



BUCHANAN BARRY LLP
CHARTERED ACCOUNTANTS

TAX NEWSLETTER
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FEDERAL BUDGET HIGHLIGHTS

The recent federal budget has since been enacted into law. We went over the bulk of the highlights in our last Newsletter, but here are some of the more relevant items in greater detail :

- The **basic personal amount**, spousal amount and age credit have been increased for 2009. This means a larger basic credit. The first \$10,320 of each person’s taxable income (after all deductions) is now tax-free; for seniors, a further \$6,408 is also tax-free.
- The lowest two **tax brackets** have been increased for 2009. The lowest bracket (15% federal tax, plus provincial tax) now applies to the first \$40,726 of taxable income, and the second bracket (22% plus provincial tax) applies to taxable income from \$40,727 to \$81,452. This will make income splitting between spouses even more attractive than before.
- The **small business income** limit, for Canadian-controlled private corporations’

active business income, has been increased from \$400,000 to **\$500,000**. This is now the level of such income that is subject to the low small business rate of corporate income tax (11% federally, plus a very low provincial rate in most provinces). (The small business rate is phased out for large corporations that have over \$10 million of “taxable capital”.)

- The Home Buyers’ Plan permits you to borrow funds temporarily from your RRSP tax-free to invest in buying a house, if neither you nor your spouse has owned a home in the past five calendar years. The limit on such withdrawals has been increased from \$20,000 to \$25,000 per person.
- A new **Home Renovation Tax Credit** is available, as a 15% federal credit for renovation costs in excess of \$1,000 and up to \$10,000. The maximum credit is thus \$1,350 (15% of \$9,000). The renovations must be contracted for after January 27, 2009, and the work must be done (or goods acquired) after January 27, 2009 and before February 1, 2010.
- A new **First-Time Home Buyer’s Tax Credit** is available, as a \$750 federal credit (15% of \$5,000). Again, this will increase in value to the extent the provinces copy it. To qualify, neither spouse may have owned a home in the previous five calendar years. Exact details are not yet available, as draft legislation has not yet been released to implement this credit.
- If you are in business (whether personally or through a corporation), a **100% capital cost allowance deduction for computers and**



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software will be allowed for purchases from January 28, 2009 through January 31, 2011 — in other words, a full writeoff from income. (Software was already allowed at a 100% rate, but due to the “first-year rule” only half could be claimed in the year of purchase. Computers were previously at a 55% rate, also subject to the first-year rule.)

- After death, RRSP and RRIF funds are generally included in the deceased’s income (unless transferred to a spouse or other qualifying relative). Where this happens, the value of the RRSP or RRIF may have dropped by the time the securities are sold and paid out to the estate. A new rule will allow **losses in the RRSP or RRIF after death** to be carried back and deducted against the income of the deceased, provided the final payout is completed by December 31 of the year after death. This is clearly a response to the severe drop in the markets in 2008.

The legislation in Bill C-10 to implement this rule allows a deduction on the deceased’s final return from the “fair market value” to the actual amount *received* from the RRSP or RRIF. Quite apart from any losses incurred, this appears to **allow a deduction for commissions paid by the RRSP to sell the securities** after death.

One thing not found in the Budget was a change to the RRSP age limit, which is currently 71. That is, by the end of the year in which you (or your younger spouse or common-law partner) turn 71, you are required to wind up your RRSP and withdraw the cash, turn it into an annuity or convert it into a RRIF (Registered Retirement

Income Fund). Quebec proposed in its November 3, 2008 Economic Update to raise this age limit to 73 for Quebec provincial tax purposes if the federal government would do the same for federal tax purposes. However, the federal government did not bite, so the limit will stay at 71 for now.

DID YOU HAVE U.S. SOURCE INCOME IN 2008?

If you had income from sources in the United States in 2008, consider what **exchange rate** to use for reporting that income. This is particularly important for 2008 because of the wild swings in exchange rates during the year.

One acceptable method is to use the official average exchange rate for the year. For 2008, this was **C\$1.0660** to the U.S. dollar.

However, depending on when in 2008 your income was earned (generally the invoice date for self-employment income, or the date of receipt for employment income or investment income), the applicable rates could be very different. For example, on February 28, 2008 the U.S. dollar was worth only \$0.9719 Canadian, while on December 5, 2008 it was \$1.2969 Canadian.

EMPLOYER-PROVIDED PARKING

As you probably know, most benefits provided by employers to employees are taxable. If you are the employee, the value of the benefit is reported on your T4 and included in your income for tax purposes. There are a significant number of exceptions, however.



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What about **parking** provided by an employer?

The Canada Revenue Agency's view is that parking is not a taxable benefit if it is provided to benefit the employer. The Courts have ruled in a number of cases that an employee who needed their vehicle for employment purposes (e.g. to go out on regular service calls, or to be available outside normal work hours) did not have a taxable benefit from parking.

