

The J Thomas McCallum Letter

advancing the understanding of income tax and valuation matters

Spring 2010

Creditor Life Insurance

As mentioned in this Letter back in 2004 and as outlined in IT-430R3, CRA's position has always been that the proceeds of a creditor life insurance policy (such as one flowing from a insured line of credit) aren't eligible for inclusion in the debtor corporation's capital dividend account.

However, in *Innovative Installation Inc vs The Queen*

2009 TCC 580

the Tax Court of Canada ruled that "received" includes a notional or constructive receipt, and so the proceeds are available as a capital dividend.

Frightening On Two Counts!

In income tax there's always been a long-held philosophical belief that you can't make an income by selling something from yourself to yourself. Now we're not so sure.

Mr. Bilodeau was a life insurance salesperson who sold himself a policy, and in keeping with the direction given by IT-470R he deducted the commissions earned, which were

otherwise included in his income (via a T-slip from the insurance company).

CRA 'turned' on its own IT and denied the deduction. The Tax Court of Canada essentially said it didn't care about CRA's administrative position one way or the other, the item was clearly taxable income under §9(1) of the Act.

Some institutions and governments are now referring to foreign-trained (or educated) professionals as "internationally" trained. This is just political spin, a misnomer which will do more harm than good to those who are intended to benefit.

Amazing Fact!

Valour Road is a residential street in the west end of Winnipeg and it used to be named Pine Street. Its name was changed in 1925 to honour

Cpl Leo Clarke, Sgt-Major Frederick William Hall, and Lt. Robert Shankland.

Each of these Canadian soldiers received our highest military decoration, the Victoria Cross, for bravery in WWI but amazingly, not only did each of them live on Pine Street but they all lived within the 700 block!

Tax Can Be Fun!

Actual statement made by the Tax Court and included in its judgement



“The application was heard in Regina Saskatchewan on June 26, 2009. The Applicant was the only witness. He resides in Gull Lake, about 300 km west of Regina, a land of open range, where big farms meet big ranches and the deer and the antelope play and the skies are not cloudy all day.”

Don't know about you but I find some black comedy in the court leaving out “where seldom is heard a discouraging word”.

Copyright

A few weeks ago I discovered that an accountant had included her client's acquired copyright in the Cumulative Eligible Capital Property pool. This is not correct. Copyright is a Class 14 asset, eligible for straight-line CCA.

Canadian copyright law on written works is 50-years beyond the end of the year the author dies.

There's (Almost) Always Logic

Students, whether in law or accounting, often struggle with their tax course(s). They look at tax law as a set of rules, often seemingly not having rhyme or reason — called “logic” here.

When arriving at a tax result, you need to understand beyond the mechanics to ensure you've actually got the correct answer. This often means going back to the “policy” behind the provision, and re-working the “logic”. Subsection 13(21.1) is a case in point

This provision prevents a terminal loss on a building where there is a

Basic Math?

If the visible minority are now over 50% of Toronto's population, doesn't that actually make them the visible “majority”? And doesn't it mean the old majority is the new visible minority?

simultaneous disposition of the land at a gain, or alternatively, a full terminal loss where there's been no disposition of the land. The “policy” item is obvious — terminal losses are 100% deductible whereas capital gains are only 50% taxable

While otherwise reasonably straight forward; where CCA has been taken on the building, the mechanics of the determined tax result need to be tracked back to the “logic” to ensure the answer is correct.

Let's use the following facts:

- building FMV/price is zero

- property FMV is \$400,000
- building cost was \$100,000
- land cost was \$35,000
- building UCC was \$40,000

Case #1: simultaneous sale

Deemed proceeds for building	\$ 40,000
UCC	\$ <u>40,000</u>
Terminal loss	\$ <u><u>NIL</u></u>

Land proceeds	\$360,000
ACB	\$ <u>35,000</u>
Capital gain	\$ <u><u>325,000</u></u>

The \$325,000 result doesn't *appear* to be correct as at first glance the gain on the property should be \$265,000 (\$400,000 less \$135,000), so let's test/reconcile it.

