



BUCHANAN BARRY LLP
CHARTERED ACCOUNTANTS

TAX NEWSLETTER
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PRIME TIME FOR LOW-INTEREST LOANS TO FAMILY MEMBERS

Under the income attribution rules in the *Income Tax Act*, if you transfer or lend property (including money) to your spouse or minor children or nieces or nephews, you will normally be subject to the income attribution rules. Generally, those rules attribute the income earned on the property to you so that it is included in your income. In the case of a transfer or loan to your spouse, the attribution ceases if you become separated by reason of the breakdown of your marriage or are divorced, or if you cease to be resident in Canada. In the case of transfer or loan to a minor child, the attribution ceases in the year in which the child turns 18 years of age or if you cease to be resident.

The attribution rules obviously negate the benefit of “income splitting”, which otherwise would be beneficial if you were in a higher tax bracket than your spouse or minor child.

There are various exceptions where the rules do not apply. Under one of the most common exceptions, the rules do not apply if you lend money or other property and charge interest at at least the prescribed rate of interest in effect under the *Income Tax Act* at the time of the loan. The annual interest must actually be paid to you in each year of the loan or by January 30 of the following year.

The prescribed rate of interest for such loans is set quarterly. In the current quarter of April 1 through June 30, 2009, the prescribed rate is at an all-time low of 1% (see “Prescribed Interest Rates”, below).

Therefore, if you lend money to your spouse or minor child during this quarter and charge a 1% annual interest rate, the attribution rules do not apply and the investment income earned by them will be included in their income rather than yours. This result will be beneficial if they are in a lower tax bracket than you, which, of course, is why you would engage in this type of income-splitting. You will be required to include the 1% interest in income. They will include the resulting investment income and be allowed to deduct the 1% interest paid to you.

Thus, for example, if you lend money to your spouse and he or she earns a 5% annual return by investing the money, 4% of that return would be effectively taxed to your spouse (5% inclusion, 1% deduction), while you would include the 1% interest. Effectively, this results in the shifting of 4% of the 5% return to your spouse for tax purposes.

Note that the exception will continue to apply to a loan set up during April-June 2009 even if the prescribed rate of interest changes under the Act. That is, as long as



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the 1% interest continues to be paid annually, the attribution rules will not apply. Unfortunately, if even one annual payment is missed, the exception ceases and the attribution rules will kick in.

***MOVING EXPENSES: MEAL
& VEHICLE EXPENSES
& THE “SIMPLIFIED METHOD”***

An individual who moves to carry on a business or employment in a new work location, or to attend post-secondary education on a full-time basis, can normally deduct moving expenses incurred in the course of the move. In order to claim the deduction, among other things, the person’s new residence must be at least 40 kilometres closer to the new work or school location than the person’s old residence.

If you made such a move in 2008, you can generally deduct in computing your 2008 income moving expenses such as vehicle travelling costs incurred in moving you and your household members, and reasonable expenses for meals incurred during the travel. Also eligible for the deduction are the cost of meals and lodging near your old residence or your new residence for up to 15 days (for example, if your new home is not yet ready to be inhabited after you move from the old home, or if you have to move from the old home earlier than your closing date for your new home).

If you wish to claim your actual meal and vehicle travel expenses, you should keep your receipts.

However, you can instead choose to claim your vehicle and meal expenses using the CRA “simplified method”, under which the CRA provides that certain set amounts can

be deducted without receipts. The amounts are published by the CRA annually, and typically change from year to year.

For the 2008 year, for meals there is a deductible flat rate of \$17 per meal, to a maximum of \$51 per person per day without receipts.

For vehicle travel costs, you can claim a flat rate per kilometre driven in the course of the move, without receipts. The flat rate depends on the province from which you moved. For example, if your travel originated in Ontario, the flat rate for 2008 is 55.5 cents per kilometre, for travel from Quebec it is 58 cents, and for travel from Alberta it is 53 cents. The rates for other provinces can be found at www.cra.gc.ca/travelcosts.