Also, the value of the benefit from parking will depend on its fair market value. If free parking is available to the public at the employment location (e.g. a shopping centre), then the parking provided to employees is not a taxable benefit. If only "scramble" parking is provided (i.e., not enough space for all employees, first-come, first-serve), the benefit will not be taxable. Parking on gravelled lots has been held to be of lower value than paid parking.

"ZAPPER" SOFTWARE

If you are in the restaurant business or another cash-heavy retail business, be very wary of obtaining or using "zapper" software. This is software that **deletes a portion of sales from an electronic cash register**, so that the business appears to have less revenue than it actually does.

In Quebec, it is illegal to own such software, and Revenu Québec (RQ) is prosecuting businesses that are found with it.

Both the Canada Revenue Agency (CRA) and RQ are engaged in audit projects to find the use of zapper software.

In one project reported in a Quebec Superior Court case in 2008 (*Weinstein & Gavino Fabrique*), RQ selected 234 restaurants at random. In each case, an auditor would eat 10 meals in the restaurant over a period of time and pay cash, keeping a copy of the receipt (or photographing it in the washroom if the waiter wanted the receipt returned). After this process was complete, the auditor and an RQ computer specialist would come to the restaurant and demand to make a copy of the restaurant's computer databases that recorded its sales. The object was to then search the databases for the 10 meals to determine whether they had been reported. The Court held that this was an acceptable method for auditing the business.

In December 2008, the CRA issued the following "Tax Alert":

Businesses warned against using tax cheating software

The Canada Revenue Agency (CRA) is aware that electronic sales suppression software is currently being marketed and sold to Canadian businesses. Business owners are reminded that hiding income to evade taxes is against the law. Using this software is not worth the risk.

Electronic sales suppression software is designed to work with point-of-sale systems and electronic cash registers. Businesses use the software to delete a portion of sales from their computer records to evade payment of income and sales taxes. In some cases, restaurant owners who suppressed sales using this software have collected



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taxes from patrons and not remitted them to the CRA as required by law.

The CRA has over 5,000 employees dedicated to finding unreported business income and ensuring that the proper amount of taxes is paid, even when sales records are missing.

The CRA is working to identify those who develop, sell, or use the software. Businesses that have used electronic sales suppression software are suspected of having hidden thousands of transactions and millions of dollars in sales. Once caught, these tax cheaters will face penalties, court fines, and possibly even jail. They will also have to pay the taxes they tried to evade, plus interest.

If you have been using electronic sales suppression software and wish to come forward, you can do so through the CRA's Voluntary Disclosures Program. If you make a full disclosure before any compliance action or investigation is started, you may only have to pay the taxes owing plus interest, and you will not face penalties or prosecution in the courts. For more information on the program, go to: cra.gc.ca/voluntarydisclosures.

If your business has been contacted about electronic sales suppression software, or you have information which could help the CRA identify those who develop, sell, or use the software, you are encouraged to report them. Go to cra.gc.ca/investigations and select Contact Us to find contact information for your local Enforcement Division.

***APPLY FOR INTEREST
RELIEF WITHIN 10 YEARS***

If you are engaged in a long-term dispute with the CRA — such as a tax shelter or other dispute that is winding its way through a slow audit, objection and appeal process — you should be aware of the “10-year” rule for waivers of interest and penalty.

Frequently the CRA delays making a decision on a file, during the audit or objection stage, for several years. This may happen because the matter has been referred to Headquarters, which takes its time reaching decisions, or because the CRA is waiting for a test case to work its way through the Courts before deciding how to deal with other taxpayers in a similar situation.

When there have been delays due to CRA inaction, you have a good case for requesting a waiver of interest (and in some cases, penalties) under the “Taxpayer Relief” (formerly called “Fairness”) provisions of the Income Tax Act. If you end up having to pay at least part of the reassessment, and you did not pay until the matter was finally resolved, there may be a substantial amount of interest which the CRA will be willing to waive under its Taxpayer Relief guidelines (for the guidelines, search for IC 07-1 on cra.gc.ca).

The danger is that a new rule that took effect in 2005 **prohibits waiver of interest and penalty unless you request it within 10 years** of the taxation year in question.

Consider the following timeline, which is not at all unusual:



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George is audited in 1999 for credits claimed on his 1996 return. He makes submissions to the auditor in 1999. The auditor does nothing until 2002 (waiting for direction from Ottawa) other than obtain a waiver of the limitation period, then issues a reassessment. George files a Notice of Objection in 2002, and the CRA does nothing until 2007 (waiting for related Court cases), then confirms the reassessment. George appeals to the Tax Court of Canada, and loses in 2009.

One month after the Court decision, George applies to the CRA to cancel some of the accrued interest because of the CRA's delays at the audit and objection stages.

The CRA will take the position that it is not legally permitted to waive *any* interest, because the original taxation year was more than 10 years back.

To avoid this problem, George would have had to apply for the waiver of interest by December 31, 2006, even though his case was not yet resolved.

So, if you are in a long-term dispute for a taxation year that precedes 1999, you're already too late to apply for interest relief, unless you or your representative have already done so.

