The J Thomas McCallum Letter

advancing the understanding of income tax and valuation matters

Winter 2008

Child Tax Credit

Before 1993 taxpayers were able to claim their children as dependents, and now that deduction is back — albeit as a federal tax credit only.

In 2007 taxpayers are allowed a tax credit of $300 ($2,000 × 15%) for children who are *under* 18 years of age at December 31st.

Interestingly, there is no income test and so the child can have any amount of income. If the child [ordinarily] lives with both parents *throughout* the year, either parent can claim the credit. There is no splitting of the tax credit between parents except as part of the transfers of unused tax credits to the other spouse.

If the parents are separated or divorced, or a single parent, the parent who claims (or is eligible to claim) the equivalent married tax credit, is the one allowed this $300 credit. Also, unlike the pre-1993 situation, a taxpayer can have this credit **and** the equivalent married tax credit for the same dependant.

A "Near-Useless" Election?

Taxpayers who are active traders in public company securities live with the uncertainty as to whether their gains/losses are business rather than capital related. The election available at subsection 39(4) of the *Income Tax Act* provides partial relief, in respect to Canadian securities, but does it really provide *any* comfort?

If made, the election allows that:—

(a) every Canadian security owned in that year or any subsequent year is deemed to have been a capital property owned by the taxpayer in those years, and

(b) every disposition of any such security is deemed to be a disposition of a capital property.

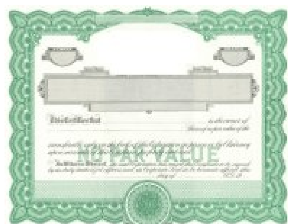
While you might think that guarantees capital treatment, it does not, as subsection 39(5) of the *Act* provides that the election does not apply to a disposition by a taxpayer who *at the time of the disposition* is a trader or dealer in securities.

So, if it's held that you are a trader, then it's irrelevant that you made the election.

Restricted Securities

It's strange isn't it, how things come in bunches? In the last two months I've had three cases of taxpayers being given restricted securities, with issues developing around the correct income treatment.

Two cases involved stock options where the shares were restricted, in that they could not be sold for a specified time period. The taxable benefit indicated in the T4 slip was based on the then trading price of the shares. Yet, given that the taxpayer couldn't sell into that market, the value of the shares should have been discounted to reflect that restriction.



The other case involved a sale of the shares of a small business corporation, where the proceeds were received in publicly-traded securities. One of the conditions was that the vendor could only sell 20 per cent of these securities in any one year, beginning the following year. Again, it would be improper to fix the proceeds realized simply as "number of units × current market price".

What goes in to determining the appropriate discount is a complex discussion, well beyond our capacity here. Appreciate that it's not just a matter of discounting the anticipated cash flow at some appropriate rate, but also factoring in the risk that the market price will change.

Don't Forget!

2007 is the first year the child fitness tax credit will be available (federal only), on up to $500 paid in fees for an eligible program for children under 16-years of age in the year.

While this credit has been well promoted, less known is the [proposed] *additional* credit available if the child is disabled and under **18-years of age**. This added credit, on a second $500 base amount, is allowed as long as at least $100 (yes, $100) has been paid on an eligible program.

Apparently Still A Problem

It's been a few years since I'd seen it in action, but the *Act's* section 84.1 recently reared its ugly head again in a client file I was reviewing for another accountant. While I'd thought this punishing provision was now recorded in the 'understood' column, I'd forgotten to appreciate that after 22-years we have a new generation of accountants, and they aren't necessarily well-versed with 'old' legislation.

§84.1 (among other things) provides for a deemed dividend where non-corporate taxpayers access corporate surplus to fund capital gains generated through a corporate re-organization, even one as simple as a capital gains

deduction 'crystallization'. But it can actually cast a wider net than that, as this client file showed.

Janice had acquired her shares in OPCO by purchasing them from her father over 10-years ago. She'd paid Dad $100,000 for the shares, and so this was the adjusted cost base (ACB) of her shares. Dad had tax-sheltered his capital gain by using the small business shares capital gains deduction (CGD).

Janice was now transferring her OPCO shares to HOLDCO. Her accountant had reckoned that in accordance with the rollover provisions (subsection 85(1) of the *Act*) she could receive non-share consideration (affectionately known as 'boot' in tax parlance) from HOLDCO, at least up to her ACB, without immediate tax consequences. **Wrong!**

Had the accountant proceeded with his plan Janice would have a deemed dividend of $99,900, and taxes of around $31,000 would have arisen. This comes about by §84.1(1)(b):—

Fair market value of 'boot'	$100,000
Modified ACB of shares	100
Deemed dividend	$ 99,900

As Dad had claimed a CGD on his original sale of the shares to Janice, her ACB is *modified* — but only for the purposes of §84.1 — to $100; that being her actual ACB less Dad's capital gain.

You will sometimes hear *modified* CB referred to as *hard* ACB. Don't let that confuse you, they are the same things.

In Case You Missed It

On December 13, 2007 Ontario announced that its annual small business limit was — retroactive to January 1, 2007 — increased to $500,000 (from $400,000).

This new limit, coupled with the reduction in the federal tax rates on business income over $400,000 (the federal small business limit), means it's slightly advantageous to pay dividends — and 68 per cent of those would be *eligible* dividends, so get out your GRIP calculator — rather than salary on that excess $100,000 income (as it is on the first $400,000 of Ontario small business income).

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J Thomas McCallum, FCGA, CBV
Whitby, Ontario
1-800-265-2686 or 905-579-0022
www.jthomasmccallum.com

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Make A Note to Attend

My Upcoming Presentations

Always Fun! Always Informative!

Date	Presentation	Location	Length
January 23	Income Tax *Pot Pourri*	Niagara On The Lake	Evening
January 25	Income Taxes At Death	Winnipeg	Half-day
January 25	Estate Freezes	Winnipeg	Half-day
February 4 & 5	Basic Personal Income Tax	Toronto	Two Full-days
February 8	Income Tax Update & Refresher	Thunder Bay	Full Day
February 11	Income Tax Update	North Bay	Evening
February 12	Income Tax Update	Sudbury	Evening
either February 16 or 23	Income Tax Update	Scarborough	Half-day
February 22	Income Tax Beyond The Basics	Toronto	Full-day

Competition Bureau Canada

“... all accountants within the various professional designations are considered competent ... Provincial regulators should give all members of accounting designations who have the appropriate level of competence the right to practise the full extent of public accounting ... The maintenance of high accounting standards does not require imposing one accounting body's detailed mandatory curriculum on others in a manner that raises the costs of entry to members of those bodies and effectively excludes members of other designations from competing. Doing so would effectively limit competition from other designations ... The Ontario Public Accountants Council should be flexible when applying the new standards under the Public Accounting Act in order to give members of all designations who have the equivalent training and education the right to practise public accounting.”

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