CHILD CARE EXPENSES

Child care expenses are generally deductible for income tax purposes if they enable either you or your spouse (or common-law partner) to carry on employment, business, research in connection with a research grant, or to attend secondary or post-secondary school. The child care expenses that qualify include those incurred for baby sitting, day care, nanny care, and boarding school and camp services.

The deduction is subject to certain dollar limits. For example, there is a general restriction that limits the deduction to \$7,000 per child under the age of 7, \$4,000 per child aged 7 through 16, and \$10,000 for a disabled child who is eligible for the disability tax credit.



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There are also thresholds for fees paid to a boarding school or camp. The deductible amount is limited to \$175 per week per child under the age of 7, \$100 per week per child aged 7 to 16, and \$250 per week per disabled child.

The deducted expenses cannot exceed 2/3 of your “earned income” for the year. Earned income includes salary, wages and other remuneration from employment, income from a business, and taxable research grants. In the case of married couples or common-law partners, the deduction must normally be claimed by the lower-income parent for the year.

However, in certain cases the higher-income parent can claim the deduction. For example, the higher-income parent can claim a deduction where the lower-income parent is in full-time attendance at secondary or post-secondary school, incapable of caring for the children because of mental or physical infirmity and confinement for at least two weeks, or in prison for at least two weeks. In any of these situations, although the higher-income parent can claim a deduction, the deductible expenses are limited to \$175 per week (of the lower-income parent’s time in school, infirmity or prison) per child under the age of 7, \$100 per week per child aged 7 to 16, and \$250 per week per disabled child. If the lower-income parent is in part-time attendance in school, the above dollar limits are applied on a monthly basis rather than a weekly basis.

If the higher-income parent claims a deduction, the lower-income parent is still eligible for a deduction, albeit reduced by the amount deducted by the higher-income parent.

Example

Jack and Jill have a 5-year old son. Jack is the higher-income earner and had \$100,000 in earned income for 2008. Jill attended university full-time for 13 weeks during the year and had earned income of \$30,000. During 2008, they paid \$9,000 in baby-sitting fees for the care of their son.

The maximum amount they can deduct for 2008 is the \$7,000 general threshold amount as noted above. Jack can claim \$175 x 13 weeks, or \$2,275. Jill can deduct the remaining \$4,725, since it is less than 2/3 of her earned income for 2008.

If the child care services are provided by an individual (such as a nanny), you must file the appropriate receipts with the CRA and provide the individual’s Social Insurance Number. The child care services can be provided by a relative, other than the other parent of the child (e.g. your spouse) or a person under the age of 18. The individual providing the child care services must be resident in Canada.

PENSION INCOME SPLITTING

Since 2007, married couples and common-law partners have been allowed to split their pension income for income tax purposes. In particular, under the pension income splitting rules, a spouse or common-law partner (pensioner) can effectively transfer to the other spouse or common-law partner (transferee) up to one-half of the pensioner’s income that qualifies for the pension income tax credit. The transferred amount is deducted in computing the



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pensioner's income, and is included in computing the transferee's income.

Although a maximum of one-half of the pension income can be transferred, any amount less than one-half can be transferred, so there is some flexibility.

The pension split is done through a joint election in prescribed form (CRA form T1032), which must be filed with the tax returns of both the pensioner and transferee for the year of the transfer. Note that although the elected amount is "transferred" for tax reporting purposes, there is no requirement that the transferee actually receive the transferred amount. That is, the "transfer" only counts towards the reporting and splitting of income for income tax purposes, and the cash received does not actually have to be split between the spouses.

The pension split is beneficial if the pensioner is otherwise in a higher tax bracket than the transferee, since the transferred amount will be subject to a lower tax rate.

The pension income that can be "split" must be "eligible pension income". For pensioners aged 65 years and over, eligible pension income includes lifetime annuity payments from a registered pension plan, a registered retirement savings plan (RRSP) or a deferred profit-sharing plan (DPSP), and payments from a registered retirement income fund (RRIF). For pensioners under 65, eligible pension income includes only "qualified pension income", which includes lifetime annuity payments under a registered pension plan, and also, if they are received as a consequence of the death of the pensioner's (former) spouse or common-law partner, annuity payments

received under an RRSP or DPSP and payments out of a RRIF, if any.