If you have a dispute for any year from 1999 forward, it would be a good idea to apply for Taxpayer Relief now, so that you are protected in the event the final resolution of the case takes more than 10 years from the taxation year and you find yourself wanting to ask for interest waiver down the road. If you're involved in a tax shelter that is under

dispute, check your correspondence from the representatives who are handling your objection or appeal; if you don't see that they had requested waiver of interest on your behalf, ask them about this issue.

UNWINDING INCOME TRUSTS

As you know if you have been investing for more than a couple of years, the Government introduced a tax on distributions from income trusts on October 31, 2006. The object of these changes was to put income trusts on the same footing as regular corporations, which pay tax on the income that they then distribute as dividends. The tax advantages of flowing income through a trust were warping the market, and many large corporations had either become income trusts or were in the process of doing so.

The changes were generally postponed to January 2011 for existing income trusts, provided they do not grow too much.

Once 2011 arrives, there will be no tax advantage to income trusts staying as trusts, and there will generally be a disadvantage, because the trust structure only works when most of the trust's income is paid out to investors on an ongoing basis. We will thus see most of Canada's income trusts "unwinding" themselves over the next two years.

The Department of Finance recently introduced draft legislation to allow this "unwinding" to happen without adverse tax consequences. This legislation, first released in July 2008, is included in Bill C-10, the "Budget" bill mentioned in the first article of this issue.



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The “unwinding” can be done in one of several different ways, depending on the structure of the income trust and its needs. One will be for the investors to transfer their trust units into a corporation in exchange for shares of the corporation. If this happens, your trust units will effectively be converted to shares of a corporation. (Similar rules will be available for publicly-traded partnerships, which are also generally subject to the new rules in 2011.)

Another mechanism will involve the income trust transferring its assets out to beneficiaries, again on a tax-free basis. If the income trust owns the shares of an operating corporation, this could be used to have the trust transfer those shares out to you as investor. Again, from a practical point of view, your income trust units would be replaced by shares of a corporation.

Watch for these developments over the next two years. If they are planned properly, there should not be any negative tax consequences to you from these “trust to corporation” conversions.

FINDING THE LAW

Do you ever want to look up and read legislation (passed by Parliament or a provincial legislature), or Court cases that you have read about? Here is a useful and free Web site to know about: www.canlii.org.

CanLII is the **Canadian Legal Information Institute**, a project of Canada’s law societies. It provides free and very efficient access to virtually all of Canada’s legislation, regulations and case law. You can search by title or case name, or search the full text of all the documents or a subset of them.

Of course, if you are trying to read complex legislation such as the Income Tax Act, it is hard to read on its own without the annotations and explanations that are provided by the publishers of the commercial editions.

AROUND THE COURTS

Taxpayer allowed to claim loss incurred but not reported in statute-barred year

The Tax Court of Canada recently allowed a loss claim carryforward, in unusual but very interesting circumstances, in the case of *Leola Purdy Sons Ltd.*, decided in January 2009.

The company in question had engaged in substantial buying and selling of securities, and had reported its gains and losses as “capital gains” and “capital losses” for several years. Capital gains, of course, are only half-taxed. Capital losses are only half deductible, and only against capital gains, so they are often of limited use.

The CRA audited the company’s 2002 taxation year, in which it had reported substantial capital gains. The auditor decided that the level of trading meant that the company was really in the business of buying and selling securities, and so its gains were **income gains, not capital gains** (and thus were fully taxable instead of only half taxable).

The company appealed to the Tax Court of Canada. It did not dispute that its gains and losses for 2002 were income gains. Instead, it argued that the same was true for 1998, and it had substantial losses from trading in securities from its 1998 taxation year, which it had reported as capital losses. The



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company sought to carry forward those losses from 1998 and claim them against the 2002 income gains.

Now, the 1998 taxation year was “statute-barred”. That is, the company could no longer appeal its 1998 assessment. However, it was not appealing its 1998 assessment. Instead it was recharacterizing its 1998 loss as a business loss, and **using the 1998 loss in 2002** as a carryforward.

The Tax Court allowed the company’s appeal, and permitted the loss carryforward. Even though the 1998 year could no longer be appealed, the loss created in 1998 was simply a balance that *could* be carried forward and used.

This decision offers interesting planning opportunities for individuals or companies that may have had losses in past years. The carryforward limit for business losses incurred in taxation years ending before March 23, 2004 was 7 years, but this was increased to 10 years, and now 20 years for losses incurred in taxation years ending after 2005. This means that if you are able to go back through your records and conclude that there was actually a business loss in, say, 2006, this amount could be claimed in any year up to 2026, even if it was not reported as a business loss at the time.

Of course, in any given case the taxpayer will have to justify the loss and will have to have kept adequate records to prove the loss. Nevertheless, the *Leola Purdy Sons* case will be a useful tool for some taxpayers in the future.

IT’S TAX TIME AGAIN!

Buchanan Barry LLP provides its personal tax clients with a Personal Tax Organizer. Our 2008 Tax Organizer was sent out in early March. If you haven’t received yours, please let us know.

Once you have your tax information assembled, please get it into us as soon as possible.

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.