

1999 – Issue #1

Several of you have suggested that a newsletter would be a good addition to the services that my office provides. Well here is our inaugural issue. I would be pleased if you would give us your feed back. **The information contained in this newsletter is general in nature.** If you see something that interests you please call to discuss how it will affect you.

OFFICE NEWS:

New Association

I am very pleased to tell you that a friend of mine, Ted MacCormac, CA, who also practises on the North Shore, and I have agreed to form an association. The primary purpose of this association is to provide back-up in the event that either of us could not carry out our regular practice due to illness, accident or another unforeseen problem.

We will meet from time-to-time to discuss our practices so that we are both familiar with our respective client's business matters. As is always the case, all files are strictly confidential and each of us will respect this confidentiality. A related benefit of this relationship is that it will broaden the services that we can offer to our clients. Our practices are in many ways similar but Ted's practice offers the ability to provide audited financial statements for a business or organization.

We will continue to operate our practices in our separate respective locations. Professional summaries for both of us are attached separately.

Email - a faster way to travel

Please send me an Email, if we have not communicated by Email before, so that I can add your name to my Email list. When ever possible, I plan to use this format for my communications.

Email security is a consideration when dealing with confidential information. At the moment, my current, unsecure, Email address is jbh_ca@jbhaley.com. I will be investigating more secure methods of communication and will advise you when anything changes.

YEAR-END TAX PLANNING

Here are a few **1999 year-end tax planning tips**:

- If you make the following **expenditures** by **December 31, 1999** they will be eligible for 1999 tax deductions: moving expenses, childcare expenses, safety deposit box fees, charitable donations, political contributions and medical expenses.
- **1999 eligible Registered Retirement Savings Plan (RRSP) contribution** amounts are noted on your 1998 **personal income tax return assessment notices**. You have until **February 29, 2000** to make tax deductible RRSP contributions for the 1999 tax year.
- Consider contributing to a **spousal RRSP** to achieve income splitting in the future.
- Persons turning **age 69 in 1999** must **mature** their RRSP into cash, an annuity or a Registered Retirement Income Fund (RRIF) by December 31, 1999. If you are required to **mature** your RRSPs in 1999 and you have additional RRSP contribution room, you should consider making an **excess contribution** by December 31, 1999.
- If you own a business, consider paying a **reasonable salary** to family members for their services rendered to the business.
- If your **1999 net income** exceeds \$53,215 you will lose all, or part, of your **old age security**. Senior citizens will begin to lose their income tax **age credit** if net income exceeds \$25,921.

- If you operate/own a business, you may want to consider the possibility of purchasing assets eligible for **capital cost allowance** before the yearend.
- If you have had taxable capital gains in the **year**, or any of the **preceding three years**, consider selling capital properties with an **underlying capital loss** prior to the yearend. This capital loss may be offset against capital gains in the **year**, or in the **three preceding** years.
- If income from an **inter vivos trust** (such as a family trust) is to be taxed on a beneficiary' s return, the income must be **paid or payable** to the beneficiary by **December 31, 1999**.
- Students may be eligible to claim a non-refundable **federal credit of 17%** on the **interest portion** of student loan payments made in 1999.
- **Registered Education Savings Plan (RESP)**

A new **Canada Education Savings Grant (CESG)** for RESP contributions will be permitted equal to 20% of annual contributions for beneficiaries up to and including age 17 (maximum \$400 per child per year).

However, contributions for 16 and 17 year olds will only qualify for certain previous plans. Therefore, consider establishing a RESP for a 15 year old before the end of the year.

- **Tax on Split Income (dubbed “Kiddie Tax”)**

The **1999 Federal Budget** proposes to apply the **maximum marginal tax rate** to certain passive income of **individuals** under the **age of 18** commencing in the year **2000**.

This includes:

- Taxable **dividends**, and other **shareholder benefits**, on **unlisted shares** of Canadian and foreign companies (received **directly** or through a **trust** or **partnership**); and
- Income from a **partnership or trust** where the income is derived from providing goods or services to a business carried on by a **relative** of the child or, of which the relative participates.

Therefore, consider **maximizing** this type of income in **1999**.

ASSETS HELD/OWNED IN A FOREIGN JURISDICTION

Revenue Canada has introduced the “**Foreign Income Verification Rule**” which requires that taxpayers report **specified foreign assets** costing over \$100,000. **Excluded** is property used exclusively in an **active business**, funds invested in registered **pension plans**, **personal-use** property, and shares in **foreign affiliates**. Where the total cost does not exceed \$100,000, taxpayers will still be required to **include any income** earned from the property.

If you file late, don't file at all and/or under-report your income from a foreign source you could be subject to **penalties**.

Y2K

I hope that everyone has prepared or is preparing for this (computerwise, that is). Prior to December 31, 1999, I **strongly recommend** that you make a point of preparing back-ups of **ALL** your data. You should back-up the data on your computer using a device such as a zip drive, or floppy disks, or off-site electronic storage to mention a few options. Of course back-ups should be a regular event in any case - disasters have occurred and the cost of recreating records, sometimes for full years transactions, is enormous.

CANADA - U.S. SOCIAL SECURITY BENEFIT

This **new** Protocol permits only **the country** where the recipient **lives** to tax the benefits. U.S. Social Security Benefits will be **taxable in Canada**. **Canada** will **include 85%** of the benefits in taxable income. The other

15% will be exempt from tax. The U.S. will stop withholding tax. **U.S. citizens** residing in Canada will only be subject to tax in Canada.