Each spouse and common-law partner (the pensioner and transferee) is eligible for the pension tax credit in respect of the eligible pension income included in their respective incomes for the year. However, if they are under 65 years old, only the "qualified pension income" described in the latter part of the above paragraph (re: pensioners under 65) qualifies for the pension credit. Up to \$2,000 of eligible pension income (or qualified pension income) per year per person qualifies for the credit, which is a 15% federal credit plus a parallel provincial credit, and is generally equivalent to a deduction at the lowest bracket of tax.

Although the pension income splitting will typically be beneficial for couples who are otherwise in different tax brackets, there are other factors that may come into play. For example, by shifting income to the transferee spouse, the spousal tax credit for the pensioner and the age credit of the transferee may be reduced.

On the other hand, if the pensioner is subject to the old age security (OAS) "claw-back" because his or her income is otherwise over \$66,335 (for 2009), the shifting of pension income to the transferee may reduce or eliminate the pensioner's OAS claw-back.

RRSP LIFELONG LEARNING PLAN

Under the so-called "Lifelong Learning Plan" (LLP) in the *Income Tax Act*, you can withdraw funds from your RRSP on a tax-free basis for the purpose of financing full-time study at a post-secondary educational institution. The funds can also be used to



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fund the education of your spouse or common-law partner.

The maximum amount that can be withdrawn is \$20,000, although you are limited to \$10,000 per calendar year. If you are married or in a common-law relationship, you and your spouse or common-law partner can each withdraw from your RRSPs, for a total of \$40,000.

The amounts withdrawn under the LLP must be repaid to the RRSP over a period not exceeding 10 years, with a minimum of one-tenth of the withdrawals being payable each year or within 60 days after the end of the year. The repayment period begins at the earlier of the second consecutive year in which you (or your spouse or common-law partner) are not enrolled in full-time studies and the fifth year after the first year in which an LLP withdrawal was made.

No interest is payable on the amounts withdrawn under the LLP. When you go to repay the amounts, the repayment is simply made by a contribution to your RRSP, although you must designate in your tax return for the year the amount of the contribution that constitutes the LLP repayment. Unlike regular RRSP contributions, the LLP repayments are not deductible for tax purposes.

If you repay less than the minimum one-tenth amount in a taxation year, the shortfall is included in your income for that year. Conversely, a payment in excess of the minimum amount required in any particular repayment year reduces the amount that must be repaid in subsequent years.

Once you fully repay your LLP balance, you can participate in the LLP again, with a fresh \$20,000 withdrawal limit.

On a final note, you can use the LLP even if you have withdrawn from your RRSP under the "Home Buyer's Plan", the latter of which allows you to withdraw up to \$25,000 tax-free from your RRSP to purchase a home (for withdrawals before January 28, 2009, the limit was \$20,000). In other words, you can use both the Home Buyer's Plan and the LLP program at the same time.

RETROACTIVE LUMP SUM PAYMENTS

The *Income Tax Act* has special rules applicable to retroactive lump sum payments, which include certain payments received in one taxation year that relate to one or more previous taxation years (and as described below). The rules are meant to be beneficial if the payment relates to several previous years and would otherwise lead to the "bunching" of income if it was included in the year of receipt and therefore subject to higher rates of tax owing to the progressive nature of the income tax system.

For example, if you are normally in a low tax bracket and receive a significant lump sum payment that relates to ten previous taxation years, the spreading out of the taxation of the payment over those ten years presumably would have resulted in less tax relative to the tax in the year of receipt, since the inclusion of the lump sum in the year of receipt likely would push you into a higher tax bracket.

The rules apply to a lump sum payment that relates to previous years and that is any of:





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- wages or salary or other income from employment, or damages in respect of the loss of an employment, that is received pursuant to a court order or judgment or out-of court settlement (this includes Pay Equity adjustments);
- an amount on account of past pension benefits that otherwise would have been received on a periodic basis;
- a spousal support payment;
- an employment insurance benefit; or
- a benefit under a wage loss replacement or disability insurance plan.

