



Facts & Tax

From **Hilborn Ellis Grant LLP**

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Hilborn Ellis Grant LLP
Chartered Accountants
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Year-End Tax Planning

1. Deductibility and Timing of Expenditures

Individuals must make the following expenditures by December 31, 2003, in order to be eligible for 2003 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 2003 eligible RRSP contribution limit is noted on your 2002 personal income tax return assessment notice. You have until February 29, 2004, to make tax-deductible RRSP contributions for the 2003 taxation year. As this date falls on a Sunday, the RRSP contributions may be made by the next business day, i.e., March 1, 2004.

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

Consider carrying forward your RRSP contribution and deducting the contribution in a subsequent year if you expect your marginal tax rate will be higher in that subsequent taxation year than in 2003 (generally will be beneficial if your 2003 year is a low income year).

The maximum addition to your RRSP contribution limit for 2004 and 2005 is \$15,500 and \$16,500, respectively. Therefore, \$86,111 of 2003 earned income and \$91,667 of 2004 earned income is required to reach the maximum for 2004 and 2005, respectively.

Individuals turning age 69 in 2003 must convert their RRSP into cash, an annuity or a Registered Retirement Income Fund (RRIF) by December 31, 2003. Selecting the RRIF or annuity option will require you to be paid a minimum yearly amount starting in 2004. 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 2003 must be reported on T4 statements, which are due on or before February 29, 2004. As this due date falls on a Sunday, the T4 statements may be filed by the next business day, i.e., March 1, 2004.

4. Social Security Clawback

For the 2003 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 \$57,879 and \$28,193, respectively. At income levels of \$94,530 and \$53,440, 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 2000 taxation year were likely taxed at a higher rate than capital gains that will be taxed in the 2003 and subsequent taxation years. If you had taxable capital gains in your 2000 taxation year, 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 the 2000 taxation year may result in greater tax savings than utilizing such capital losses in the 2003 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 2000 taxation year. Note that the final trading date of a Canadian security for settlement in 2003 is December 24, 2003.

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7. Gifts of Qualifying Securities to Charities

Consider donating securities with accrued gains directly to a charitable organization rather than selling the securities and donating the proceeds.

The income inclusion rate for capital gains realized as a result of a gift of qualifying securities to charities is 25%, i.e., one half of the general inclusion rate of 50%. Qualifying securities include shares and debt obligations listed on a prescribed stock exchange, shares of mutual fund corporations and units of mutual fund trusts.

If given the option of donating the cash or an equivalent value of qualifying security, it is more beneficial to donate the security as opposed to donating the cash, as there exists an additional tax savings of 11.6% of the capital gain realized on the disposal of the qualifying securities.

8. 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, 2003.

9. 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, 2003.

10. Health and Dental Premiums for the Self-Employed

Individuals will be allowed to deduct, in computing business income, amounts payable in respect of the 2003 taxation year for Private Health Service Plan Coverage paid for themselves and their family. Some of the conditions that are required to be met in order for the individual to obtain the deduction include:

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

The maximum amount of the deduction that can be claimed by the individual for themselves and their family is limited to \$1,500 per person.

11. Instalment Reminder

If you are required to pay tax instalments for the 2003 taxation year, remember that your final instalment must be paid by December 15, 2003.

Your first instalment for the 2004 taxation year must be paid by March 15, 2004.

12. Pay Interest on Employee Loans before January 30, 2004

If you were provided with 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, 2004, in order to reduce any deemed taxable employment benefit. If the loan was used to purchase an automobile or acquire investments, the amount of the benefit may qualify as deductible interest expense.

Non-Competition Payments

In a recent Federal Court of Appeal case, it was concluded that a payment received by an individual on the sale of shares of a corporation as consideration for a promise not to compete with the corporation would not be taxable. The Federal Court of Appeal held that the individual's right to carry on a business was not "property" and therefore there would be no disposition of property resulting in a capital gain. This decision by the Federal Court of Appeal suggested that a portion of the proceeds received on the disposition of the shares of a business could be received tax-free.

