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YEAR-END TAX PLANNING

64(1)



Some 2003 year-end tax planning tips include:

1. If the following *expenditures* are made by *individuals* by **December 31, 2003** they will be eligible for 2003 tax deductions: moving expenses, child care expenses, safety deposit box fees, charitable donations, political contributions and medical expenses.

2. 2003 eligible Registered Retirement Savings Plan (RRSP) contribution amounts are noted on the 2002 personal income tax return assessment notices. You have until March 1, 2004 to make tax deductible RRSP contributions for the 2003 year.

Consider contributing to a *spousal RRSP* to achieve income splitting in the future.

The maximum 2003/2004 additions to deductible *RRSP contribution room* are \$14,500 and \$15,500 respectively.

The 2004 contribution requires 2003 earned income of \$86,111 ($\$86,111 \times 18\% = \$15,500$).

3. Persons turning *age 69 in 2003* must

mature their RRSP into cash, an annuity or a Registered Retirement Income Fund by December 31, 2003. Certain 2003 *excess* contributions may be deducted in the year 2004 if *contribution room* is available.

4. If you own a business, consider paying a *reasonable salary* to family members for their services rendered to the business.

5. Ensure that all deductible *alimony or maintenance payments* are made by December 31, 2003.

6. An individual whose 2003 *net income* exceeds \$57,879 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 \$28,193.

Individuals facing these problems should contact their professional advisors for assistance in *managing* their 2003 personal income.

7. Consider purchasing assets eligible for *capital cost allowance* before the yearend. For example, *employees* may claim capital cost allowance on *automobiles, aircraft and musical instruments* required to be used in their employment.

8. 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 yearend. This capital loss may be offset against capital gains in

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the *year*, or in the *three preceding* years.

9. If income in an *inter vivos trust* is to be taxed on a beneficiary's return, the income must be *paid or payable* to the beneficiary by **December 31, 2003**.

10. Individuals may claim a *tax credit* related to the *interest portion* of student loan payments made in 2003.

11. *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 \$400 per child per year).

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12. **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 are actively engaged alone, or as a **partner**, in their business, and either self-employment is their primary source of income or their income from other sources does not exceed \$10,000.

13. **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**.

This includes:

1. Taxable **dividends**, and other **shareholder benefits**, on **unlisted shares** of Canadian and foreign companies (received **directly** or through a **trust** or **partnership**); and
 2. Income from a **partnership** or **trust** where the income is derived from providing goods or services to a business carried on by a **relative** of the child or, of which the relative participates.
Therefore, consider **minimizing** this type of income in **2003**.
14. The tax rate for higher income individuals is now **significantly lower** on **capital gains** than on dividends thereby presenting an incentive to receive capital gains.
15. Canadian resident shareholders **receiving shares** in **foreign tax-free reorganizations** will be able to treat the shares as a reduction in adjusted cost base, as opposed to a taxable dividend.
16. A **refund of Employment Insurance** paid for non-arm's length employees may be available upon application.

2003 REMUNERATION

64(2)

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



1. In general, **bonus down** active business earnings in excess of the annual business limit - \$225,000 for a December 31, 2003 yearend. Leaving corporate **active business income** over this amount may present a **tax deferral** but there will likely be an **overall higher tax** to pay when dividends are finally paid out. Some companies may find it advantageous to have **greater than, say, \$225,000** of active business income because of other federal and provincial tax incentives.
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. Retaining **income in the corporation** may effect provincial and federal **capital tax** and certain **provincial clawbacks**.
7. Excessive **personal income** affects receipts subject to **clawbacks**, such as **old age security**, the **age credit**, **child tax benefits**, **GST credits**, etcetera.
8. Salary payments require **source de-**

ductions to be remitted to Revenue Canada 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**.
11. Some provinces have "**payroll taxes**" thereby increasing the costs of paying salaries versus dividends.

EMPLOYMENT INCOME

64(3)

SPECIAL WORKSITE

An employer may make **non-taxable board and lodging payments** to an employee at a **special worksite**.