Under the lump-sum rules, you can choose to have the lump sum payment taxed as if it were included in the previous years to which it relates, rather than having it taxed as if it was fully included in the year of receipt. You can file CRA form T1198 with your tax return for the year in which you receive the payment, and the CRA will perform the necessary calculations to determine whether the rules are beneficial.

The retroactive lump sum rules apply only if the lump sum received in a year is \$3,000 or more (excluding any interest element). The rules apply to amounts received after 1994 relating to years as far back as 1978.

PRESCRIBED INTEREST RATES

The CRA has announced the prescribed annual interest rates for the April 1 to June 30, 2009 quarter:

- The interest rate charged on overdue taxes, Canada Pension Plan contributions, and Employment Insurance premiums is 5% compounded daily.
- The interest rate paid on late refunds paid by the CRA is 3%, compounded daily.

- The rate used to calculate taxable benefits for employees and shareholders from interest-free and low-interest loans is 1%.

AROUND THE COURTS

Moving expenses allowed in respect of switch from part-time to full time employment

Under the Income Tax Act, you are generally allowed to deduct your moving expenses if the move is made to enable you to carry on a business or to be employed at a location (referred to in the Act as “the new work location”). Among other requirements, you must move at least 40 kilometres closer to the new work location. Typically, the expenses are allowed if you move for a new job with a new employer or to a different location with the same employer. However, in the recent *Gelinas* case, the taxpayer was allowed to deduct her moving expenses even though she remained with the same employer at the same building.

The taxpayer had been a part-time nurse at a hospital in Oshawa, Ontario, working two shifts a week. She decided to apply for a full-time position in the same hospital but in a different department and on a different floor. She got the full-time position, and decided to move closer to the hospital since she would now be driving to work five days a week.

Initially, the CRA had disallowed the moving expense deduction, ruling that she was not moving to enable her to work at a new work location, since she was already employed at the hospital. However, the Tax Court of Canada held otherwise. The Court found that the taxpayer’s new full-time position was sufficiently different from the old part-time position, such that it could be said that the





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move enabled her to carry on the new job. The Court was of the view that even though both positions were at the same hospital, the move was necessitated by the significant difference in her work circumstances. Therefore, her moving expenses were deductible.

Settlement payment included in income under “surrogatum principle”

In general terms, under the “surrogatum principle”, the income tax treatment of an amount received as a settlement or on account of damages depends on what it is replacing. If the payment compensates for an amount that would have been income, it is taxable as income.

In the recent *Goff Construction* case, a firm purchased some land from the taxpayer company, but on the condition that it could be re-zoned. The initial zoning application was rejected, and the purchaser, through its law firm, appealed the application to the Ontario Municipal Board (OMB). That appeal was unsuccessful, and the OMB held the purchaser and taxpayer jointly and severally liable for costs in the amount of \$1.35 million (the “OMB liability”). The taxpayer appealed to have its portion of the OMB liability reduced, and it was successful. The taxpayer incurred significant legal expenses in doing so.

The taxpayer then sued the purchaser’s law firm for its conduct at the initial proceeding before the OMB. The parties settled out of court, and the law firm paid the taxpayer \$400,000 in damages. The issue in the case was whether the settlement payment was included in the taxpayer’s income under the surrogatum principle.

The Court found that pursuant to the surrogatum principle, the tax treatment of the settlement payment was to be determined by reference to the tax treatment of the legal expenses. Since the legal expenses were deducted in computing the taxpayer’s income, the settlement payment was included in the taxpayer’s income.

Buchanan Barry LLP has served the Calgary business and non-profit community since 1960. We are a full-service chartered accounting firm providing accounting, audit, assurance, advisory, tax and valuation services to clients in the oil and gas sector, the service industry, real estate, the retail and wholesale trade, the manufacturing industry, agriculture, the non-profit sector and professionals.

Should you have any questions regarding the foregoing or other tax matters, please do not hesitate to contact members of our tax group at (403) 262-2116.

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This letter summarizes recent tax developments and tax planning opportunities. We recommend that you consult with an expert before embarking on any of the opportunities in this letter, which may not be appropriate to your own specific circumstances.