

## PERSONAL TAX

### 63(1)

#### DISABILITY TAX CREDIT (DTC) - PROSTHETIC DEVICE

In an April 8, 2003 *Tax Court* of Canada case, the taxpayer suffered from a congenital birth defect that required him to wear a **prosthetic device** - a partial artificial left leg. The



device may only be worn for ten to twelve hours a day and, even while worn, the taxpayer feels a certain amount of pain.

The Court permitted the DTC and noted that Mr. R could **not** use the prosthesis **at all times** and, even when it was used, his ability to walk could not be compared favourably to an able-bodied person.

## EMPLOYMENT INCOME

### 63(2)

#### DEFENSIVE DRIVING COURSE

In a March 25, 2003 *Technical Interpretation*,



Canada Customs and Revenue Agency (CCRA) notes that where an employer pays for a **defensive driving course** for an employee whose duties involve a lot of driving, this likely will **not** be a **taxable benefit** to the employee but

will be **deductible** to the employer.

#### Editor's Comment

In **owner-manager** situations, this beneficial treatment may only apply to **employment** rather than **shareholder** based benefits. **Documentation** is important.

#### RETIRING ALLOWANCE

In a March 20, 2003 *Technical Interpretation*, CCRA notes that where **employment** has **ceased** and the former employees go into business and some of their **business income** is earned from their former employer, the severance payments paid to the former employees would qualify as **retiring allowances** eligible to be rolled over to an **RRSP**.

The maximum amount that may be rolled over is \$2,000 for each year employed prior to 1996 and an additional \$1,500 for each year prior to 1989 for which the employer's contributions to a pension plan or deferred profit sharing plan had **not vested** at the time the retiring allowance is paid.

#### EXPENSES

In a February 5, 2003 *Tax Court* of Canada case, the taxpayer was an **investment advisor** for Wood Gundy and incurred expenses in earning his commission employment income. The Court **permitted a deduction** for out-of-pocket costs - such as **donuts** that he purchased by the dozen and dropped off in various lunch rooms of clients. Also, he was permitted to deduct **small tools**.

Unfortunately, **computer** capital cost allowance (CCA) was **not allowed** as the

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Income Tax Act only permits employees to claim CCA on automobiles, aircraft and musical instruments.

#### Editor's Comment

Alternatively, **leasing** computers is deductible.

#### SHORT-TERM DISABILITY INSURANCE

In a May 21, 2003 *Technical Interpretation*, CCRA notes that when an employer provides a **short-term disability insurance plan** or a **paid sick leave plan** for its employees that meets certain conditions, the employer can **apply** for a **reduction** of employment insurance (EI) premiums. If this is approved, **5/12** of the reduction **must** be given to the employees.

#### Editor's Comment

For details, see website [www.hrdc-](http://www.hrdc-)

# Tax Tips & Traps

## TEACHERS

In a May 29, 2003 *Correspondence*, CCRA remind *teachers* that they may *deduct supplies* required to be purchased in their employment. This *requirement* could be through a *written contract* with the employer or be *understood* that the employee was to make such payments. Therefore, a teacher may deduct the cost of supplies, whether there is an express or an implied requirement to provide the supplies, *if the employer* has *certified* that the employee qualifies for the deduction by completing *Form T2200*.

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## BUSINESS/PROPERTY INCOME

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### 63(3)

#### REASONABLE EXPECTATION OF PROFIT (REOP) - RENTAL PROPERTY

In a May 26, 2003 *Federal Court of Appeal* case, the Tax Court had previously disallowed the losses on a rental house in Edmonton, Alberta on the basis that there was no REOP because there was a non-deductible *personal element*. The property had formerly been the Appellant's *home*, the Appellant used the property as collateral for a line of credit for his realty business, and the Appellant acknowledged *retaining pride* in maintaining the home as an asset to the neighbourhood.

#### Good News!

The *Federal Court* overturned the Tax Court decision and found that these *elements are not* sufficient to make the property something *other than a commercial activity*.

#### HAWAIIAN CONDOMINIUM

In a May 20, 2003 *Tax Court* of Canada case, a corporation acquired a *Hawaiian condominium* in



*1985* and rented it out until *1992* at which time it was *simply used* by the owner and employees and clients for promotional purposes.

