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TAX PERSPECTIVES

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Introduction

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This issue of Tax Perspectives contains its usual assortment of articles on Canadian and international tax. The articles, all written by TSG members, inform you of recent developments, outline tax planning strategies that may be useful and caution you on pitfalls to avoid.

Around TSG, it has been a busy year. We welcome back Kim Moody who had previously merged his practice with a national accounting firm. Kim started Moody's LLP in Calgary this October.

The Ruchelman Law Firm, a New York based tax law firm, has opened a Toronto office. It is headed by Edward Northwood, a well-known U.S. tax lawyer who specializes in cross-border estate planning.

Peter Weissman has joined Cadesky and Associates LLP as a partner and will be based in their new downtown Toronto office. Grace Chow has become Chair of STEP Canada, and has joined Larry Frostiak and John Poyser as co-author of the *Practitioner's Guide to Trusts, Estates and Trust Returns*, published by Carswell.

Lastly, our sister organization, the International Tax Specialist Group (ITSG) will hold its Worldwide Conference in Toronto in November. Representatives from 25 countries are expected to attend.

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The Trouble With Stock Options

by Michael Cadesky, FCA, TEP

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Stock options have been widely used as the executive compensation tool of choice, from the largest of public companies to small entrepreneurial private businesses. For the employee, they usually have two main benefits: the ability to receive money at 50% of the normal tax rate, and owning a financial instrument that has only upside and no downside risk. For the employer, a stock option program can be motivational and help to retain key employees. Also, the compensation has the benefit of being "cashless" to the company. Unlike a normal bonus, where the company would bear the expense and pay cash to the executive from its own funds, a stock option, when exercised, does not require a cash payment by the company. Quite the reverse, it is the employee who will make a payment to the company, equal to the exercise price under the stock option.

These are the benefits to the executive and the company. Now what about the problems?

Stock options, unfortunately, have a number of potential drawbacks associated with them. Here is a list of points to watch.

When the employee exercises a stock option, a benefit results by virtue of employment, equal to the difference between the fair market value of the stock at the time of exercise, and the price paid for the stock. For example, if stock was worth $12 at the time the stock option was exercised, and the payment to be made for the stock was $2, a $10 benefit would result. This benefit is taxable as employment income. If at the time this stock option was granted, the stock was not worth more than $2, a 50% deduction may be taken from the employment benefit, so that only $5 would be subject to tax in the example above.

If the employee, upon exercising the stock option, sells the stock immediately, then all is fine. But, if the stock is retained, and the price in the market declines, adverse results can occur. Once the stock option is exercised, the employment benefit ($10 in the example above) is fixed. The cost of the stock for income tax purposes becomes the fair market value at which the stock was issued to the employee ($12 in the example above). If the stock were subsequently sold at a loss, this loss would be considered

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Moving To Canada – Some Tax Aspects

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Canada remains a popular destination for immigrants. Accordingly, I discuss below, in non-technical terms, some tax considerations when an individual moves to Canada and becomes a Canadian resident for tax purposes.

In practice, there are two likely scenarios:

- The immigrant ("Laurel", in this article a single woman) contacts a Canadian tax adviser ("Hardy") by phone or email from her home country, or during a visit to Canada while still a non-resident. She has not been resident previously in Canada, or
- Laurel arrives in Canada as a resident, and later presents herself to Hardy and says, "Here I am. What can you do to minimise my Canadian taxes?"

In the second case, little can be done, except perhaps to set up an immigration trust, discussed below. I shall deal primarily with the immigrant who gives a Canadian tax adviser the opportunity to review the tax aspects of the move before the move occurs.

Residence

Hardy should ask Laurel questions to confirm whether (and the date on which) she will become a Canadian resident for tax purposes. If she is moving from a country with which Canada has a double tax treaty, Hardy should refer to Article 4 of the relevant treaty and review the definition of resident in the context of Laurel's circumstances.

If Laurel is arriving from a non-treaty jurisdiction (for example, Hong Kong, Taiwan, Colombia, Greece or Turkey), Hardy must consider the possibility that his client remains a resident of her former country, and so is a dual resident. Hardy should discuss this with Laurel's tax adviser in her former country of residence. Dual residence can result in double taxation, and Laurel may be able to avoid the situation by taking appropriate steps. For example, she might be told to dispose of her former residence when she moves.

Immigration of a US citizen

If Laurel is a U.S. citizen, she remains liable to U.S. income tax on her world-wide income. Consequently, a myriad of different considerations apply, which are beyond the scope of this article. Hardy must consult an experienced U.S. tax adviser and work with the adviser to arrive at the best solution. Offshore trusts can cause tax problems for U.S. citizens; sometimes a U.S. resident immigration trust can be a solution.

Temporary Residence "Nowhere"

If the tax laws of the country from which Laurel is emigrating provide that Laurel becomes non-resident when she leaves that country or possibly even earlier, she has the possibility of short-term residence "nowhere". To do this, she would visit a jurisdiction that does not tax individuals spending a short time there, before becoming a Canadian resident.

Depending on tax legislation in Laurel's former country of residence, there may be tax saving opportunities for Laurel while resident "nowhere". For example, certain income received during that period may not be taxed anywhere.

For this approach to be effective, advance planning is essential, as well as coordination between Hardy and Laurel's foreign tax adviser.

Property Owned by Laurel on her Arrival Date

The starting point for most assets owned by Laurel on the date she becomes resident here is their fair market value at that date. This means that only the gain or loss between the date Laurel becomes a Canadian resident and the date the property is sold will be taxed. There are exceptions for so-called "taxable Canadian property", which includes Canadian real estate and shares in Canadian private corporations.