On October 7, 2003, the Department of Finance released a proposed amendment in response to the Federal Court of Appeal decision. Based on the proposed amendment, non-competition payments will be fully taxable to the recipient as ordinary income.

An exception to the income treatment exists where proceeds are receivable by the taxpayer in respect of both, a non-competition payment relating to the business carried on by the corporation, and an arm's length disposition of shares of a corporation. In such cases, the amount of the non-competition payment may be treated as part of the proceeds of disposition of the shares, to the extent that the non-competition covenant contributes to the value of the taxpayer's shares, i.e., the purchaser would have paid less for the shares if the non-competition covenant was not provided.

This treatment only applies to the sale of shares. As such, if the taxpayer chooses to have the corporation sell its business assets, the receipt of a non-competition payment by the taxpayer would be fully taxable to the taxpayer.

With respect to the payer of the non-competition payment, they will be allowed to add the payment to the cost of the shares, or in the case of a business asset acquisition they will be allowed to treat the payment as an eligible capital expenditure.

The above rules will apply to amounts received or receivable after October 7, 2003, other than amounts received before 2005 pursuant to a written agreement made on or before October 7, 2003 between parties dealing at arm's length. As such, if a written agreement was entered into before October 7, 2003, the non-competition payments would be received tax-free.





Loss on Impaired Loans

Where a taxpayer makes an interest-bearing loan to a corporation and the loan subsequently becomes uncollectible, the taxpayer may be permitted to claim a loss for income tax purposes. Where the lending of money does not form part of the taxpayer's normal business activities, the loss realized on the loan should be treated as a capital loss and thus only deductible against capital gains realized.

In order to realize a capital loss, the taxpayer will have to dispose of the loan to an arm's length third party or file an election under the Income Tax Act that deems the taxpayer to have disposed of the loan at the end of the year. However, in order to file such an election, the taxpayer must be able to establish that the full amount of the loan became uncollectible in the year.

It is the Canada Customs and Revenue Agency's (CCRA) view that you must prove that you have exhausted all legal steps to collect the loan before making such an election. Notwithstanding the CCRA's view, a recent Tax Court of Canada case has provided the following comments with regards to when a loan is uncollectible:

- a) it is a matter of the taxpayer's judgement as a prudent business person; and
- b) a bad debt may be claimed after having personally considered the relevant factors and honestly and reasonably determining it to be uncollectible at the end of the fiscal year.

Where the uncollectible loan was made to a small business corporation that became bankrupt or insolvent in the year, the capital loss realized on the loan may qualify as a business investment loss. Fifty percent of the business investment loss (allowable business investment loss) may be deducted against income from all sources. However, your business investment loss is reduced by any previously claimed capital gains exemption. The claiming of business investment losses has come under increased scrutiny by the CCRA. As such, prior to making a claim, proper documentation to substantiate your business investment loss should be obtained, e.g., support for the amount of the loan and support that the corporation is a small business corporation.



Automobile Benefits – Standby Charge

One of the most common taxable benefits that arise for employees is from the personal use of employer owned or leased automobiles. Since the employee, who has a company automobile available for his or her personal use, does not have to spend tax-paid dollars on either purchasing or leasing an automobile, a benefit is being conferred upon the employee. Where the employer owns the automobile, the standby charge benefit to employees is calculated as 2% per month, for each month the employee has use of the automobile, times the automobile's original cost. For a leased automobile, the benefit is equal to two-third's times the monthly lease costs (excluding insurance) times the number of months the employee has use of the automobile.

Prior to the 2003 Federal Budget, the standby charge was reduced where the employee's employment use of the automobile was high, i.e., more than 90% of the usage was for employment purposes and the personal use portion averaged less than 1,000 km per month. The 2003 Federal Budget reduces the standby charge in situations where the employee uses the automobile more than 50% of the time for employment purposes and the personal use portion averages less than 1,667 km per month. This change is less restrictive and provides more employees with the opportunity to reduce their standby charge as compared to the previous 90% employment use requirement.