Caution!

In an August 14, 2003 **Tax Court** of Canada case, the taxpayer was employed to work at a "**special worksite**" but, did not receive payments from the employer for his board and lodging. The taxpayer took the position that had he been paid these amounts they would be tax-free. Therefore, the incurring of expenses related to this "special worksite" should be deductible.

Unfortunately, the Court did not agree.

Editor's Comment:

It may have been better to have part of the remuneration paid separately as "**board, lodging and transportation**" expenses at the **special worksite**.

COMMISSION SALESPERSON

In a July 14, 2003 **Internal Technical Interpretation**, CCRA concluded that a **commission salesperson** may **deduct internet fees** if the fees are paid to earn commission income. However, internet fees were **not deductible** by regular employees.

Tax Tips & Traps

TIPS

In a June 30, 2003 *Tax Court* of Canada case, CCRA included **tip income** on the taxpayer's return of \$918 for 1993 and \$4,785 for 1994 rather than the \$102 and \$2,214 that the taxpayer claimed were the actual amounts of the tips. CCRA's calculation was based on the taxpayer's **pro-rata percentage** of the tips received by the restaurant based on her **percentage of salary** as compared to the **total salaries paid**. The tips received by the restaurant were based on the **average percentage of tips paid to waitresses** on sales at the restaurant of **11.24%**.

The *Court* agreed with CCRA and noted that they found the **taxpayer's evidence evasive** and did not discharge the onus of proving CCRA's assessment incorrect.

INDIVIDUAL PENSION PLANS (IPPs)

A 62 year old person who had been maximizing RRSP contributions every year established an IPP in his corporation for 2003. The deductible corporate contributions for 2003 are - **past service** \$109,600, **current service** \$22,400, for a total of **\$132,000**. For 2004 and 2005 the deductible contributions are \$24,100 and \$25,900 respectively. The deductible contributions will vary, depending on the taxpayer's circumstances. These tax deductible contributions are considerably greater than would be available with an RRSP. These Plans are **complicated** and require **actuarial calculations**. They are generally beneficial to individuals over age, say, **40** earning a **base salary** of more than **\$100,000**.

BUSINESS/PROPERTY INCOME

64(4)

EMPLOYEE VS. INDEPENDENT CONTRACTOR

In a June 26, 2003 *Tax Court* of Canada



case, the taxpayer was a "**supervisor**" with a construction company but filed his tax return as an **independent contractor** and deducted expenses accordingly. CCRA argued that the individual was an **employee** and his deductions were restricted.

Good News!

The *Court* found that the individual was an "**independent contractor**", not an "**employee**", and noted that:



1. **Control Test** - There was **very little control** over the services provided by the taxpayer - "Not once did they check to see if I was there, or told me to be there at any set time or date."
2. **Ownership of Tools** - The taxpayer **owned his own** hand tools, forms, scaffolding, and provided his own truck.
3. **Chance of Profit and Risk of Loss** - Even though the taxpayer had responded to a question from the field auditor that he had, "no chance of profit", upon investigation in Court, it was determined that he "**wasn't thinking properly**" when he answered this question. In fact, there was evidence that a profit or loss did apply in his case.
4. **Integration** - The taxpayer was providing the services as a **person in business** on his own account.

The Court was also influenced by:

1. The wording of the **actual contracts** between the construction company and the taxpayer.
2. The taxpayer had **income from other sources** in previous years.
3. The taxpayer paid **salaries** to other persons - a further indication of the limited degree of control exercised by the construction company.

Editor's Comment

There are **serious implications** for the **payer** if CCRA successfully challenges the

"independent contractor" status. A **CCRA Ruling** could be considered.

CAPITAL GAINS AND LOSSES

64(5)

GUARANTEEING CHILD'S DEBTS - OUCH



In a June 10, 2003 *Tax Court* of Canada case, the **mother** had **guaranteed the debts** of her **son's** corporation. The son's corporation was unsuccessful and the mother paid off the loans over the years 1989 to 1993 and claimed **business investment loss** deductions.

