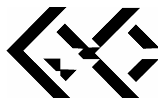

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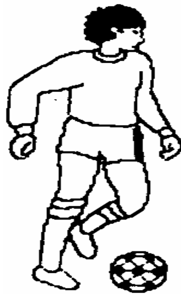
PERSONAL TAX

83(1)

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. (See ***www.cra.gc.ca/whatsnew/checklist-e.html***)

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 ***negoti-***

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ated 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***.

For more information see the ***Canada Child Tax Benefit*** section at ***www.cra.gc.ca***.

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***).

Editor's Comment

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".

EMPLOYMENT INCOME

83(2)

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***.

SUPPLEMENTAL EMPLOYEE RETIREMENT PLANS (SERPs)

Even though a corporation may provide a ***retirement package*** for an ***employee*** through a Registered Pension Plan based on salaries of up to $117,000, persons earning ***more than that*** could also receive a ***SERP***.

If the ***SERP*** is ***funded*** by the ***employer***, this will likely be a ***Retirement Compensation Arrangement*** (***RCA***) and the ***employer*** will be entitled to a ***tax deduction*** however, there will be a ***50% refundable tax*** liability. When the funds are ***paid and taxed*** to the ***employee,*** the 50% is refunded.

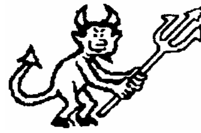
If the ***SERP*** is ***unfunded***, there are ***no tax implications*** other than a ***deduction*** to the ***payor*** and ***taxable income*** to the ***recipient*** when ***paid***.

Some employers/employees have taken advantage of the ***RCA*** rules by paying the amounts to the individual when they become a ***non-resident*** and subject to a much ***lower tax***. ***CRA*** are ***reviewing RCAs*** which are considered to be ***tax avoidance schemes***.

BUSINESS/PROPERTY INCOME

83(3)

GREENHOUSE GAS (GHG) EMISSIONS



In a 2008 ***Government Release,*** CRA notes that given that taxpayers may be required to reduce their ***GHG emissions*** relating to their business operations, CRA expects that ***contributions*** to provincial and federal government funds due to ***regulatory requirements*** will normally be ***tax deductible***. However, if the expenditure provides the taxpayer with ***ongoing benefits*** with a view to bringing into ***existence an asset*** of enduring benefit, the amount may be a ***depreciable property*** or, an ***eligible capital property***.

However, where the payment is a ***fine or penalty*** imposed by a provincial or federal government, the amount would ***not be deductible***. See CRA's ***Income Tax Technical News No. 34*** (www.cra.gc.ca) for general comments regarding ***GHG credits***.

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.

OWNER-MANAGER REMUNERATION

83(4)

DIRECTOR LIABILITY

Case 1 - Not Liable

In a December 21, 2007 General ***Tax Court*** of Canada case, the ***directors*** were ***assessed*** for the outstanding liability for ***GST***, plus interest and penalties, at the time the company was ***struck*** from the Registrar of Companies for failure to file returns.

The taxpayers ***successfully argued*** that they could ***not be assessed*** as they ***ceased to be directors*** of the company more than ***two years*** before the assessment was issued.

Case 2 - Not Liable

In a February 11, 2005 Informal ***Tax Court*** of Canada case, the taxpayers/directors were found ***not to be liable*** for the ***unremitted GST/HST*** at the time the company became bankrupt on the basis that they signed a document ***resigning their directorships*** more than ***two years*** before CRA assessed them in 2002. Therefore, the ***two-year statute of limitations*** was applied.

Case 3 - Not Liable

In a May 22, 2008 Informal ***Tax Court*** of Canada case, the director was found ***not to be liable*** for the ***unremitted source deductions*** because he exercised ***due diligence***.

Case 4 - Not Liable

In a May 26, 2008 General ***Tax Court*** of Canada case, the taxpayer/director was held ***not to be liable*** for the ***unremitted GST*** because of the ***due diligence*** defence including he had ***entrusted the day-to-day operations*** to a ***person*** in whom he had total confidence and he had ***no reason to suspect*** that the GST/HST returns were not being properly made as the company

was making its GST remittances.

In the ***absence of doubt*** it appears ***reasonable to rely*** on the ***manager***, particularly when the company is not experiencing financial difficulties.

