LEVY PILOTTE
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Newsletter

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MULTIPLYING THE SMALL BUSINESS DEDUCTION FOR INDIVIDUALS IN PARTNERSHIPS

Over time, individuals who operated businesses together have tried to benefit from the use of the Small Business Deduction (SBD). Sometimes, the benefit was achieved by:

- Incorporating the group of individuals.
- Incorporating segments of the business if the individuals (professionals) could not incorporate.
- Individuals setting up professional corporations which operated in partnership structures or as independent companies with a group sharing the expenses.

There were always a number of tax issues that appeared to restrict the ability to multiply the use of the SBD. The Canada Revenue Agency (CRA), in a number of technical interpretations, has eliminated most of these concerns by stating that, where an individual has established a corporation to provide the individual's technical services to a partnership:

- Income of the corporation is active business income and is not specified partnership income that must share the SBD with all partners.
- The corporation is not carrying on a personal service business (because the partner was not an employee of the partnership).
- The fees paid to the corporation are deductible to the partnership.
- The fees paid to the corporation are taxable to the company and not deemed taxable to the individual.
- The arrangement is not subject to the general anti-avoidance rule (GAAR), as long as there is a business purpose, such as more control over practise preferences, expenditures, and estate and financial planning.

Therefore, each individual could have their own corporation that provides services to the partnership and is eligible for the full amount of the SBD.

The above applies to income for providing the services, which is different from income from the other activities of the partnership, such as profit on staff, etc., that would remain as partnership income. Normally, one would consider the value of the hourly time rate charged by the individual, plus management services, as the direct services value.

There is a CRA interpretation that permits the same corporation to provide both the services and the ownership of the partnership. This may be a more aggressive approach.

Share ownership of the corporation may be restricted by any professional body that is involved. Proper documentation, implementation, and continued monitoring will be important requirements.

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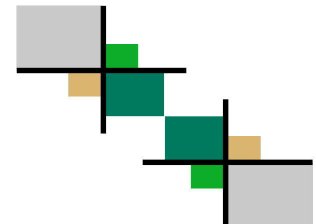

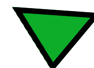

Special points of interest:

- ***Taxpayers can make payments directly to CRA electronically.***
- ***Personal tax instalments:***
  - ***September 15, 2007***
  - ***December 15, 2007***
  - ***March 15, 2008***
  - ***June 15, 2008***

DONATING YOUR TAX PROBLEMS AWAY

Most of you will remember a time when you were asked to support a cause, and your first question was, "Do I get a tax receipt?" The credit you receive when you file your tax return is a non-refundable tax credit, and when your total donations are greater than $200 in a tax year, the credit is calculated at the highest personal tax rate (48.2% in Quebec) even if you are not in the highest tax bracket.

Most of you will also remember saying, "There are so many good causes to support." This has made it increasingly difficult for charities to compete for support. Understanding the importance of charities in our economy, the government introduced another tax incentive to donors. At first, the incentive was to reduce the amount of the capital gain that is taxable to 50% of the amount that is ordinarily taxable, if publicly traded securities were donated to a charity. Then, in May 2006, this incentive was improved. Now, if publicly traded securities are donated to a charity, none of the capital gain is taxable; and, yes, you would get a donation receipt for the full value of the securities donated. The securities must, however, be donated directly to the charity and be listed on a prescribed exchange in order for the capital gain to be non-taxable.

The following table illustrates the benefit, assuming the taxpayer has prescribed securities worth $10,000, which had an original cost of $1:

	Shares sold and proceeds donated	Shares donated directly
Fair Value	$ 10 000	$ 10 000
Tax on sale	(2 400)	-
Remaining to donate	7 600	10 000
Donation to Charity	(7 600)	(10 000)
Tax credit received	$ 3 650	$ 4 800

If the securities are donated directly, the charity will get $10,000 of value instead of $7,600, and the taxpayer will get a tax refund of $4,800 instead of $3,650. The charity would be ahead $2,400, and the taxpayer ahead $1,150. When the charity sells the securities, they would not have to pay any tax on the gain either, since they are exempt for income tax purposes. Win/Win.

The ability to donate securities is not limited to individuals. A corporation can also donate securities and still receive credit for the donation at their corporate rate, and also eliminate the tax on the accrued gains in the securities.

How can this apply to you?

If you wish to support a particular campaign of a charity, and have a dollar amount in mind, you can fulfill that support by donating shares from your portfolio that have accumulated gains, eliminating any tax you would have to pay on gains realized on the sale of the shares. You will still be giving the same amount, but will be saving taxes, meaning you will keep more money as well. You can also replace some of your regular cash donations with securities donations.

