The actual formula begins with the number of years of employment prior to 1989, and reduces this by the "equivalent number of years" that the employee was a vested member of a pension plan or DPSP.

The equivalent number of years is equal to the number of calendar years for which the employer made a plan contribution, times the vested portion at the time the retiring allowance is paid. A partial year of employer contributions is counted as one year. However, because of the "vested portion" formula, the equivalent number of years can be fractional.

A third issue that must be considered relates to the years of service: the years are in respect of service with the employer and any related employers. Employers would be considered related if one is controlled by the other or both are controlled by the same person or group of persons.

Another consideration often overlooked is that the eligible amount can be transferred to an RRSP directly or indirectly. An employer can submit the eligible amount directly to the taxpayer's RRSP. (A retiring allowance cannot be transferred to a spousal RRSP.) If a direct transfer is utilized, then the taxpayer can avoid salary withholding tax on the amount transferred.

Alternatively, the taxpayer may receive the funds directly (less withholding taxes) and later decide to make a transfer to an RRSP. Such a transfer must be made in the same year as the receipt of the retiring allowance, or within 60 days following the end of that year. The taxpayer should be able to recover some or all of the taxes withheld when filing his or her tax return and claiming the appropriate deduction for the amount transferred to an RRSP.

Remember that this transfer and deduction is over and above the regular RRSP contribution limit.

I/R 5401.06

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TAXATION OF SEGREGATED FUND POLICY GUARANTEES

One of the primary advantages a segregated fund policy has over a mutual fund investment is its ability to guarantee the return of capital. Many segregated fund policies guarantee the full or partial return of capital upon maturity and death.

The owner of a segregated fund policy who receives a payment under the guarantee will have income tax consequences. The receipt of such a payment is considered to be proceeds of disposition. The capital gain produced will generally offset all or part of the owner's accrued capital loss when the guarantee is honoured at the time the segregated fund policy is surrendered.

The following chart shows some possible income tax implications to Albert, the owner of a non-registered segregated fund policy.

Consider scenario A where Albert makes an initial deposit of $10,000 to a non-registered segregated fund policy and later, when the guarantee is triggered, the market value of the policy is $8,000. The payout is comprised of the market value of the funds ($8,000) plus the guarantee payment of $2,000, resulting in proceeds of disposition that equal $10,000. Since Albert's original contribution was $10,000 and he has not had taxable income or withdrawals from the policy, the result is a zero tax liability.

In scenario B, if Albert had reported income of $1,000 while he owned the segregated fund policy, the result would have been an adjusted cost base (ACB) of $11,000 ($10,000 + $1,000) compared with the proceeds of disposition of $10,000. The guarantee payment of $2,000 reduces Albert's accrued capital loss of $3,000, leaving a capital loss equal to the $1,000 of allocated income. Similarly, in scenario C, the ACB and accrued capital losses are

		Scenario A ($)	Scenario B ($)	Scenario C ($)
Purchase price	1	10,000	10,000	10,000
Allocated income	2	zero	1,000	2,000
Current value	3	8,000	8,000	8,000
Accrued capital loss (1+2-3)	4	2,000	3,000	4,000
Guarantee payment (1-3)	5	2,000	2,000	2,000
Proceeds of disposition (3+5)	6	10,000	10,000	10,000
ACB (1+2)	7	10,000	11,000	12,000
Capital loss (7-6)	8	zero	1,000	2,000

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higher but the guarantee payment still reduces the accrued capital loss down to the level of allocated income.

While the receipt of a guarantee payment will have income tax implications, the result may simply be the reduction of an accrued capital loss. However, this is not always the case.

The scenarios outlined here represent the basic principles only. There will be differences in tax reporting between guarantee payments made directly to policyholders and those used to purchase additional units. Tax reporting details will depend on whether the timing of the guarantee payment and of the redemption of units coincides. And tax reporting for capital gains and capital losses may be separate even where the amounts offset each other.

