Tax Letter

September 2013

IRMINA M KOZA, CMA

DORELLE Business Services
DORELLE TAX

www.dorelle.ca

PH: 705.503.0490
DIR: 705.220.5475
FAX: 705.503.0540

irmina@dorelle.ca

Call or e-mail for an appointment

Barrie, ON

Spousal and Child Support Payments

A general rule is that spousal support payments made to an ex-spouse or common-law partner are deductible in computing the payer's income, if they are required by a Court Order or a written agreement. The payments are then included in the recipient's income.

On the other hand, child support payments are no longer deductible for the payer, and are tax-free for the recipient, for court orders and agreements made after April 1997.

Certain conditions must be met to determine if a certain payment qualifies as spousal or child support.

Why File Tax Returns

Did you know...?

You have to file a tax return to be eligible to receive certain benefits and credits.

Important facts for:

- **Seniors**: You may be eligible to receive goods and services tax/harmonized sales tax (GST/HST) credit, or you may be allowed to split up to 50% of your pension income.
- **Post-secondary students**: You may be able to claim the interest paid on your student loans and to carry forward or transfer your tuition, education, and textbook amounts. You might also be eligible for other credits and benefits, but you won't know unless you file. By filing your return, you will find out how much RRSP deduction room you have available for the future.
- **Newcomers to Canada (immigrants)**: When you enter Canada and establish significant residential ties, you generally become a resident of Canada for tax purposes. If you are considered a Canadian resident for tax purposes, you may have to file a tax return and report your "world" income (from sources both inside and outside Canada) received during the year. Even if you did not receive any income, filing a return will allow you to apply for credits and benefits you may be eligible for.
- **Adults 19 and older**: You may be eligible for the GST/HST credit!
- **Parents**: The CRA administers many tax credits and benefits, such as the GST/HST credit, the Canada Child Tax Benefit, the Universal Child Care Benefit, and the Children's Fitness Tax Credit through the income tax return that you file every year. Don't miss out!

Interest deductions

Interest on money borrowed for the purpose of using it to earn income from business or property is deductible in computing your income. On the other hand, interest on personal loans is not deductible. Therefore, if possibility exists, it makes sense to use your borrowings for income earning purposes rather than personal purposes.

Therefore, if you have current income earning investments such as stocks, bonds or mutual funds, and are thinking of borrowing funds for personal purposes, you can effectively shift the borrowing to make it for income earning purposes. That is, you can sell your investments, use the proceeds for personal purposes, and then borrow to re-purchase your investments. Since the borrowings would be used directly to purchase the income-earning investments, the interest would be tax deductible.

However, you may run into a scenario where the sale of your investments may generate capital gains. Thus, this strategy works best with investments with little or no accrued gains. Also, if your investment generates a loss at the time of sale, the loss will be denied due to the superficial loss rules that deny the loss if you re-acquire the same investments within 30 days of the sale.

~ NEWS FOR CORPORATIONS ~

Higher tax for Personal Services Business Corporation

What is a personal services business corporation? It is a corporation that provides services to a *third party (ie. Client)* that, in the absence of the corporate structure, the shareholder of such corporation would be considered an employee of the *third party*.

Under legislation passed on June 26, 2013 (retroactive to corporate taxation years beginning after October 31, 2011), the tax rate on such income is now the general corporate tax rate plus an additional 13%. The federal tax alone is 28%, plus provincial corporate tax could potentially amount to a cumulative rate of 38-44% (depending on the province).

Because of this higher tax rate, payments of dividends from the corporation will result in excessive taxation. That is, the dividend tax credit assumes a corporate tax rate of 15% rather than the actual 28% for this type of corporation.

Double taxation can be avoided if the income is paid out as salary to the shareholder. In this case, the payment will be deductible for the corporation, and taxed at the individual's regular marginal tax rates. The new rules do prevent deferrals of tax through retention of earnings in the corporation and subsequent payment of dividends.

Dividend Tax Credit amounts are Changing

Federal gross-up and Dividend Tax Credit (DTC) amounts are changing, effective for dividends paid after 2013. The new gross-up will be 18% of the dividend, and the new DTC will be 13/18 of the gross-up. These changes will result in additional tax payable at the shareholder level.

Canadian Controlled Private Corporation (CCPC) is subject to a lower tax rate on the first $500,000 of active business income. The lower tax rate is 11% versus the general corporate rate of 15%. The provincial rates vary by province, but all provinces provide a lower rate for the CCPC's active business income.

Currently, dividends paid by CCPC's are grossed up by 25% of the dividend (assuming payment from low-rate income). The shareholder then gets a federal dividend tax credit of 2/3 of the gross-up. The Gross up and DTC mechanism effectively provides a credit to the shareholder roughly equivalent to the corporate tax paid in order to prevent double taxation of the business income earned in the corporation.

... from current Tax Court Files

Wages paid to employee-children in the form of "luxury" items

In the *Bruno* case, the appellant operates a business that specializes in supplying custom window coverings.

In computing income from business for the 2007 and 2008 taxation years, Ms. Bruno deducted the amounts of $18,000 and $7,000, respectively, on account of wages paid to her two children who provided services for the business.

The issue is whether this deduction was properly disallowed by the Minister of National Revenue. The CRA denied the deduction on the grounds that the expenditures were personal in nature and that the children did not have sufficient discretion over the expenditures.

Ms. Bruno's two children were 15-16 and 13-14 in the years at issue and helped out in the business on weekends and holidays. She did not pay the children cash wages but agreed to buy them certain luxury items (ie. items other than basic necessities) in lieu of wages. On her tax return, the taxpayer deducted the purchase price of the luxury items as salary or wages paid to her employees.

The Tax Court of Canada held that "if the children are owed wages in reasonable amount, a deduction may be claimed if the wages are paid in the form of purchasing luxury personal items chosen by the children". However, due to the lack of sufficient details regarding all purchases, the Judge could not determine the exact number of items that qualified for the deduction. Therefore, as a rough measure, the Judge allowed 50% of the purchases as a deduction.