The J Thomas McCallum Letter

advancing the understanding of income tax and valuation matters

Spring 2008

When 90% Isn't 90%

There are a number of essential tests which must be met before the shares of a private corporation are eligible for the capital gains deduction (CGD). One of these is generally referred to as the 90 per cent test. That percentage isn't specified in the *Income Tax Act*, but rather, is CRA's definition of the phrase "all or substantially all" found in §248(1) at the definition of "small business corporation"

"... a particular corporation that is a Canadian-controlled private corporation all or substantially all of the fair market value of the assets of which at that time is attributable to assets that are

(a) used principally in an active business carried on primarily in Canada by the particular corporation or by a corporation related to it,"

CRA's interpretation of "principally" is that it means more than 50%. Readers will recall an earlier edition where I disagreed with this interpretation, but here that doesn't matter.

> Why is it that "multicultural" all so very often excludes Canadian culture?

Assume that your client operates an active business through Active Limited and that she also owns all the shares of another corporation — Landlord Inc. Landlord's only asset is the real property from which Active Limited operates.

Further assume that 75 per cent of Landlord's real property is rented to Active and the other 25 per cent is rented to an arm's length business operation.

Are the shares of Landlord eligible for the CGD?

It seems to me that *all* of the fair market value of Landlord's assets is attributable to assets (land and building) which are used *principally* (more than 50%) in Active's business. And so, Landlord's shares qualify for the CGD even though something less than 90% of those assets are used in the active business of the related corporation.

What Is "Income" Anyway?

"Income" is a very difficult concept, and nearly-impossible to capture a definition of in words; that's likely why there is no definition in the *Income Tax Act*.

I recently received a reminder from an American-based casino that poker tournament winnings are taxable (in the USA). That got me to thinking — why are the winnings taxable? How is it the winnings are income?

Picture this: 1,000 players (who aren't professionals) each pay $100 (plus a $10 fee to the tournament facilitator) to play and the top three players win $60,000, $30,000 and $10,000.

All that's really happened here is that 997 players have had their $100 'wealth' redistributed to the three winning players. That's income? It gets even more intriguing if you reflect on the fact the $100 is already after-tax earnings, and so it is really capital.

So here what's being taxed as income, is really just the redistribution of wealth/capital — or viewed another way — the circularization of money, not the creation of wealth.

When you and I earn $100 in salary, we have $60 (after-tax) to spend. Most often we spend it on non-deductible goods and services, and yet the person we spend it with also pays taxes on the $60, and when he/she takes their after-tax $36 and spends it, the lucky recipient also gets to pay taxes on the $36, and so it goes on *ad infinitum*.

Seems we're all just chasing an ever-diminishing dollar, and at that, it's the same dollar!

I Wonder About Three Things

1. If the Ontario Institute of Chartered Accountants would be so vociferous and tenacious in promoting a "national standard" for public accounting if the standard put forward was the Alberta model and not the Ontario one?

2. Whether those calling for a "national securities regulator" would be as supportive if it was proposed to be located in Winnipeg rather than Toronto?

3. What the Ontario economy might look like if the province was creative, innovative and forward-looking rather than looking at its [now] twilight industries in the rear-view mirror?

Phishing

The United States government is sending out economic stimulus tax rebate cheques, and already the scammers are hard at work.

Twice now I've received a rather official looking e-mail directing me to an 'IRS' site where I can complete an application to have my rebate credited to my Mastercard or Visa. All I had to do was provide my account numbers, including the CVV number from the back of the card, and my personal information. Sadly, I wonder how many will fall victim to this cam?

Americans *Can* Be Funny

I recently received a complimentary copy of a law journal. While published in the USA, it is devoted to Canadian law. Although it appears to be an excellent publication, I won't be subscribing.

The inside leaf of the journal indicates that subscriptions are $125 per year in the U.S. **and** Canada (presumably those are American dollars).

However, the promotional letter sent along with the complimentary copy, invited me to subscribe for "*only* $279 Canadian dollars". I guess they haven't heard the Canadian dollar is (give or take a cent or two) at par with the American dollar.

Let's Play *Where's The Slip*?

When a person dies they are deemed to have disposed (for income tax purposes) of their RRSP or RRIF at its fair market value. The plan issuer/trustee is supposed to issue a T-slip for that value, but I recently had to chase down such a T4RIF for a deceased client. After six months I finally received it. Other accountants have told me they've had the same experience.

I wonder how many estate administrators who self-prepare the final T1 return don't report that income because they haven't received a T-slip? Even more, I wonder how many times CRA catches up?

CRA Stats at 28/5/08

Number of Returns (in millions)	2008	2007
NETFILE	4.2	4.0
TELEFILE	.5	.5
EFILE	9.0	8.2
PAPER	10.0	10.4

Have a wonderful summer!

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