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YEAR-END TAX PLANNING

84(1)

Some 2008 year-end tax planning tips include:

1. Certain expenditures made by individuals by December 31, 2008 will be eligible for 2008 tax deductions or credits including: moving expenses, child care expenses, safety deposit box fees, charitable donations, political contributions, medical expenses, alimony, eligible employment expenses, union, professional, or like dues, carrying charges and interest expenses, certain public transit amounts, and children's fitness amounts.
2. You have until March 2, 2009 to make tax deductible Registered Retirement Savings Plan ("RRSP") contributions for the 2008 year.
Consider contributing to a spousal RRSP to achieve income splitting in the future.
3. If you own a business, consider paying a reasonable salary to family members for services rendered to the business.
4. An individual whose 2008 net income exceeds \$64,718 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 \$31,524.

Contact your professional advisors for assistance in managing 2008 personal income.

5. Consider purchasing assets eligible for capital cost allowance before the year-end.
6. Consider selling capital properties with an underlying capital loss prior to the year-end if you had taxable capital gains in the year, or any of the preceding three years. This capital loss may be offset against the capital gains.
7. Registered Education Savings Plan ("RESP")
A Canada Education Savings Grant ("CESG") for RESP contributions will be permitted equal to 20% of annual contributions for children (maximum \$500 per child per year).
8. Health and dental premiums for the self-employed
Individuals will be allowed to deduct amounts payable for Private Health Service Plan coverage in computing business income provided they meet certain criteria.
9. A refund of Employment Insurance paid for non-arm's length employees may be available upon application to CRA.
10. Taxpayers that receive "eligible"

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dividends from private and public corporations will have a significantly lower tax rate on the dividends. Notification from the corporation to the shareholder is required. See 84(2) - #2.

11. Eligible public transit passes will be entitled to a tax credit.
12. A fitness tax credit for children under 16 enrolled in certain organized sports is available.
13. A Registered Disability Savings Plan may be established for a person who is eligible for the Disability Tax Credit. Non-deductible contributions to a lifetime maximum of \$200,000 are permitted which are eligible for tax-deferred grants and bonds. Please contact your professional advisors for details.

Tax Tips & Traps



2008 REMUNERATION

84(2)

Some general guidelines to follow in remunerating the owner of a Canadian-controlled private corporation earning "active business income" include:

1. Bonusing down active business earnings in excess of the annual business limit may reduce the overall tax. However, leaving corporate active business income over this amount presents a tax deferral.

Professional advice is needed in this area.

2. Notification must be made to the shareholders when an "eligible" dividend is paid - usually in the form of a letter dated on the date of the dividend declaration. If all shareholders are directors, the notification may be made in the directors' minutes.

Please contact your professional advisor for advice before paying an eligible or ineligible dividend.

3. Elect to pay out tax-free "capital dividend account" dividends.
4. Consider paying dividends to obtain a refund of "refundable dividend tax on hand".
5. 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.
6. Dividend income, as opposed to salaries, will reduce an individual's cumulative net investment loss balance thereby providing greater access to the capital gain exemption.
7. Excessive personal income affects receipts subject to clawbacks, such as old age security, the age credit, child tax benefits, and GST credits.

8. Salary payments require source deductions to be remitted to the Canada Revenue Agency on a timely basis.

9. Individuals that wish to contribute to the Canada Pension Plan or a Registered Retirement Savings Plan may require a salary to create "earned income".

10. Salaries paid to family members must be reasonable.

BUSINESS/PROPERTY INCOME

84(3)

MANUFACTURING AND PROCESSING ("M&P") PROPERTY

M&P property acquired after March 18, 2007 and before 2010 will be eligible for enhanced capital cost allowance deductions (50% straight-line method).

BUILDINGS

An enhanced capital cost allowance rate is available for M&P buildings (10%), and other non-residential buildings (6%).

To qualify, the building must be brand new. Used buildings are not eligible.

CHANGE IN USE

In a May 16, 2008 Tax Court of Canada case, Mr. and Mrs. Evans operated an electrical business partnership in which they owned a garage which was used as a workshop and storage facility. The business was then turned over to their sons who had been working as employees for a number of years. However, Mr. and Mrs. Evans retained ownership of the garage, which was used by the sons in the business but did not charge rent for the use of the garage.

