



2010 FOURTH QUARTER

Tax Tips & Traps

2010 REMUNERATION

Some **general guidelines** to follow in remunerating the owner of a Canadian-controlled private corporation earning “active business income” include:

1. **Bonusing down** active business earnings in excess of the annual business limit may reduce the overall tax. However, leaving corporate active business income over this amount presents a tax deferral.
2. **Notification** must be made to the shareholders when an “eligible” dividend is paid - usually in the form of a letter dated on the date of the dividend declaration. If all shareholders are directors, the notification may be made in the Directors’ Minutes.
3. Elect to pay out tax-free “**capital dividend account**” dividends.
4. Consider paying dividends to obtain a refund of “**refundable dividend tax on hand.**”
5. Corporate earnings in excess of personal requirements could be left in the company to obtain a **tax deferral**. The effect on the “Qualified Small Business Corporation” status should be reviewed before selling the shares.
6. **Dividend income**, as opposed to salaries, will reduce an individual’s cumulative net investment loss balance thereby providing greater access to the capital gain exemption.
7. Excessive **personal income** affects receipts subject to clawbacks, such as old age security, the age credit, child tax benefits, and GST credits.
8. Salary payments require **source deductions** to be remitted to the Canada Revenue Agency on a timely basis.
9. Individuals that wish to contribute to the **Canada Pension Plan** or a Registered Retirement Savings Plan may require a salary to create “earned income.”
10. Salaries paid to family members must be **reasonable**; unlike dividends.

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EMPLOYEE VS. INDEPENDENT CONTRACTOR

In a June 22, 2010 Tax Court of Canada case, the Appellant was found to be engaging the truck driver in insurable/pensionable employment income, not as an independent contractor.

The Court noted that factors which suggest that the trucker was an employee of the Appellant include:

1. Tools/equipment - The Appellant provided all the tools and equipment, including the truck.
2. Chance of profit/risk of loss - The trucker had no expenses and no liability exposing him to a risk of loss. There was no opportunity for him to increase his income.
3. Control - The trucker received instructions from the Appellant and reported to the Appellant on a daily basis for work assignments.

Also, in a June 30, 2010 Tax Court of Canada case, CRA took the position that the 43 incorporated and 53 unincorporated truck drivers were employees of the payer and subject to EI and CPP.

The Court concluded that the 43 incorporated truck drivers were independent contractors because the intent of the incorporated workers and the Appellant was that of being independent contractors. However, based on the evidence presented, the Court found that the remaining 53 workers were employees.

Also, in a **May 4, 2010** Tax Court of Canada case, the Court found that a professor at the University of British Columbia was engaged as an independent contractor not an employee and noted that the professor honoured the contract which defined the independent contractor status by becoming a GST Registrant, invoicing his time with GST and bidding on new contracts as existing contracts expired.

BUSINESS/PROPERTY INCOME

EMPLOYMENT INSURANCE ACT (EIA)

In a September 25, 2008 Tax Court of Canada case, the Court concluded that the relationship between Brother 1 and Sister 1, who each owned 30% of the Corporation, was such that the salary paid to them was not subject to EI under the EIA. (Individuals that control more than 40% of the voting shares are automatically exempt from EI.)

The EIA notes that insurable employment also does not include employment if the employer/employee are not dealing with each other at arm's length. However, this requires that the terms and conditions of their employment are different from those of other arm's length employees.



The Court noted that the Brother and Sister stated that they had a great deal of autonomy and freedom in carrying out their tasks. They both assumed their responsibilities, knowing very well that they did not need to obtain any approval. Decisions were made during dinners at their mother's home or at other locations.

The Court concluded that the familial aspect of the business had a marked influence on its operation to the point that some important decisions were made based on the familial connection rather than on the economic reality of the business. The Brother and Sister also received a salary that was different and not comparable in terms of hours worked to other employees. They both received generous bonuses when the business was flourishing.

GENERAL PURPOSE ELECTRONIC DATA PROCESSING EQUIPMENT (GPEDPE)

GPEDPE (computers and ancillary equipment) are eligible for a 100% tax deduction in the year if acquired after January 27, 2009 and before February, 2011. Keep this January 31, 2011 deadline in mind.

ESTATE PLANNING

DONATED ARTWORK

In a November 23, 2009 Tax Court of Canada case, CRA successfully reduced the donation tax credit on artworks donated by the Appellants to a museum in 1999 and 2000 by successfully challenging the fair market value of the artworks.

CLEARANCE CERTIFICATES

In a June 16, 2010 Technical Interpretation, CRA notes that where a legal representative distributes the deceased person's assets without first obtaining a Clearance Certificate, the Income Tax Act, the Employment Insurance Act, and the Excise Tax Act permit the CRA to assess the representative personally for unpaid tax debts.

TRANSFERRING CAPITAL LOSSES BETWEEN SPOUSES

Typically, a loss must be claimed by the individual who owned the asset while it declined in value. However, CRA has confirmed that they accept transactions which transfer capital losses between spouses. This could be useful where one spouse owns appreciated assets, or has realized a capital gain, while the other has capital losses.

Careful planning is required to ensure all technical requirements are met. Please contact us for details.

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