



# Facts & Tax

From **Hilborn Ellis Grant LLP**

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## Year-End Tax Planning

### 1. Deductibility and Timing of Expenditures

Individuals must make the following expenditures by December 31, 2002, in order to be eligible for 2002 tax deductions/credits: moving expenses, child care expenses, safety deposit box fees, charitable donations, political contributions, investment counsel fees, accounting fees, professional dues and medical expenses.

### 2. Registered Retirement Savings Plans (RRSP)

Your 2002 eligible RRSP contribution limit is noted on your 2001 personal income tax return assessment notice. You have until March 1, 2003, to make tax-deductible RRSP contributions for the 2002 taxation year.

Consider contributing to a spousal or common-law partner's RRSP to achieve income splitting in the future.

The maximum addition to your RRSP contribution limit for 2003 and 2004 is \$13,500 and \$14,500, respectively. Therefore, \$75,000 of 2002 earned income and \$80,556 of 2003 earned income is required to reach this maximum for 2003 and 2004, respectively.

Individuals turning age 69 in 2002 must convert their RRSP into cash, an annuity or a Registered Retirement Income Fund (RRIF) by December 31, 2002. Selecting the RRIF or annuity option will require you to be paid a minimum yearly amount starting in 2003. The minimum yearly amount will be based on your age at the beginning of each year. However, you can elect to have the payment based on your spouse's or common-law partner's age at the time you establish your RRIF or annuity.

### 3. Payment of Salaries

If you own a business, consider paying a reasonable salary to family members for services they render to the business during the year. Ensure that withholdings for income tax, Canada Pension Plan, Employment Insurance and any applicable provincial payroll taxes are remitted as required.

The amount of the salary and the amounts withheld for 2002 must be reported on T4 statements, which are due on or before February 28, 2003.

### 4. Social Security Clawback

For the 2002 taxation year, an individual's old age security pension benefit and age amount will be reduced by an amount equal to 15% of the individual's net income in excess of \$56,968 and \$27,749, respectively. At income levels of \$92,541 and \$52,603, the full amount of the old age security pension benefit and age amount, respectively, will be reduced to nil.

### 5. Utilization of Capital Cost Allowance

Consider purchasing assets eligible for capital cost allowance before the year-end. For example, employees may claim capital cost allowance on automobiles required to be used in their employment.

### 6. Realization of Capital Losses

Capital gains realized in the 1999 and 2000 taxation years were likely taxed at a higher rate than capital gains that will be taxed in the 2002 and subsequent taxation years. If you had taxable capital gains in your 1999 and/or 2000 taxation years, consider selling capital properties with an underlying capital loss prior to the year-end. With the reduction in the capital gains inclusion rate and lower income tax rates, capital losses used to offset capital gains realized in either the 1999 or 2000 taxation years may result in greater tax savings than utilizing such capital losses in the 2002 and subsequent taxation years. Avoid triggering capital gains in the balance of this year if you already have capital losses that can be carried back to your 1999 and/or 2000 taxation years.

Note that the final trading date of a Canadian Stock for settlement in 2002 is December 24, 2002.

### 7. Payment of Income Through a Trust

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, 2002.

**8. Registered Education Savings Plan (RESP)**

A Canada Education Savings Grant (CESG) for RESP contributions will be permitted equal to 20% on the first \$2,000 of annual contributions made to an eligible RESP of a qualifying beneficiary who is under the age of 18 throughout the year. The maximum CESG amount that a beneficiary can receive is \$7,200. The annual limit for contributions to an RESP is \$4,000 and the lifetime limit is \$42,000.

Ensure that you take advantage of the CESG by making RESP contributions before December 31, 2002.

**9. Health and Dental Premiums for the Self-Employed**

Individuals will be allowed to deduct amounts payable in respect of the 2002 taxation 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.

**10. Instalment Reminder**

If you are required to pay tax instalments for the 2002 taxation year, remember that your final instalment must be paid by December 15, 2002. As this payment date falls on a Sunday, the instalment may be paid by the next business day, i.e., December 16, 2002.

Your first instalment for the 2003 taxation year must be paid by March 15, 2003.

**11. Pay Interest on Employee Loans before January 30, 2003**

If you had a low-interest bearing loan from your employer during any part of the year, you are deemed to have received a taxable employment benefit. The amount of this benefit is reduced by any interest actually paid on the loan. However, the interest must be paid within 30 days of the end of the calendar year, i.e., January 30, 2003, in order to reduce any deemed taxable employment benefit.



**Income Splitting Opportunities**

For the fourth quarter of the 2002 calendar year, the Canada Customs and Revenue Agency has set its prescribed interest rate at 3% for all income tax purposes other than to compute interest on taxes owing or refundable. This provides taxpayers with an opportunity to take advantage of various income splitting techniques.