The Problem

The Court found that the garage was no longer used to earn income from a business or property by Mr. and Mrs. Evans. Therefore, there was a change of

use and a deemed disposition at fair market value triggering significant recaptured capital cost allowance.

The Court noted that had the sons paid Mr. and Mrs. Evans rent for the property, this problem would not have occurred.

TERMINAL LOSS UPON THE CESSATION OF A BUSINESS

In a July 22, 2008 External Technical Interpretation, the Canada Revenue Agency ("CRA") notes that if a business is discontinued, the taxpayer is not entitled to claim a terminal loss for the undepreciated capital cost of a class of depreciable property until all the assets in the class are disposed of.

Furthermore, the taxpayer is not entitled to claim capital cost allowance on the property in any subsequent year unless it is used in that year to earn income from a business or property.

MARRIAGE BREAKDOWN

84(4)

WHOLLY DEPENDENT PERSON

In an April 30, 2008 Tax Court of Canada case, the Court confirmed that a divorced person is not entitled to a tax credit for a wholly dependent person if he/she is required to pay a child support amount for the person - whether or not they in fact pay the amounts, or it is fair that they should have to pay the amounts.

SPOUSAL SUPPORT

In a June 4, 2008 Alberta Court of Appeal case, the Judge initially ordered Mr. S to pay spousal support indefinitely. However, the Alberta Court of Appeal has now limited the payments to eight years from the date of the marriage breakdown. Mr. S' lawyer successfully argued that, in some cases, ongoing spousal support payments are not warranted.

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CHILD SUPPORT

An Ontario Court ordered the father to pay \$1,068 a month for two teenage sons he had out of wedlock and that he barely knows.

The taxpayer had argued that this would impose "undue hardship" on him since he was already supporting children that he had with his wife.

The Court noted that there is no reason to prefer the children born within the marriage to those born outside it. Children in both families should be treated equally.

ARREARS

Sometimes, the payer does not pay alimony on time. Alimony, like most forms of personal income, is taxable on the cash basis. Alimony which is due, but not paid, is neither taxable nor deductible.

When alimony arrears are paid, any amount that would have been taxable/deductible spousal support if paid on time is taxable/deductible at the time of payment. This assumes, however, that the amounts are payable on a periodic basis and are, in fact, paid. Where an agreement is made to pay some different, normally lesser, amount in lieu of arrears, the status of the payment may be lost.

Consider: Perhaps a written agreement setting out the expected status of the arrears payment should be prepared. If the payments do not ultimately realize the expected tax status, an adjustment could be made between the parties.

PRIOR PAYMENTS

Often, spousal support is paid prior to preparation of a written separation agreement. As such, the payments are not made under a written agreement and would generally not be taxable or deductible. However, where a later agreement or order provides that an amount received and paid previously is to be considered paid and received under the agreement or order, the amounts may be

taxable/deductible. The payments must have been made in the calendar year of the later order or agreement, or the immediately preceding taxation year. This sets a deadline on the completion of an agreement in this regard.

Consider: The agreement could indicate the parties' intent that the amounts will be deductible to the payer and taxable to the recipient.

CHILD SUPPORT

The Federal Child Support Guidelines are located on the federal Department of Justice website at

<http://www.justice.gc.ca/eng/pi/sup-pen/grl/fcsg-lfpae.html>. Further details on the Federal Child Support Guidelines are also available at <http://www.justice.gc.ca/eng/pi/sup-pen/index.html>.

The Federal Child Support Guidelines first became effective May 1, 1997 and resulted in child support payments not being subject to tax to the recipient and not being tax deductible by the payor. The child support amount under the guidelines varies by province to account for differences in provincial tax rates, cost of living, etc.

ESTATE PLANNING

84(5)

DONATION SCHEMES

In a February 23, 2007 Tax Court of Canada case, the taxpayer received a donation receipt for five times the amount of the cash donation.

Taxpayer Loses

CRA successfully disallowed the charitable donations, even in statute-barred years, and applied gross negligence penalties.

Also, in a July 14 2008 Tax Court of Canada case, the taxpayers acquired original works of art from Canadian Art

Advisory Services ("CAAS") Inc. and shortly thereafter donated them at much higher values to charities identified by CAAS.