The sole motivation for the guarantee was to help her son. **No guarantee fee** was charged and no possibility of income was available.

Therefore, the *Court* **disallowed** the mother's **business investment loss** on the basis that the guarantees were **not incurred to earn income**.

Editor's Comment

Charge a **guarantee fee** next time.

CORPORATE TAX

64(6)

ASSOCIATION

The Income Tax Act has **rules** that "**associate**" **two corporations** that have the **same de facto control**. Therefore, they have to share the small business deduction.

For example, if Mr. A and Mrs. A each own a corporation and there is no signing authority, or business transactions, or shareholdings between the two corporations, it is **arguable** that the companies are **not associated**. Therefore, the family could have **two small business deductions**.

The **corporations** should strive for **separate and distinct** financing, customers, employees, offices, business licenses, Workers Compensation registration, GST

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registrations, CPP and EI and source deduction registration and any other *stand-alone* issue.

Professional advice is needed in this area.

DISSOLUTION FOR FAILURE TO FILE ANNUAL RETURNS

In a June 10, 2003 *Tax Court* of Canada case, the *corporation was struck* in the late 1980s for *failing to file Annual Returns* but was *revived* in February, 1999 under an *Application for Revival*.

Bad News!

The Court noted that the *Certificate of Revival did not have* the effect of *reviving* the corporation *retroactively*. The corporation was simply *non-existent* at this time. The income earned belongs to the owner who generated that income through his activity.



PERSONAL TAX

64(7)

DISABILITY TAX CREDIT (DTC) - NEWBORN

In a July 9, 2003 *Tax Court* of Canada case, the *taxpayer's son* was born on November 27, 1993 *without a left hand*. The Court found that a *missing left hand* is a disability that qualifies for the *DTC transfer* to the parent.

MOVING EXPENSES

In a June 12, 2003 *Technical Interpretation*, CCRA reviewed a situation where a taxpayer *moved* and, because of *employment commitments*, the spouse joined the taxpayer three years later. Therefore, *three years* after the change of employment, the *old house* was sold and the taxpayer successfully deducted the *selling cost* as a *moving expense*.



MEDICAL EXPENSE - HARDWOOD FLOORING

In a June 17, 2003 *Tax Court* of Canada case, the taxpayer incurred expenses of approximately *\$11,000* in 1999 to *install hardwood flooring* which was successfully claimed as a *medical expense*. The flooring was acquired because the taxpayer's spouse suffered from serious *allergies*. The *doctor* noted that, "because of significant health impairment... the spouse was unable to be functional in his home until the carpets were removed and replaced with hardwood...".

MEDICAL EXPENSES - ATTENDANT CARE

In a July 3, 2003 *Technical Interpretation*, CCRA notes that where a *senior citizen* pays for *various homecare services*, such as meal preparation and laundry, these expenses could qualify as "*attendant care expenses*" and be eligible as *medical expenses* if the taxpayer is entitled to the *disability tax credit*. Only attendant care expenses that *do not exceed \$10,000* for the year (*\$20,000* in the year of death) qualify for the credit.

Depending on the situation, *eligible tasks* could include meal preparation, housework, transportation, and personal services such as banking and shopping. However, attendant care expenses would *not* normally include a payment to a person employed to do a specific task, such as a *dry-cleaner*.

MEDICAL EXPENSE - SCHOOL TUITION FEES

In a July 8, 2003 *Tax Court* of Canada case, in the year 2000 the taxpayer paid *tuition fees and room and board* to an Academy for his two *attention deficit children* and successfully claimed a *medical expense credit* of *\$42,662*.

A *doctor certified* that the children required the *equipment, facilities* and *personnel* specially provided by this Academy.

INTEREST ON A STUDENT LOAN

Interest paid on a *student loan* made under the *Canada Student Loans Act* or a *provincial statute* is eligible for a tax credit.