Income splitting is achieved by transferring an income-producing asset, which includes cash, to a non-arm's length person, i.e., spouse, common-law partner or minor child, who is earning lower amounts of income than the transferor. If done incorrectly, the income earned, including capital gains realized on the asset, may be attributed back to the transferor.

These attribution rules could be avoided by ensuring that the transferor receives fair market value consideration in exchange for the property transferred. One way of achieving this is to take back a promissory note (equal to the fair market value of the property transferred) that earns interest at the prescribed rate in effect at the time the loan was incurred. The interest payable on the loan must be paid during the year, or within 30 days from the end of the year. The interest received by the transferor is included in income and the transferee claims an interest expense deduction.

This means that if an individual loans money to their spouse, common-law partner or minor child during the period from October 1, 2002, to December 31, 2002, at a rate of 3%, any income earned or capital gains realized by the spouse, common-law partner or minor child on the borrowed funds will be taxed in their hands. The result is that the transferor's income on the funds loaned is capped at 3% and the transferee will be taxed on any income earned in excess of 3%.

Should the prescribed interest rate increase in the future, the transferor would still be required to charge interest at a rate of 3%, i.e., the prescribed rate in effect at the time the loan was issued. Accordingly, as interest rates are likely to increase over time, the income splitting benefits will likely increase over time.

**Employment Expenses**

As another taxation season approaches, it is fitting to prepare for it by comparing the type of employment expenses deductible for a regular salaried employee with those deductible by a commissioned employee.

Salaried employees are able to deduct certain accounting and legal fees, assistant's salary, automobile expenses (including parking), long distance telephone calls, office rent, supplies and travel incurred for the purposes of earning employment income.

In addition to the above expenses, a commissioned employee also has the benefit of claiming advertising and promotion, cell phone airtime, 50% of entertainment expenses, equipment leases, licenses and training expenses. However, the amount of the deductible expenses are limited to the amount of commission income earned.

Where a commissioned employee's expenses exceed his or her commission income, he or she may choose to deduct expenses as if he or she were not a commissioned employee but rather a salaried employee. However, this would limit the type of expenses that may be deducted to those allowed to a salaried employee. This alternative should be made only where total expenses deductible as a salaried employee are greater than the total expenses that would be deductible as a commissioned employee.

Both types of employees are required to obtain a signed copy of Form T2200 "Declaration of Conditions of Employment" from their employer. Although the form is not required to be filed with their personal income tax return, it should be kept on file should the Canada Customs and Revenue Agency request it. The form sets out the types of expenses that may be deductible by the employee.

# Personal Income Taxes

## A. Income Tax Rates

Personal income tax rate cuts that were scheduled to come into effect in 2003 have now been delayed by the Ontario budget by one year. As such, the revised projected personal income tax rates for Ontario residents for the 2002, 2003 and 2004 taxation years for salary, interest and other income are as follows:

Ranges of Other Taxable Income	Tax Rate (%) – 2002			Tax Rate (%) – 2003			Tax Rate (%) – 2004		
	Fed.	Ont.	Total	Fed.	Ont.	Total	Fed.	Ont.	Total
\$0 to \$31,700	16.00	6.05	22.05	16.00	6.05	22.05	16.00	5.65	21.65
\$31,700 to \$56,150	22.00	9.15	31.15	22.00	9.15	31.15	22.00	8.85	30.85
\$56,150 to \$63,500	22.00	10.98	32.98	22.00	10.98	32.98	22.00	8.85	30.85
\$63,500 to \$66,150	26.00	13.39	39.39	26.00	13.39	39.39	26.00	11.16	37.16
\$66,150 to \$103,000	26.00	17.41	43.41	26.00	17.41	43.41	26.00	17.41	43.41
Over \$103,000	29.00	17.41	46.41	29.00	17.41	46.41	29.00	17.41	46.41

The above rates should only be used for estimating the tax within the ranges of other taxable income and not for doing a detailed tax calculation. The ranges of taxable income listed above will continue to be indexed for inflation. The projected top personal combined Federal and Ontario tax rates for the 2002, 2003 and 2004 taxation years are as follows:

Salary, Interest and Other Income	46.41%
Canadian Dividends	31.34%
Capital Gains	23.21%

## B. Non-Refundable Tax Credits

Effective January 1, 2002, the Federal and Ontario governments adjusted the basic personal amount to \$7,634 and \$7,686, respectively (combined tax credit of \$1,686), the spousal or common-law partner amount and amount for eligible dependant to \$6,482 and \$6,526, respectively (combined tax credit of \$1,431), the caregiver amount and amount for infirm dependants to \$3,605 and \$3,623, respectively (combined tax credit of \$795), the disability amount to \$6,180 and \$6,210, respectively (combined tax credit of \$1,364) and the education amount to \$400 and \$414 per month, respectively (combined tax credit of \$89) for full-time education and \$120 and \$124 per month, respectively (combined tax credit of \$26) for part-time education.

