taxpayer Loses**

The Federal Court overturned the Tax Court decision and noted that Ms. L simply acted out of a sense of moral obligation to Ms. D. No consideration was paid for the funds. Therefore, the Income Tax Act bound Ms. L for Ms. D's unpaid taxes up to the amount transferred to her.

### **IMPORTING A VEHICLE INTO CANADA**

In a 7-page May 12, 2008 Release (BSF5048 - Revised: Importing a Vehicle Into Canada), the Canada Border Services Agency discusses issues and examples on importing a vehicle into Canada (Just Google - BSF5048).

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](http://www.mhc-ca.com)

To receive future newsletters via email, please send your request to [info@mhc-ca.com](mailto:info@mhc-ca.com)

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