I/R 7401.044

HOME OFFICE EXPENSES

Taxpayers are allowed to deduct certain expenses related to home workspaces. However, employees and self-employed individuals must first meet the following conditions:

1. the workspace must be the self-employed taxpayer's principal place of business, or the principal place where the employee performs the employment duties; or
2. the workspace must be used exclusively for the purpose of earning business or employment income; **and** it must be used on a regular and continuous basis for meeting clients, customers, or patients. The term "meeting with" has, in some situations, been taken to include phone meetings.

Note that where the workspace is the taxpayer's principal place of employment or business (i.e., the first condition above has been met), the workspace does not have to be devoted solely to the business or employment activity.

If a taxpayer meets the above criteria, the types of expense that are eligible for deduction are based on three classifications:

- A ***self-employed individual*** can deduct all reasonable expenses associated with maintaining a home office. Such expenses can include a portion of the mortgage interest, rent, utilities, property taxes, insurance premiums, capital cost allowance, and upkeep and maintenance. Remember, though, that a claim for capital cost allowance will make the work space portion of the home subject to recapture and capital gains tax on a future sale of the property.

- An ***employee whose income is commission-based*** and who sells property or negotiates contracts on behalf of the employer can deduct expenses similar to those of a self-employed individual, with the exception of mortgage interest and capital cost allowance on the home.

- An ***employee who does not fit the commission definition above*** will only be allowed to deduct some of the home expenses mentioned above. Specifically, such an employee is permitted a deduction for a portion of the utilities, maintenance, and rent. A rent deduction is only allowed for property that is not owned personally by the taxpayer. In the situation where the taxpayer owns the home, a mortgage-related deduction is not allowed.

In order for any employee to qualify for the deduction of home office expenses, that employee must be required to provide a home office as a condition of employment. This means that the employee is expected by the employer to maintain a home office for which he or she is not reimbursed. The taxpayer and the employer must complete Form T2200 – *Declaration of Conditions of Employment* annually to prove that these requirements have been met.

The calculation to determine the reasonable portion of the expense pertaining to the workspace in the home is generally based on the proportion of the area of the home devoted to the home office (e.g., 200 square feet out of 2,000 square feet represent 10 per cent of the expense).

In situations where the workspace is used exclusively for the purpose of earning income from the business, these calculations are used without further reduction. Where the workspace is not used exclusively for that purpose (the first condition above applies), the above calculations are adjusted to reflect the percentage of time devoted to the employment or business activity (e.g., 60 per cent of 10 per cent equals six per cent of the expense).

It should be noted that the deduction is based on a reasonable portion of the actual expenses incurred and not the value of the office space. This means that the taxpayer must track all the home expenses and allocate a reasonable portion (as discussed above) as home office expenses.

Taxpayers (whether employees or self-employed) cannot create or increase a business or employment loss by deducting home workspace expenses. Any eligible expenses that are not deductible in one year can be carried forward and claimed against income earned through the same source in the following year.

I/R 7401.00, 5100.00

RETIRING ALLOWANCES

A retiring allowance is an amount paid to an employee who is leaving a job. It can be paid either as recognition for long service, or as compensation for the loss of the employment. Generally, the retiring allowance is treated as taxable income. Where the employee held the position prior to 1996, however, a portion of the retiring allowance may be eligible for tax-deferred rollover to an RRSP.

In general terms, the amount that can be transferred into an RRSP is calculated as follows:

- $2,000 times the number of years prior to 1996 that the employee was employed with the employer or a related employer; and

- $1,500 times the number of years of employment, prior to 1989, during which the employee was not a member of a pension plan or deferred profit sharing plan (DPSP) of the employer or a related employer.

As simple as the general rule sounds, there are a few details worth noting.

The first part of the formula allows $2,000 per year of employment. Any full or partial calendar year of employment is included in the formula as a whole year. For example, consider an employee who was hired in December 1980 and left the position in January 2002. Based on these facts, he or she would be entitled to 16 years in the first part of the formula (i.e., 1980 to 1995 inclusive).

The second part of the formula allows $1,500 per year of employment while the employee was not a vested member of a pension plan or DPSP. However, the calculation is somewhat more complicated.