Employers and employees should consider alternatives that could minimize the standby charge benefit. One method of reducing the standby charge benefit is to have the employee either reimburse the employer for the personal use of the automobile or pay for their own operating expenses. Employees should keep records that detail their daily travel, differentiating those kilometres incurred for employment purposes from those incurred for personal purposes.

Another alternative would require employees to utilize their own automobile for employment purposes and have the employer pay the employee an allowance for their employment use. Where the employee receives an allowance, the amount is required to be included in the employee's income unless it is considered to be reasonable. A reasonable allowance is one that is based solely on the number of kilometres that the automobile is used for employment purposes. Therefore, if an employee receives a combination of a flat rate and reasonable per kilometre rate that covers the "same use" for the automobile, the total combined allowance would be taxable to the employee. However, if the flat rate allowance is not compensating the employee for any of the costs of the automobile covered by the reasonable per kilometre allowance, only the flat rate allowance would be required to be included in the employee's income. The inclusion of an allowance in an employee's income would permit the employee to deduct automobile expenses associated with the use of the automobile for employment purposes.



Quick Tax Facts

Canada Customs and Revenue Agency (CCRA) Lowers the Penalties on Later Payroll Remittances

On June 20, 2003, the CCRA announced that it would be lowering the penalties for employers who voluntarily pay their payroll remittances, but are a few days late.

Starting in July 2003, for employers who make every effort to remit but are late within a few days of the due date, the new revised penalty structure will be: 3% for remittances that are late 3 days or less, 5% for remittances that are 4 or 5 days late, 7% for remittances that are 6 or 7 days late, and 10% for remittances that are 8 or more days late.

There will be no changes to the penalty for failing to deduct or withhold payroll taxes. Employers who fail to remit or pay as required will still be subject to penalties of 10%, or 20% when the failure was made knowingly or under circumstances amounting to gross negligence.

Employment Insurance Premiums – Do you have to pay?

An employer is required to withhold from their employee, Employment Insurance (EI) premiums for each dollar of insurable earnings up to a yearly maximum (for 2003 the maximum annual insurable earnings is \$39,000). However, there are certain types of employment that are not subject to EI premiums. For instance, an employer is not required to withhold EI premiums when the employer employs a person who owns more than 40% of the voting shares issued by the employer.

In addition, an employer is not required to withhold EI premiums from any employee who is related to the employer, unless it is reasonable to assume that a similar employment arrangement would have been negotiated with an unrelated person. Should you have any doubts as to whether or not you should withhold EI premiums when employing family members, a ruling should be requested from the CCRA. If the employment is determined to be exempt from EI, a refund of premiums remitted in the prior three years could be obtained. However, the employee will not be eligible for benefits as a result of that employment.

Attendant Care Expense – Retirement Home

The Canada Customs and Revenue Agency has outlined in a recent Fact Sheet that for the 2002 and subsequent taxation years, they will permit senior citizens, who live in a retirement home and are eligible for the disability tax credit, to claim as a medical expense, the attendant care portion of their retirement residence rent.

According to the Fact Sheet, the attendant care component of the fees paid to a retirement home are the salaries and wages paid to employees of the retirement home who provide: health care, meal preparation, housekeeping services for the resident's personal living space, laundry services for the resident's personal items, social programs, transportation driver and security.

In order to make this claim, you must obtain a receipt from the retirement home disclosing the portion of the fees that were paid for the aforementioned services. In addition, you must be eligible to claim the disability tax credit (a completed Form T2201 must be completed and signed by a medical practitioner if not already done in previous years) for the year in which the claim is being made. For the 2002 taxation year, eligible seniors may request an adjustment to their personal income tax return by filing a T1 Adjustment Request (Form T1 – ADJ).



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