



Periodic Information Newsletter

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In lieu of Holiday Cards, this year Baratz Judelman, Chartered Accountants has decided to donate to the following charities: Canadian Cancer Society, The Hospital for Sick Kids and The Daily Bread Food Bank.

The partners and staff of Baratz Judelman take this opportunity to extend to you and your family best wishes for the Holiday Season and health, happiness and prosperity.



YEAR-END TAX PLANNING

1. If the following **expenditures** are made by **individuals** by **December 31, 2007** they will be eligible for 2007 tax deductions: moving expenses, child care expenses, safety deposit box fees, charitable donations, political contributions, medical expenses, and alimony.
2. **2007 eligible Registered Retirement Savings Plan (RRSP) contribution** amounts are noted on the 2006 **personal income tax return assessment notices**. You have until **February 29, 2008** to make tax deductible RRSP contributions for the 2007 year.

Consider contributing to a **spousal RRSP** to achieve income splitting in the future.
3. The 2007 Budget changed the **RRSP conversion age** from **69 to age 71** for 2007. **Special rules** apply to persons age 69 or 70 who have already converted their RRSPs to an annuity or a Registered Retirement Income Fund.
4. If you own a business, consider paying a **reasonable salary** to family members for services rendered to the business.
5. An individual whose **2007 net income** exceeds \$63,511 will lose all, or part, of their **old age security**.

Senior citizens will begin to lose their income tax **age credit** if net income exceeds **\$30,936**.

Contact your professional advisors for assistance in **managing** personal income.
6. Consider purchasing assets eligible for **capital cost allowance** before the year-end.
7. If you 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 year-end. This capital loss may be offset against the capital gains. Any repurchase of investments must be made after 30 days in order for the tax loss to be valid.
8. **Registered Education Savings Plan (RESP)**

A **Canada Education Savings Grant (CESG)** for RESP contributions will be permitted equal to 20% of annual contributions for children (maximum \$500 per child per year).

The **\$4,000** annual RESP **contribution** limit has been **eliminated** and the **lifetime** limit has been increased to **\$50,000** from \$42,000. With this change, consideration should be given to the benefits of making larger contributions early and generating tax-free earnings versus losing some of the government grants which are subject to annual limits.
9. **Health and dental premiums for the self-employed**

Individuals will be allowed to **deduct** amounts payable in respect of the year for **Private Health Service Plan** coverage in computing **business income** provided they meet certain criteria.

10. Tax on Split Income

The Income Tax Act applies the **maximum marginal tax rate** to certain **passive** income of **individuals** under the **age of 18**. Therefore, consider **minimizing** this type of income.

11. A **refund of Employment Insurance** paid for non-arm's length employees **may** be available upon application to CRA.
12. Taxpayers that receive "**eligible**" dividends from private and public corporations will have a significantly lower tax rate on the dividends. **Notification** from the corporation to the shareholder is required at the time that the dividend is paid.
13. Eligible **public transit passes** will be entitled to a tax credit.
14. A **\$500 fitness tax credit** for children under 16 enrolled in certain organized sports will be available commencing in 2007.



2007 REMUNERATION

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

1. **Bonusing down** active business earnings in excess of the **annual business limit** may reduce the **overall tax**. However, leaving corporate **active business income** over this amount presents a **tax deferral**. The **disadvantage** of the additional tax on dividends has been significantly **reduced** or **reversed** with the new **lower tax rates** on "**eligible**" dividends.

Professional advice is needed in this area.

2. **Notification** must be made to the shareholders when an "**eligible**" dividend is paid - usually in the form of a **letter dated** on the date of the **dividend declaration**. If all **shareholders** are **directors**, the **notification** may be made in the **Directors' Minutes**.

Please contact your **professional advisor** for advice before paying an **eligible** or **ineligible** dividend.

3. Elect to pay out tax-free "**capital dividend account**" dividends.
4. Consider paying dividends to obtain a refund of "**refundable dividend tax on hand**".
5. Corporate earnings in excess of personal requirements could be left in the company to obtain a **tax deferral**. The effect on the "**Qualified Small Business Corporation**" status should be reviewed before selling the shares.
6. **Dividends**, as opposed to salaries, will reduce an individual's **cumulative net investment loss** balance thereby providing greater access to the **capital gain exemption**.

7. Excessive **personal income** affects receipts subject to **clawbacks**, such as **old age security**, the **age credit**, **child tax benefits**, and **GST credits**.
8. Salary payments require **source deductions** to be remitted to Canada Revenue Agency (CRA) on a timely basis.
9. Individuals that wish to contribute to the Canada Pension Plan or a Registered Retirement Savings Plan may require a **salary** to create "**earned income**".
10. **Salaries** paid to family members must be **reasonable**.