The Court *disallowed* the owner's *travel expenses* to the Hawaiian Condominium as *personal* in nature. However, with respect to the *costs related to the condo*, such as *interest* expense, *utilities* and *condo* fees, the Court found that 20% of the days used were by the owner and the balance were by customers or employees. Therefore, 20% of the expenses were disallowed as an expense to the company and were taxable to the owner.

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## CAPITAL GAINS

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### 63(4)

#### QSBC SHARE

In an April 23, 2003 *Technical Interpretation*, CCRA notes that for the capital gain on the sale of a qualified small business corporation share (*QSBC*) to be eligible for the *capital gain exemption*, criteria must be met including that the share must not have been owned by anyone other than the individual, or a related person, throughout the twenty-four months immediately preceding the disposition. Also, the Income Tax Act *deems* shares that were issued after June 13, 1988 to have *been owned immediately before* their issue by a non-related person *unless* they meet specific circumstances, such as being issued as part of a transaction in which the person disposes of *all or substantially all* of the assets used in an active business.

In this Technical Interpretation, the taxpayer carried on a *trucking proprietorship*. He had two different buyers for his trucks and, therefore, wished to transfer some trucks on a rollover basis to *one corporation* and the other trucks to the *other corporation* and then sell the shares of each corporation and claim the capital gain exemption.

Not surprisingly, CCRA concluded that the shares would *not be eligible* for the capital gain exemption because all or substantially all of the assets used in an active business proprietorship were not transferred to each corporation.

#### REPLACEMENT PROPERTY

In a May 22, 2003 *Technical Interpretation*, CCRA notes that a taxpayer may *elect* to *defer* the income or capital gains where a "*former property*" is *involuntarily* disposed of or, a "*former business property*" is *voluntarily* disposed of, and "*replacement property*" is acquired.

#### NON-COMPETITION PAYMENTS

The *Federal Court* recently found that amounts received for signing a *non-competition agreement* were tax-free. Consider this:

1. Until there is *future legislative or jurisprudential developments*, the seller of shares of a corporation may receive a *tax-free receipt* for signing a *reasonable non-competition* agreement.
2. The result may be *different* for a person receiving the payments who *carried on the business*, such as a sole proprietor, partner, or corporation.
3. It may be prudent to engage an *expert* to determine the *value* to be assigned to the non-competition amount.

#### Editor's Comment

*Caution* - If a current, former, or future employer of the recipient makes the payment, it could be considered *employment income*.

#### TRANSFER OF CAPITAL LOSS TO A SPOUSE

In a May 27, 2003 *Technical Interpretation*, CCRA reviewed a situation where Mr. X owns shares with an adjusted



# Tax Tips & Traps

cost base of \$100,000 and a fair market value of \$5,000. As Mr. X has never had any capital gains, the capital loss will be of little value to him. However, *Mr. X's wife* had substantial capital gains and *would like to use* Mr. X's accrued *capital losses*.

The Technical Interpretation discusses how the losses could be *transferred to Mrs. X*.

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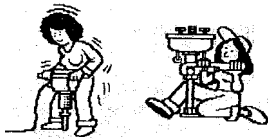
## CORPORATE TAX

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### 63(5)

#### THE SMALL BUSINESS DEDUCTION

The federal *small business deduction* for a Canadian-controlled



private corporation (CCPC) is *16%* times the lesser of the active business income, taxable income - modified by foreign tax credits, and the corporation's "*business limit*". The "business limit" is proposed to *increase* in *2003* from \$200,000 to \$225,000, to \$250,000 in 2004, to \$275,000 in 2005 and to \$300,000 in 2006.

Also, these limits must be *allocated* among associated corporations.

#### SCIENTIFIC RESEARCH (SR&ED)

CCPCs are also eligible to earn *investment tax credits* at an enhanced rate of *35%* on up to \$2 million of *SR&ED* expenditures. As a consequence of the proposal to increase the "*business limit*", the Budget also proposes that the *\$2 million expenditure limit* be *phased out* where taxable income in the previous year is between *\$300,000 and \$500,000*.

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## CCRA

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### 63(6)

#### DIRECTOR LIABILITY

In a December 31, 2002 *Tax Court* of Canada case, the taxpayer was the *sole director* of T Inc., and was held *personally liable* by CCRA for *unremitted source deductions* and *GST*.

The taxpayer argued that he was *statute-barred* as he was *unable to act* as a *director* due to a severe computer failure which resulted in the termination of the company's business and the appointment of a *receiver manager*. *Two years* expired from this date to the date of the issuance of the assessment.