In a June 27, 2003 *Tax Court* of Canada case, the taxpayer took out a "*new loan*" to repay a loan subject to the *Canada Student Loans Act*.

Bad News!

The *interest* on the "*new loan*" is *not eligible* for the tax credit.

MARRIAGE BREAKDOWN

64(8)

RRSP TRANSFER

The Income Tax Act permits a *tax-free transfer of an RRSP* from one spouse to another as a *division of property* in a "*settlement of property or support rights*" in a marriage breakdown.

RETROACTIVE CHILD SUPPORT

The British Columbia Supreme Court recently required Mr. G to pay a *retroactive child care payment* of *\$641,842* (*\$3,565/mo.* for 15 years) because he *did not fully disclose his wealth and income* when the original *\$500/month* child support agreement was made.



FARMING

64(9)

GRAVEL SALE

In a 2003 *Advance Income Tax Ruling*, CCRA Ruled that where a farm corporation owns land with *gravel*, when the corporation sells all the gravel for a *lump sum* the proceeds received will be a *capital gain not regular income*. Capital gains are only 50% taxed.

However, in an August 29, 2003 *Technical Interpretation*, CCRA note that where

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an individual receives an amount based on the *shale extracted* from the property, the amount received will be considered *income* because it is based on *production*.

SALE OF TREES

In a July 22, 2003 *Technical Interpretation*, CCRA notes that where a *farmer* receives an amount for allowing someone to *cut and remove timber* from his/her farm, the *gain* on the sale may be a *capital gain*, not regular income, if all of the following *conditions* are satisfied:



- (a) the taxpayer *did not acquire* the property with the *intention of selling* the timber or land;
- (b) the sale agreement is an *isolated* transaction;
- (c) the price is a *fixed amount*;
- (d) the timber is removed over a *short period of time*; and
- (e) the purchase price *does not depend* on the *use or production* of the land.

WEB TIPS

64(10)

USED CAR VALUATION

http://www.gmcanada.com/english/financing/fin_financ.html

If you are looking for *values of used vehicles*, this site is perfect for you. On the left hand column of the website is a link named "*Appraise Your Vehicle*" that will

take you to the "*Canadian Black Book*" valuation tool.

GST

64(11)

AGENCY

GST is payable on the selling price when a person is acting as an *agent* in making a sale on behalf of a supplier.

On August 18, 2003 CCRA introduced 17-page *Publication P-182R - Agency* which discusses this. It also provides *four examples*.

Example 1 reviews a *property management company* which manages a number of residential apartment buildings for various landlords. *Example 2* reviews a *cost-sharing arrangement* where three professionals share office space and operating expenses. *Example 3 and 4* reviews a contract which includes a *reimbursement of expenses*.

INPUT TAX CREDITS (ITC)- MILEAGE ALLOWANCES

In a July 22, 2003 *Tax Court* of Canada case, *Melville Motors Ltd.* paid *mileage allowances* to each of its *employed* vehicle salespersons. The Excise Tax Act permits an *ITC of 7/107th* of the *reasonable* allowances paid.

Good News!

The *Court* found that the allowances *were based on kilometres driven* and were *reasonable*. Therefore, the *ITCs* were *allowed*.

INPUT TAX CREDITS

In a January 15, 2003 *Tax Court* of Canada case, the taxpayer carried on a *courier proprietorship* business. CCRA successfully *disallowed* some of the *input tax credits* on the basis that the taxpayer *did not keep a log* for the use of his vehicle or receipts for his entertainment expenses.



DID YOU KNOW...

64(12)

ADMINISTRATIVE MONETARY PENALTY SYSTEM (AMPS)

The *AMPS system* was fully implemented by CCRA on *October 7, 2002* to *assess penalties* for non-compliance with *Customs laws*. These penalties are *significantly higher* than previous.



A non-compliant taxpayer could face increased monetary penalties, increased audit activity, inspections and seizures, as well as loss of importing privileges.

CCRA's *Voluntary Disclosure Program* will allow importers to come forward and avoid AMPS penalties.

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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