CAPITAL GAIN ATTRIBUTION

The **advantages** of transferring **capital gains** to children are great. Therefore, the transfer should be well **documented**.

Gifts of assets from **parents to children** will result in **attribution on income** (like interest and dividends) but, not generally, on **capital gains**. In some situations, rather than formalizing a Trust to own the assets, the **assets** are simply put "**in trust**" in the child's name.

This may **cause problems** if it is **not in fact a Trust**. A **Trust** requires the three certainties of **intention, property** and **beneficiary**. A Trust should name the beneficiary, the settlor and the trustees.

Caution:

To **avoid attribution**, the trustee and the settlor (person contributing the asset) **should not be the same person**. Also, the Trust Indenture could indicate that the property **will not revert** to the settlor and that the settlor's permission is **not required** to distribute assets to the beneficiary.

1999 REMUNERATION

Some **general guidelines** to follow in **remunerating the owner** of a **Canadian-controlled private corporation** earning "**active business income**" include:

- **Bonus down** active business earnings in excess of \$200,000.
- Salary payments require **source deductions** to be remitted to Revenue Canada on a **timely basis**.
- Individuals that wish to contribute to the Canada Pension Plan or a Registered Retirement Savings Plan may require a salary to create "**earned income**".
- Salaries paid to family members must be **reasonable**.
- **Bona fide dividends** paid on one class of shares, to the **exclusion** of the other, may be accepted based on the recent Supreme Court decision in Neuman vs. H.M.Q..

Revenue Canada as a general practice will **not challenge** the reasonableness of **salaries or bonuses** paid to a principal shareholder who is **active** in the corporation's business.

Revenue Canada may limit this position if bonuses are paid out of a corporation's **investment income, inter-corporate management** fees and remuneration paid to **spouses, other family members** or **non-residents**. Revenue Canada **reserves the right** to require **evidence** that the remuneration is **reasonable**.

SUING REVENUE CANADA (Some good news)

In a **British Columbia Supreme Court** case, Mr. Longley had requested **confirmation** from Revenue Canada that taxpayers could receive a federal **political contribution tax credit** under certain circumstances.

Revenue Canada refused to acknowledge that "**Longley's Loophole**" met the provisions of the Income Tax Act even though the Department of Justice had given an opinion that it **worked technically**. Therefore, Mr. Longley sued Revenue Canada on the basis that this caused damages to him and benefited the federal government in the form of unclaimed tax credits.

Mr. Longley was **awarded damages** from Revenue Canada for **loss of reputation** (\$5,000) and for **punitive damages** (\$50,000) to dissuade Revenue Canada from acting again in such an **arrogant dishonest** way. The Court noted that Revenue Canada must deal, "fairly and openly with all taxpayers and administer the Act in accordance with the law".

PRINCIPAL RESIDENCE EXEMPTION

Revenue Canada recently noted that an individual that has land in **excess of ½ hectare** may still be **eligible** for the **principal residence exemption** if the excess land is **necessary** for the “use and enjoyment” of the residence. This **includes** situations where it was **required by law or regulation** to acquire land that exceeds ½ hectare and, throughout the period, the property is continuously owned by the taxpayer.

QUALIFIED FARM PROPERTY

In a Revenue Canada **Technical Interpretation**, the taxpayer died in 1995 owning a 100 acre piece of farmland that was **rented** to an **arm’s-length farmer**. Previously, the farm was actively farmed in the family since the 1800’ s. The taxpayer died **intestate** (without a will) and it has now been established that the assets were to be left equally to the **children** of the taxpayer.

Revenue Canada note that the property appears to be “**qualified farm property**”, eligible for the **\$500,000 capital gain exemption** and **continues to qualify** after its transfer to the children. The subsequent **income and expenses** from the property should be reported on the children’s **T1 Returns** from the date of death.

THE CHRISTMAS PARTY (aren’t they generous)

Revenue Canada recently noted that it is a **non-taxable benefit** when an employer provides a party or other social event, which is generally available to all employees, if the amount per employee is reasonable. (Revenue Canada uses a **cost of \$100** per person as a guideline.)

Ancillary costs, such as transportation home, may increase the amount considered reasonable.

Happy Holidays to all of you

PROFESSIONAL SUMMARIES

John Haley, CA

John graduated from the University of Montana’s School of Business in 1972. John obtained his CPA (US) designation in 1980 and his CA designation in 1983. He spent more than 11 years with the international firm of Price Waterhouse (now PriceWaterhouse Coopers), in three different countries, before establishing his own firm in 1989. John has a diversified accounting practice serving the accounting and tax needs of owner-managed businesses and in addition he provides personal financial planning and personal tax consultations for his non-corporate clients.

Ted MacCormac, CA

Ted has a B.Comm. degree from UBC (1968) and obtained his CA in 1970. He became a partner in Gardner, McDonald & Co., a small national firm of chartered accountants in 1973 and in Touche Ross & Co (now Deloitte & Touche) in 1981. In 1987, he returned to Vancouver after transfers to Montreal, Ottawa and Edmonton and started his own practice serving audit, accounting and tax needs of owner-managed small- to medium-sized businesses, non-profit organizations and individuals.