#### Good News!

The Court noted that the two year *limitation period* runs from the time when an individual *ceases to be in a position* in law and in fact to exercise the powers of a director. The taxpayer could do nothing after the receiver-manager was appointed and, therefore, he had ceased to be able to act as a director.

#### Editor's Comment

A *legal resignation* as a director more than *two years* before CCRA issues the assessment is the best evidence.



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## MARRIAGE BREAKDOWN

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### 63(7)

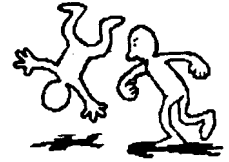
#### ARREARS

In a January 30, 2003 *Tax Court* of Canada case, the taxpayer was in *arrears* on periodic spousal support amounts. A Court found that the taxpayer must pay \$23,595, being \$7,500 of costs and \$16,095 for arrears as a *final payment due under the said Judgment*. There shall be *no obligation* of the husband to pay *any*

*other spousal* support to the wife.

#### Bad News!

The *Tax Court* found that the payment was *not deductible* even though it is generally accepted that periodic payments which have fallen into arrears and subsequently paid in lump-sum are *deductible* in the hands of the payer and *taxable* to the recipient.



However, in this case, the payment did *not* represent the *full amount* of the arrears due and, more importantly, the amount paid *released* the taxpayer from any *future* obligations.

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## CHARITIES

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### 63(8)

#### CHARITABLE GIFT ANNUITIES

In a February 17, 2003 *Technical Interpretation*, CCRA reviewed a situation where an *eighty-year old* taxpayer contributes *\$100,000* to a charity and the charity agrees to make *annual annuity* payments to the taxpayer of *\$7,700* as long as the taxpayer lives.

CCRA notes that the Income Tax Act permits the charity to issue a *donation receipt* for the excess of the fair market value of the property transferred (\$100,000) over the advantage provided to the donor. Assuming that \$52,300 would be required to acquire an annuity paying \$7,700 for the life of the donor, the *donation receipt* could be for *\$47,700* (\$100,000 - \$52,300).

#### ART FLIPS

CCRA has *reassessed* over *3,000 Canadians* who claimed a *charitable donation tax credit* on the *donation of art* -

adding up to about \$7 million in unpaid



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taxes. CCRA looks at several aspects when it suspects an “*art flip*”:

1. **How long** the art was held. If it is purchased and sold in the same year, CCRA will be suspicious.
2. **The art’s value** - is there a significant difference between the amount it was bought for and the amount sold for?
3. Is there an **appraisal** on the art by an independent qualified appraiser?

Taxpayers that have been reassessed have the option of filing a **Notice of Objection** within the prescribed time.

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## FARMING

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63(9)

### QUALIFIED FARM PROPERTY

In a March 28, 2003 *District Office Memo*, CCRA reviewed a situation where



Mr. and Mrs. X bought farmland from **Mrs. X’s father** (Mr. A) who had **previously farmed** the land. Mr. and Mrs. X

only farmed the land on a marginal basis. Mr. X and Mrs. X divorced and now wish to **sell the farm**, which they still **own jointly**.

CCRA confirmed that Mr. and Mrs. X’s share of the land would still be **qualified farm property (QFP)** eligible for the \$500,000 capital gain exemption since an **individual’s parent** may satisfy the **use tests**.

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## WEB TIPS

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63(10)

### COMPUTER VIRUSES

Not all anti-virus protection software packages detect viruses and solve and update systems at the same time or speed. Therefore, it may be a good idea to check your system with a secondary virus scanner either periodically or if your system feels sluggish. For a **free virus scan** go to:



<http://housecall.trendmicro.com/>

Click the link in the middle of the page ‘SCAN WITHOUT REGISTERING’ and follow the instructions.

## RETIREMENT INCOME

See Canadian Retirement Income Calculator - <https://srv260.hrhc-drhc.gc.ca/> or go to [www.hrhc.gc.ca](http://www.hrhc.gc.ca) and search for Canadian Retirement Income Calculator.

Hosted by H.R.D.C., this calculator provides a **forecast of annual pre-tax retirement income**. With the use of a seven module procedure, this tool allows users to **manipulate most conditions** that affect **C.P.P.** (i.e. taking it early or reducing the number of years paid into the plan), **O.A.S.**, **employer pensions**, **RRSP**, and other **amounts**. Once the information is entered, a summary may be printed. One may then change pieces of previously entered data and print out the new summary sheet for comparison.

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