Gain as determined:	\$325,000
Less: CCA already allowed	\$ <u>60,000</u>
Actual Gain	\$ <u><u>265,000</u></u>

All's well!

Case #2: land sold after building demolition

Deemed proceeds for building	\$ 20,000
UCC	\$ <u>40,000</u>
Terminal loss	\$ <u><u>20,000</u></u>

Land proceeds	\$380,000
ACB	\$ <u>35,000</u>
Capital gain	\$ <u><u>345,000</u></u>

Once more, the gain result doesn't *appear* to make sense, until you test/reconcile.

Gain as determined	\$345,000
Less terminal loss	\$ <u>20,000</u>
	\$325,000
Less CCA already taken	\$ <u>60,000</u>

Actual Gain \$265,000

Again, all's well!

Things I'd Forgotten

It's amazing what you knew but have forgotten. This past tax season I was forced by accountant client questions to re-discover:—

- where there's a filing extension on the death of a taxpayer, that extension also applies to the deceased's spouse,
- in the year of death, while capital losses are deductible (within limits) against all forms of income, those losses are actually claimed in determining taxable income *not* net income,
- the penalty for late-filing a capital dividend election is a relatively minor amount: the lesser of 1% per annum and \$41.66 per month.

Anyone Else Remember?

- When the day's three meals were breakfast, dinner and supper;
- When player salaries in the Canadian Football League were higher than the National Football League (sometimes called the "No Fun League"); and
- When Canada had a marginal income tax rate of 80% (that was

1971, although it was [before my time] an astounding 84% in 1949!).

Buy/Sell Terms

It's not uncommon to see the buy/sell terms of a shareholder agreement drafted as the right to match a third-party offer.

This is a very poor approach because it shifts all the costs of examining the business opportunity to a prospective outside purchaser who knows that all of their efforts might be wasted because an existing shareholder has the right to simply match the offer. The vendor cannot realise the maximum price through this approach.

It's much better to give the other shareholder(s) only a right of first refusal, and failure to take up that right means the vendor is then free to seek an outside buyer.

Another short coming in some shareholder agreements is where there is a "put/call" provision but the shareholders are not of equal financial strength.

Let's assume there are two shareholders, one is wealthy and one is not. The wealthier shareholder can easily 'take out' the more indigent one.

The positions of the two shareholders might be (somewhat) equalized by requiring the wealthier shareholder to pay cash if the put/call is exercised whereas the more impoverished

shareholder is allowed time payments via a vendor-take-back.

Did You Know?

The word barber originates from the Latin *barba* (meaning beard), that *tonorial* is another word for barbering (hence tonsorial shop rather than barber shop), and that a barber was first called a *tonsor*.

The barber shop pole originates from the time barbering included "blood letting" and symbolises bandages wrapped around an arm before/after the blood-letting.

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Make A Note to Attend

My Upcoming Presentations

Always Fun! Always Informative!

June 4	Corporate Reorganizations <i>Plus</i>	Toronto	Full-day
June 15	Essentials of Private Corporation Income Tax	Toronto	Full-day
June 18	Income Taxes At Death	Toronto	Full-day
Autumn	About 15 presentations are scheduled (details to be included in next newsletter)	Various	Full-day

Ontario Serves and Protects

The province of Ontario has passed legislation protecting those holding the three recognized Canadian accounting designations by making it an offence for any non-member individual or corporation to take or use the CGA, CA*, CMA** designation alone or in combination with other words or abbreviations, or to take or use any term, title, initials, designation or description implying that they are a CGA, CA or CMA. The offence is punishable by a \$10,000 fine.

Exceptions are allowed for:—

- referencing authentic professional accounting qualifications obtained outside of Ontario in a speech or presentation at professional or academic conferences,
- applications for employment or private communications respecting retaining the individual's services *if* the reference is made to indicate educational background *and* the individual **expressly indicates** that he or she is not a CGA, CA, CMA and is not governed by the Association, Institute or Society
- responses to requests for proposals if the reference is to demonstrate meeting the requirements for the work to which the proposal relates.

For the purposes of the above employment exception, stating the name of the jurisdiction from which the qualifications were obtained *is not* a sufficient express indication.

* including the ACA designation

** including the RIA designation

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