If you have large accumulated gains in your portfolio and are considering leaving a bequest in your Will, you can identify the securities and dollar amount you want to donate in your Will, and your beneficiaries would save the tax when they file your final return. Basically, you will be giving the same amount of money to the charity, but will have more money left to your beneficiaries. However, the wording of your Will is very important to enable the credit to be claimed on your final return, as is the type of securities; therefore, it is always advisable to discuss your plans with an accountant.

SPOUSAL RRSPs ARE STILL A GOOD TAX-PLANNING TOOL

On June 22, 2007, the Government gave final approval to the Bill that enables taxpayers to income-split pensions commencing in 2007. Under these new rules, a pensioner can allocate up to 50% of annual pension income to a spouse (or common-law partner) and have that income taxed at presumably a lower marginal tax rate in the hands of the spouse.

While the new rules have been embraced as a sizeable gift for pensioners, they in fact provide only limited tax relief, and mostly only for those 65 years of age and older. Therefore, the spousal RRSP is still an excellent means for couples to split income and save income taxes despite the availability of pension splitting.

The pension splitting rules apply to RPP income, regardless of the taxpayer's age, and also to income from an RRSP annuity, a RRIF, a LIF (locked-in RRIF), or a deferred profit-sharing plan annuity where the taxpayer is 65 or over. There is no age restriction for the spouse who receives the income allocation.

Many situations where people would want to make use of income splitting will not qualify under the rules. For example, a simple withdrawal of money from an RRSP, whatever your age, will not qualify; the individual would first have to convert the RRSP to an annuity or a RRIF and also be at least age 65.

This means a spousal RRSP will still be worthwhile in many situations for splitting income and saving on taxes. For example, if you have a lot of investment income from non-registered investments, it may make sense for your spouse to be taxed on more than 50% of total pension-related income (including from RRSPs, RRIFs, etc.). If you had made use of a spousal RRSP, this could be achieved.

Suppose you want to make withdrawals from an RRSP to buy a home. You could effectively double the amount you could withdraw (to a maximum of $40,000 from $20,000) under the Home Buyers Plan if you and your spouse both had an RRSP, including a spousal RRSP. The same potential doubling would apply for those couples wanting to make RRSP withdrawals under the Lifelong Learning Plan.

Also, spousal RRSPs create flexibility for couples to respond to unexpected events at any age. If, for instance, a couple has a sick child, money in an RRSP (again including a spousal RRSP) could, under certain circumstances, be withdrawn without paying income tax by the spouse staying home to care for the child.

The benefits of using a spousal RRSP are definitely there if you are under age 65, but they also make sense in certain situations for those who are older. If you are 65 years of age and over, you would have to convert your RRSP to a RRIF before withdrawals would be eligible under the pension-splitting rules. A spousal RRSP could come in handy if you didn't want to do that.

In another example, if you are over the age of 69 (once passed, the 2007 Federal Budget will increase the age to 71), you would no longer be permitted to contribute to your own RRSP to shelter employment income from income tax. But, if your spouse is young enough to still be allowed to have an RRSP, you could make tax-saving contributions to a spousal RRSP.

Because of the special rules on withdrawals from spousal RRSPs, it is always advantageous to make contributions before December 31 each year.

A contribution must stay in a spousal RRSP for three calendar years before it is withdrawn or the withdrawal will be attributed back to the contributor.

PAYING THE CRA ELECTRONICALLY VS. OLD-FASHIONED CHEQUES

In 2006, the Canada Revenue Agency (CRA) offices stopped date-stamping your cheques when they received them; so, it is your word over the CRA's if they misplace your cheque. Paying the CRA late can range from regular interest charges to penalties of up to 20%.

Most financial institutions will allow you to pay your personal taxes online, including instalments, April 30th payments, and prior arrears balances. The electronic payments are date-sensitive, meaning you no longer have to worry about Canada Post, couriers, or parking to deliver your cheque to the CRA. If you are paying online, please keep a printout or PDF of the transaction for proof of payment, as well as the relevant bank statement.

Alternatively, for individuals, there are services such as the CRA's "My Account" and "Represent a client." However, we recommend going directly through your financial institution.

Business owners, proprietors, or corporations may also pay the following online through their financial institutions: income tax, GST, and payroll source deductions. You may wish to check with your financial institution for automatic electronic post-dated payment options, which would be helpful for paying fixed amounts like personal and corporate income tax instalments.

For more detailed information from the CRA, go to: http://www.cra-arc.gc.ca/eservices/payments/menu-e.html. Click either "business clients" or "individual taxpayers" at the bottom of the page for more details. The CRA has also included the links to financial institutions to speed up your research.

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