



COMMENT

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APPROACHING YEAR-END

Tax planning for individuals should take place throughout the entire year. However, there are always certain items that should be reviewed as December 31st approaches. While some year-end decisions require action before the close of the current year, others might result in the conscientious delay of action until after year-end. A sampling of some items to consider follows.

Charitable donations and political contributions

Make all charitable donations and political contributions before year-end to qualify for tax credits for the current year.

The federal tax credit for charitable donations is 16 per cent on the first \$200 and 29 per cent thereafter. The provinces offer additional donation tax credits.

The federal tax credit for federal political contributions is 75 per cent of the first \$200, 50 per cent of the next \$350 and 33.3 per cent of the next \$525. Thus, the maximum federal tax credit (\$500) is allowed on a contribution of \$1,075. Remember that if federal taxes payable are less than the credit, the excess is not refunded and cannot be carried forward.

Federal tax credits are not available for payments to provincially registered organizations. However, the provinces may offer tax credits for these political contributions.

Alimony and child support

To be deductible, family support payments must meet a number of complex criteria. One basic requirement is that the qualifying amount be paid before the end of the taxation year to be deductible in that year. The payment may relate to current or prior obligations.

Note, however, that advance payments for the following year's support obligations are not deductible on the current tax return or in the following year. Payments must be made in the taxation year to which they specifically apply (based on the terms of the agreement) or for past obligations not yet paid. Otherwise, the deduction will be lost.

Residence

Your place of residence on December 31st determines which province taxes your income for the entire year.

For example, moving in December from a province with relatively high tax rates to another province with lower rates will create windfall tax savings on all income earned in the year. The taxes withheld at source will be credited against the lower taxes payable in your new province of residence.

Conversely, if you plan to move to a higher-taxing province, you may want to delay the move until January of the following year.

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Family salaries

Paying reasonable salaries to family members working for the business can result in lower overall taxes for the family. This is commonly known as “income splitting.” Certain sole proprietorships and partnerships record their income and expenses on a cash basis instead of an accrual basis. For such taxpayers, salaries must be paid before year-end to be deductible in the current year.

Spousal RRSP withdrawals

Withdrawals from a spousal RRSP will be taxed in the hands of the contributing spouse or common-law partner if they are made in the year of, or in the two years following, a spousal contribution. Contributions and withdrawals are counted on a calendar-year basis.

This “attribution” might therefore be avoided by delaying a withdrawal until after year-end. Alternatively, if attribution is favourable, a withdrawal from a spousal RRSP might be accelerated.

Capital losses

Taxpayers may carry back their net capital loss and apply it to reduce net capital gains in the three immediately preceding taxation years (causing reassessments). Because 1999 was the last full calendar year in which the 75 per cent inclusion rate for capital gains applied, and applicable tax rates may have been higher, a net capital loss triggered before the end of 2002 may produce a larger tax refund than such a loss triggered after 2002.

I/R 7400.00

AUTOMOBILE BENEFITS

There are many situations where a company supplies an automobile to an employee. Whether the automobile is part of an employee’s benefits, or where a shareholder uses a company-owned vehicle for personal travel, there are significant tax consequences.

The Income Tax Act sets out a two-part taxable benefit calculation for an automobile provided to an employee or shareholder. While the discussions below refer to an employer/employee relationship, the same rules apply to shareholder benefits.

The first part of the taxable benefit is called the *standby charge*.

- For employer-owned cars, the standby charge is generally two per cent per month of the total cost of the vehicle. (Where the employee is a car salesperson, the charge is only 1.5 per cent per month.) The benefit is based on the entire cost of the vehicle, even though the company’s capital cost allowance (CCA) claims will be restricted for “luxury” cars. In 2002, a luxury car is any vehicle that costs more

than \$30,000 (before federal and provincial sales taxes).

- For employer-leased cars, the standby charge is generally two-thirds of the lease charge (excluding any amount for insurance on the car). Again, the benefit calculation uses the entire leasing cost, even though the employer’s deductible lease payment may be restricted for luxury cars.
- The standby charge can be reduced if the employee is required to use the car for work, and the car is actually used “all or substantially all” for business. If both these requirements are met, and personal use averages less than 1,000 kilometres a month, the standby charge otherwise determined is multiplied by personal kilometres driven divided by 12,000 (assuming the car is available for the whole year). For example, if the employee drives only 3,000 personal kilometres in the year, the standby charge is one quarter of what it would otherwise be. The Canada Customs and Revenue Agency (CCRA) takes the view

that “all or substantially all” means 90 per cent or more.

- To the extent the vehicle is not available to the employee for all 12 months of the year, the standby charge can be further reduced. The employee can control availability to some extent, by leaving the car with the employer while away on vacation or while travelling on business.
- The standby charge is reduced by any payments the employee makes to the employer for the personal use of the car.

The second part of the taxable benefit is called the ***operating benefit***. This benefit applies where the employer pays operating costs related to personal use.

