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FALL 2008 NEWSLETTER

PERSONAL TAX

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. 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.

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.

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.

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).

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”.

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.

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.

EMPLOYMENT INCOME

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 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.

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 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.

GST

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 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.

AGRICULTURE AND FISHING

In a 20-page CRA Release (GST/HST Memoranda Series, 4.4 Agriculture and Fishing), CRA noted that most supplies of agricultural and fishing products are not zero-rated. However, some agricultural products are not



zero-rated such as cut flowers, foliage, bedding plants, sod, living trees, firewood, fur and animal hides, feathers, down, processed wool, maple-sugar candy, gravel, stones, rock, soil, and the urine from pregnant mares, which are GST/HST taxable.

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).

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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