Taxpayers Lose

The Court noted that the value for donation purposes should be the amount paid by the taxpayers minus the 15% retainer fee paid to CAAS.

REDEEMER FOUNDATION

The Redeemer Foundation operates a forgivable loan program that finances the education of students at an affiliated college. CRA was concerned that some charitable donations to the Redeemer College were not valid alleging that the donors' contributions were made solely to finance the education of their own children. CRA served the Redeemer Foundation with a requirement to report the identity of each donor and the name of the related student.

On July 31, 2008, the Supreme Court of Canada concluded that CRA is entitled to the donor information.

We understand that CRA did send Notices of Reassessments to some of the donors.

Editor's Comment

This appears to open up a charity's donor list to CRA, upon request.

EXECUTORS OF AN ESTATE

In a June 11, 2008 Tax Court of Canada case, the issue was whether \$15,000 received for services rendered as executors of the uncle's estate is taxable as assessed by CRA.

Taxpayers Lose

The taxpayers' argument that the amount was a specific legacy that their uncle gave them under his will, and not remuneration for services rendered, was not accepted by the Court. Given the way in which the will was drafted, the Court found that the \$15,000 constituted taxable income from employment.

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This is not considered to be a non-taxable legacy because a legacy does not entail any obligation or responsibility of the legatee.

REGISTERED CHARITIES NEWSLETTER

In the Summer 2008 Special Edition No. 30, CRA notes that their Website (www.cra.gc.ca/charities) has a new section "Operating a Registered Charity" which includes over 50 pages of information such as checklists, issuing receipts, Form T3010, disbursement quotas, books and records, audits and sanctions, making requests that require approval, policies and technical information, and frequently asked questions.

The checklists are available at www.cra-arc.gc.ca/tx/chrts/chcklsts/menu-eng.html.

The question and answer structure is arranged by areas of interest (for example, applying for registration), and then is divided by subject matter (for example, issuing receipts), and then subdivided to answer the specific questions (for example, information that is required on a receipt).

Also, you could get on the electronic mailing list by registering at www.cra-arc.gc.ca/esrvc-srvce/mlst/sbscrbchrts-eng.html.

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

To receive future newsletters via email, please send your request to info@mhc-ca.com

GST/HST

84(6)

LEGAL FIRM - DISBURSEMENTS

In a June 13, 2008 Tax Court of Canada case, CRA assessed the law firm as owing \$77,350 in GST on legal disbursements which were paid on behalf of its clients and which were almost exclusively taken out of the law firm's Trust funds.

Law Firm Wins!

The evidence established that certain disbursements were not subject to GST, including appraisal reports, motor vehicle accident reports, courier fees, transcript fees, investigative reports, hospital records, security reports, medical reports, parking fees, travel expenses, security and search certificates, birth certificates, marriage certificates, and death certificates.

Legal disbursements for office expenses were subject to GST.

CREDIT CARD EXPENSES

CRA allows a Registrant who is an employer, partnership, charity or public institution to use factors to calculate Input Tax Credits ("ITCs") in respect of the tax deemed paid by employees, partnership members or volunteers where credit cards have been used to make purchases.

This is an administrative policy of CRA

and is not legislated. Some Registrants may prefer to use the exact calculation method.

Beginning January 1, 2008, when the rate of GST/HST became 5% and 13%, respectively, the factor allowed on credit card expenses became 4/104 or 12/112.

CRA will permit Registrants to use factors for calculating ITCs on expenses charged to company credit cards, provided the conditions in CRA Guide P-184 (July 31, 2008) are followed.

DID YOU KNOW...

84(7)

WORK PERMIT PROGRAM

Changes were announced by the Federal Government on April 21, 2008 to the Post-Graduation Work Permit Program that will permit international students graduating from eligible programs at certain post-secondary institutions to have open and longer work permits. The previous duration of one or two years has been extended to an open work permit with no restrictions on the type or location of employment and, in certain cases, has been extended to three years.

Do a Google search of "Post-Graduation Work Permit Program" for details.

The preceding information is for educational purposes only. As it is impossible to include all situations, circumstances and exceptions in a commentary such as this, a further review should be done. Every effort has been made to ensure the accuracy of the information contained in this commentary. However, because of the nature of the subject, no person or firm involved in the distribution or preparation of this commentary accepts any liability for its contents or use.

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