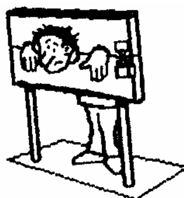
The point at which the ***due diligence*** is expected from a director is ***when he/she has knowledge***, or ***ought to have knowledge***, of the failure to remit, or that the remittances may not be correct. At that point, a ***director must*** take a ***meaningful positive step*** toward preventing the failure.

Case 5 - Not Liable

In a June 2, 2008 General ***Tax Court*** of Canada case, Ms. R was an ***administrator*** of a ***Non-Profit Organization*** and was assessed by CRA for personal liability for the ***unremitted GST*** for the Organization.

The Court accepted that Ms. R exercised the ***degree of care, diligence and skill*** that a reasonably prudent person would have exercised in comparable circumstances to prevent the Organization's failure to remit the net tax owed.

Case 6 - Liable



In a May 22, 2008 ***Tax Court*** of Canada case, the Court found that the taxpayer was ***personally liable*** as a ***director*** for the ***unremitted source deductions*** of his company.

The Court noted that:

1. The taxpayer was an ***inside director***. He did ***not*** establish that he acted in a ***reasonable and prudent manner*** in attempting to prevent the failure with respect to the source deduction remittances.
2. He was the ***sole shareholder and director*** of the corporation. Money that was paid out to other creditors or employees could have been available to reduce the balances owing to CRA. It was a ***conscious decision*** to keep the ***business running*** in hopes that things would improve and that the amounts outstanding to CRA would somehow be paid in the future. These actions ***do not satisfy*** the ***due diligence*** duty.

Case 6 - Liable

In a May 2, 2008 General ***Tax Court*** of Canada case, the taxpayer/director was found to be ***personally liable*** for the ***unremitted source deductions*** on the basis that he was a "***de facto director***". Where a corporation operates without having been properly organized and the only director of record plays no part in running the corporation, those persons who direct the affairs of the company may be held to be ***de facto directors***, whether or not they had explicitly represented themselves as directors to any third party. The ***essential question*** is whether those individuals have, in fact, taken on the ***role of director*** of the corporation.

In this case, the taxpayer ***was aware*** of the unremitted source deductions and, therefore, was ***personally liable*** as a ***de facto director***.

THE FIGHT IS ON

In an April 25, 2008 General ***Tax Court*** of Canada case, ***Mr. F*** was given ***40%*** of the ***equity***, and ***all*** of the ***voting shares***, of his father's corporation (***H***). His two sisters were each given ***30%*** of the ***equity*** by way of ***non-voting shares***.

The two sisters commenced ***litigation*** against their brother (Mr. F) for a lack of financial disclosure, and excessive draws and remuneration taken from the company. Mr. F incurred legal fees of $636,949 which he attempted to deduct as legal expenses incurred for the purpose of either collecting or establishing salary or wages owed.

Taxpayer Loses

The ***Court*** found that the ***legal fees*** were ***not deductible*** because they were not incurred to collect or establish a right to remuneration from ***H***.

The Statement of Claim alleged that most, or all, of the funds inappropriately paid out were received by ***Mr. F's spouse***, which is not surprising because Mr. F testified that he personally had very significant legal exposure as a result of ***H's*** business operation.

However, the Court did agree with Mr. F's request to ***seal*** the ***confidential settlement agreements***.

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.

ESTATE PLANNING

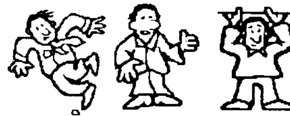
83(5)

FUNDRAISING ACTIVITIES

5-page CRA Guide ***RC4456*** provides information concerning ***fundraising activities*** of ***registered charities*** including prohibitions on fundraising through an ***unrelated business***. Also included is a ***checklist*** for small charities to assess their ***fundraising activities***.

AUDITING CHARITIES

5-page CRA ***Guide T4118*** provides information on ***why*** a charity is ***audited*** including random selection, review of specific legal obligations, follow-up on possible non-compliance or complaints, and to confirm that assets have been distributed after revocation.



The Release also discusses ***how*** an ***audit is conducted*** and ***what happens*** after the audit is concluded.

Also discussed are ***objection and appeal processes*** and the charity's responsibilities such as filing the annual ***T3010A Information Return***, meeting annual ***disbursement quotas***, keeping adequate ***books and records***, issuing accurate donation ***receipts***, engaging only in ***allowable activities***, informing the Charities Directorate of any ***changes*** to the structure, and maintaining the ***charity's status*** as a legal entity.

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.

GST

83(6)

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 ***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***. This was discussed in this Release.

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.