## C. Refundable Education Credit

In its 2001 budget, the Ontario government introduced a new refundable tax credit, effective January 1, 2002, for tuition fees paid to independent schools in Ontario. The credit applies to the first \$7,000 of tuition fees paid per child for kindergarten, primary and secondary grades. The rate applicable for this credit is 10% in 2002, and is to be increased by 10% each year until it reaches 50% in 2006, i.e., a credit of \$3,500 per child in 2006. The 2002 Ontario budget delayed the increase for 2003 until January 1, 2004. As such, the maximum credit will likely not be reached until 2007.

# Corporate Income Taxes

In addition to the delay of the personal income tax rate cuts, the 2002 Ontario budget also delayed the scheduled corporate income tax rate cuts announced in the 2001 budget. As such, the following is a revised schedule of the combined Federal and Ontario corporate income tax rates for taxation years ending on December 31, 2003, 2004, 2005 and 2006:

Type of Income	Tax Rate (%)	Tax Rate (%)	Tax Rate (%)	Tax Rate (%)
	2003	2004	2005	2006
Income Eligible for SBD* – first \$200,000	18.62	18.12	17.12	17.12
Income Not Eligible for SBD*	36.62	33.12	31.62	30.12
Manufacturing & Processing	33.12	32.12	31.12	30.12
Investment Income	48.29	46.79	45.29	43.79

\*SBD – Small Business Deduction

## Quick Tax Facts

### Attribution of Capital Gain to Spouse on Property Transferred to and Sold by an Ex-Spouse

When property is transferred to a spouse as a result of a marriage breakdown, the capital gain that arises on the subsequent sale of the property will attribute back to the transferor if the sale occurs before the divorce has been finalized. This attribution could be avoided if a joint election is filed in the transferor's personal income tax return that relates to the year the property had been transferred.

### Legal Costs Incurred to Establish Spousal Amount

The Canada Customs and Revenue Agency (CCRA) has recently reconsidered its position concerning the deductibility of legal expenses related to obtaining spousal support. The CCRA now considers legal costs incurred to obtain spousal support under the *Divorce Act*, or under the applicable provincial legislation in a separation agreement, to have been incurred to enforce a pre-existing right to support. Consequently, these costs are deductible. In addition, the CCRA now accepts that legal costs of seeking to obtain an increase in support or to make child support non-taxable are also deductible.

This change in position will be effective for future assessments and reassessments and will not apply retroactively.

### Political Contributions

Contributions to federal registered parties and federal candidates in an election are deductible from federal tax otherwise payable. The maximum deduction allowed is \$500 and is achieved when the contributions made in the year total \$1,075. In addition, federal political contributions can only be used as a tax deduction in the year in which the contributions are made and only to the extent of the federal taxes otherwise payable.

Unlike federal political contributions, tax credits arising from contributions to Ontario registered candidates in an Ontario provincial election, registered constituency associations or registered parties are refundable even if you have no Ontario income taxes to pay or the total amount of tax credits is more than your Ontario income taxes owing. The maximum yearly Ontario political contribution tax credit is \$1,000, which is reached when you have made eligible contributions totaling \$2,275. The Ontario political contribution tax credit cannot be claimed for contributions to municipal or federal elections.

Official receipts must accompany all claims for the federal and Ontario political tax credit. There is no ability to carry forward the federal and Ontario political contributions made in one year to the next. Administratively, either spouse or either common-law partner may claim the credits. However, a single contribution cannot be divided between spouses, or common-law partners, if only one receipt was issued.

## Payments Made to Non-Residents

When a person pays a non-resident a fee, commission or other amount for services rendered in Canada, a 15% non-resident tax is required to be withheld by the payer and remitted to the Canada Customs and Revenue Agency (CCRA). The amount withheld must be remitted to the CCRA by the 15th day of the month following the month in which the payment was made to the non-resident performing the services. In addition, the payer is required to complete a T4A-NR statement reporting the payments made to the non-resident in the year. For payments made to non-residents in 2002, the T4A-NR statements will be due on or before February 28, 2003.

Some examples of payments commonly made to non-residents in respect of services rendered in Canada that are subject to the 15% withholding tax are amounts paid for consulting services, lecturer fees, entertainer fees and fees paid under service contracts.

The non-resident may file an application form, i.e., Form R105, to have the tax waived or reduced. If the application is approved, the CCRA will authorize the respective payer to either not withhold or to withhold at a reduced rate. As such, prior to making payments as described above, the payer should ensure that the recipient is not a non-resident or has a waiver from the CCRA such that the payer is not required to withhold all, or a portion, of the 15% non-resident tax. Payers who fail to withhold without authorization from the CCRA may be assessed tax, penalty and interest.



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