PERSONAL TAX RETURNS

SCHOLARSHIP/FELLOWSHIP EXEMPTION

Canada Revenue Agency notes that the Income Tax Act **fully exempts** income received as a "**scholarship, fellowship or bursary**" where the income is connected to the individual's enrollment at a **designated education institution**.

For a **university outside Canada** to be a "**designated educational institution**" it must be "a university... at which the individual... was enrolled in a course, of **not less than thirteen consecutive weeks** duration, leading to a degree".



ESTATE PLANNING

PENSION SPLITTING

The Income Tax Act permits **spouses** (or common-law **partners**) to **split** "**eligible pension income**" commencing in 2007.

Advantages include **shifting income** to a lower tax bracket spouse, reducing or eliminating the "clawback" of **Old Age Security**, reducing or eliminating the "clawback" of the **age amount credit** and, additional access to the **\$2,000 pension credit**.

CANADA PENSION PLAN (CPP) COLLECTED EARLY

To qualify for **CPP early** the person must be at least **age 60** and either have **stopped working** or **earned less** than the current monthly maximum CPP benefit in the month the **pension begins** and the **prior month**.

For example, if a person turned 60 in November, 2007, the first CPP cheque could come in December, the month after you turn 60. (Service Canada recommends that you **apply for** your pension **six months before** you wish the CPP to begin.) In this example, the taxpayer could go back to work in January, 2008 and, CPP would not apply on any of the future earnings.



When taking CPP early the amounts are reduced by **one-half of 1% per month**. For example, by taking the CPP five years early the CPP payments would be **30% less** than that which would have been received at age 65 (6% per year times 5 years = 30%).



OTHER RECENT DEVELOPMENTS

Basic personal amount increased from \$8,929 to \$9,600 retroactive to January 1st, 2007 (January 1st, 2009 - \$10,100).

Spouse and equivalent to spouse amounts to be equal to basic personal amount effective January 1st, 2007.

GST reduced to 5% from 6% effective January 1st, 2008 (HST 14% to 13%).

Lowest personal federal tax rate reduced to 15% from 15.5% January 1st, 2007.

Non-refundable child tax credit for 2007 calculated as \$2,000 per child under 18 on December 31st, multiplied by the lowest personal tax rate.

Capital gains exemption on qualified small business corporation shares increases to \$750,000 from \$500,000 for dispositions on or after March 19th, 2007.

Changes to capital cost allowance rates effective March 19th, 2007:

- Computer equipment from 45% to 55%.
- Buildings used for manufacturing and processing from 4% to 10%
- Manufacturing and processing equipments purchased before 2009 from 30% declining balance to 50% straight-line, ie: year 1 - 25%, year 2 - 50%, year 3 - 25%.



EMPLOYEE OR SELF-EMPLOYED - RC4110

New **CRA** Guide **RC4110** includes information on determining **employer/employee versus independent contractor** status. This is important because of the **significant trend** for employers to engage **independent contractors**, as opposed to employees, to save on payroll costs such as Employment Insurance (**EI**), Canada Pension Plan (**CPP**), and vacation pay. Recipients initially may be in

favour of this status to **avoid source deductions** and to access **deductions** available to self-employed people but, this **may change** if they are **laid off** and they wish to **claim EI**.

Problems

There is significant **down-side** to a business that engages **independent contractors** who are subsequently determined by CRA to be **employees**. CRA may **assess** the payor for CPP and EI causing significant financial hardship to the business. Also, certain **expenses** of the recipient may be **disallowed**. Therefore, it is essential to ensure that the relationship meets these CRA Guidelines.



BUSINESS/PROPERTY INCOME

CONDOMINIUM RENTAL LOSSES

In a March 2, 2007 **Tax Court** of Canada case, the taxpayer incurred **rental losses** on a **luxury condominium property** in Whistler, British Columbia of \$16,247, \$37,156 and \$27,177 in the years 2001, 2002 and 2003.

Taxpayer Loses

The Court **disallowed a deduction** for the **losses** and noted that:

1. The taxpayer and his family had **significant personal use** of the condominium for recreational purposes. Therefore, the taxpayer must show a **commercial manner** for it to be considered a **source of income**.
2. There was **little evidence** respecting the ability to show a **profit**.

The property was purchased for \$1.3 million and financed with a \$900,000 mortgage. The Appellant recognized that he would have had to **reduce the interest expense** to make a profit but, had been unable to do so.

No analysis was done by the Appellant with respect to the property's potential to earn a profit other than a "back-of-the-envelope kind of thing".