- Generally, the operating benefit is a fixed amount per personal kilometre driven by the employee. For 2002, the fixed amount is 16¢ per kilometre (car salespersons have a reduced rate of 13¢ for 2002).
- If the car is primarily used in employment duties, then the employee can elect that the operating benefit be calculated as one-half of the standby charge. The CCRA has taken the view that “primarily” means 50 per cent or more.
- The operating benefit can be reduced by any payments made by the employee to the employer for the use of the car (to the extent the payment has not reduced the standby charge).

A shareholder should carefully consider the different options for car ownership. If the company owns the car, the taxable benefit will create a personal income tax liability. In addition, the standby charge will remain the same year after year, because the formula always uses the original cost of the car. While the company may have some tax deductions related to the ownership of the car, the deductions may be limited by the luxury car rules.

An alternative for the shareholder is to borrow from the company to buy the car personally. While this will result in a taxable benefit if the loan calls for low or no interest, this may be more economical than the taxable benefits that accrue on a company-supplied vehicle. Remember that the entire loan principal will be a taxable benefit unless the loan is given by virtue of the individual’s employment rather than the share ownership. Also, reasonable repayment terms have to be agreed upon at the time the loan is given, and the vehicle must be required for use in the individual’s employment duties.

Employee and shareholder benefits should be analyzed taking into account the value of the benefit, the cost of taxes borne by the employee, and the after-tax cost to the employer of providing the benefit. Shareholders should be especially diligent in this analysis, because they both fund the employer’s cost of the benefit and bear the tax cost of receiving the benefit.

I/R 2400.01

THE TAXATION OF SEPARATION

Separating spouses and common-law partners face numerous decisions when dividing up the family assets and liabilities in order to go their separate ways. While income taxes should not be the “tail that wags the dog,” it is still very important to understand the tax implications for each party. Note that for tax purposes, spouses and common-law partners (including same-sex partners) are

treated equally. However, common-law partners may be treated differently than spouses for family law purposes.

Spousal support payments are deductible by the payer to the extent that they fall under a court order or written agreement. However, any deduction of support payments results in a corresponding reduction to the payer’s earned income for RRSP purposes.

Spousal support payments have the opposite implication for the recipient: payments received must be included in income and will increase the recipient's earned income for RRSP purposes.

Child support payments made under an agreement or court order dated after April 30, 1997, are not tax deductible to the paying parent and are non-taxable in the hands of the receiving parent. It is important for court orders and agreements to clearly distinguish child support from spousal support. Payments that do not specifically identify an amount as spousal support will be deemed to be child support and therefore subject to different taxation than might otherwise be expected.

The other significant area with income tax implications is the division of property.

The Income Tax Act provides for a tax-deferred rollover of capital property between separated or former spouses or common-law partners if the transfer is for the settlement of marital property rights. This provision can be used upon separation or divorce to move assets between these individuals. Any accrued capital gain or loss is not triggered at the time of transfer, and the cash flow cost of taxes is deferred.

If the separating individuals accept the automatic rollover provision, the subsequent disposition of the property by the recipient will trigger a capital gain or allowable capital loss (subject to stop loss rules) that is attributed back to the transferor. Attribution will occur up until the time the divorce is finalized, or in the case of common-law partners, until the separation has lasted for 90 days. However, this attribution rule can be overridden during the separation period by signing a joint election not to have it

apply. This is an important provision to consider because the tax liability may be a significant factor in the real value of an asset.

It should be noted that after the divorce (or common-law separation) is finalized, the capital gain triggered by a subsequent disposition is not attributable to the transferor: attribution rules for capital property do not apply after divorce.

Alternatively, the transferor may elect out of the rollover treatment on the transfer of the capital property. A deemed disposition is triggered at the fair market value of the property at the time of the transfer to the spouse or common-law partner. This allows the transferor to report an accrued capital gain, and the resulting income tax liability becomes the transferor's immediate responsibility. (Note though that a capital loss can't be claimed if the transferor and the recipient are still married or common-law partners at the time of the transfer.) The recipient will have an adjusted cost base equal to the fair market value of the property, and any capital gain arising upon a subsequent disposition would be taxed to the recipient.

Note that there is no attribution of income from property transferred between spouses or common-law partners if the transfer is in settlement of property rights. Apart from the potential attribution of an accrued capital gain, any income earned on the property after the original transfer would be taxable to the recipient.

The income tax rules governing the transfer of property are complex. It is imperative that the separating individuals understand the implications to minimize unpleasant surprises.

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Contributors to this issue of Comment:

James W. Kraft, CFP, CLU, CH.F.C., CA, MTAX, TEP and Deborah Kraft, CFP, CLU, CH.F.C.

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350 Bloor Street East, 2nd Floor, Toronto ON M4W 3W8
P:(416) 444-5251 or 1-800-563-5822 • F:(416) 444-8031
www.caifa.com • info@caifa.com**