The valuation of quoted stocks is obviously not a problem. For other assets (for example, foreign real estate or foreign businesses), consideration should be given to obtaining a formal valuation at Laurel's arrival date.

If Laurel leaves Canada permanently within 60 months of becoming resident, a special provision of the Canadian Income Tax Act ("ITA") exempts any deemed capital gain on her departure for assets she owned on her arrival date.

Pre-Arrival Planning

All income that Laurel receives on or after the date that she becomes a Canadian resident will be subject to Canadian tax. She should therefore try to receive all significant income while she is non-resident. For example:

- Bonuses from a former employer, and any other lump sum payments related to her foreign employment, should be received before she becomes a Canadian resident, as should any lump sum pension payments.
- One way of handling accrued bank interest is for Laurel to close out her interest-earning bank accounts while non-resident. This usually results in income being credited to the account on the date the account is closed. Laurel can immediately transfer the balance to a new bank account.
- Interest on her investments may be payable after Laurel's arrival in Canada. These investments could be sold while she is non-resident and repurchased after the payment date.
- Laurel should consider postponing the payment of tax-deductible expenses until after she becomes resident in Canada.

- Hardy might bill Laurel for his professional services before she becomes resident in Canada. This avoids GST on his fee.
- Existing stock options, vested or non-vested, may present problems. Hardy will need to work with Laurel's foreign tax adviser to determine the most effective way of minimising the total (Canadian and foreign) tax cost of exercising the options and avoiding double taxation. Alternatives include exercising the options before arrival, waiting until Laurel is resident here, or exercising them while she is resident "nowhere". With a cooperative employer, it may be worth looking at the possibility of cancelling the options and replacing them with equivalent, but more tax-efficient, remuneration.

Foreign Source Income and Foreign Accrual Property Income ("FAPI")

In general, foreign source income earned after Laurel's arrival will be subject to Canadian tax, with a foreign tax credit to offset any foreign tax paid on that income. However, reference must be made by Hardy to the relevant double tax treaty, which may limit or eliminate the taxation of some items of income (e.g. certain pension payments), and govern the calculation of the foreign tax credit.

If Laurel controls a foreign corporation which earns "passive" income, such as interest and portfolio dividends or rental income, the income of the corporation will be taxable to her personally on an ongoing basis once she becomes resident in Canada. There is an exception when the "passive" income is ancillary to business income. Hardy should consider alternatives – for example, putting the shares of the foreign corporation into an immigration trust, or liquidating the corporation and transferring its assets to an immigration trust.

Immigration Trust

A five year "immigration trust" may provide a significant benefit for Laurel.

Generally, if a Canadian resident contributes to a foreign trust, the trust will be taxable in Canada. However, there is an exception for new arrivals. Such persons may set up an offshore trust (usually in a no-tax jurisdiction), transfer assets to it, and take advantage of a special provision of the ITA which provides for the income of the trust to be exempt from Canadian taxation for a maximum of five years.

If the trust is settled before Laurel becomes a Canadian resident, the full five year exemption may be claimed.

At the end of the five year period there are various possibilities. For example, the trust may distribute the assets to the Canadian resident beneficiaries, who will acquire them at their fair market value at the date of the distribution. The trust may become a Canadian resident trust on the fifth anniversary date by replacing the offshore trustee with a Canadian resident trustee. The adjusted cost base of the assets of the trust will be their fair market value at the date the trust becomes resident here. If the latter approach is followed, consideration should be given to selecting an Alberta resident trustee, so making the trust liable to tax at the top Alberta personal tax rate, which is six or seven percentage points lower than the rate in most other Canadian provinces.

Several technical provisions of the ITA have to be taken into account when the "immigration trust" deed is drafted. Accordingly, a professional with experience in setting up such trusts should be used. Sometimes an immigrant to Canada is already the beneficiary of an offshore trust. In that case, a specialist should be asked to advise on whether the trust could operate as an immigration trust. If not, what changes to the trust deed are required?

It is essential to consider the financial consequences of setting up an immigration trust. The tax potentially saved over the five years must be compared with the cost of setting up and operating the trust for the same period, before a final decision is taken.

It is essential that an immigrant trust be non-resident. For this purpose, the residence of the trustees is the deciding factor. Normally a professional trustee should be appointed (usually a trust company).

The immigrant who seeks advice after arrival

Most of the suggestions above do not work if Laurel waits to contact Hardy until after she has become resident here.

The immigration trust is still available, but not for the full five year period. Depending on how long Laurel has been resident, it may be available only for four or even fewer years. In some cases, this will reduce the potential tax saving below the costs of setting up and operating the trust.

Conclusion

A number of tax-saving possibilities may be available to the immigrant who seeks professional advice in Canada before becoming resident here. Many of the tax planning opportunities are either impossible or much more difficult to implement after becoming Canadian resident.

Canadian Unlimited Liability Companies

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While of little interest to Canadians, unlimited liability companies are of great interest to U.S. purchasers of Canadian companies.

Since 1900, corporate law in Nova Scotia has been modeled on the English style registration system and differs from Canadian corporate law in other provinces, which is entirely statute based. A Nova Scotia Unlimited Liability Corporation ("NSULC") is one of three types of corporations that can be created in that province (either with or without share capital).

In 1995, the U.S. Internal Revenue Service ruled that an NSULC is an "eligible entity" with the result that it will be treated as a partnership if it has more than one shareholder or a "disregarded entity" if it has only a single shareholder. However, under the "check-the-box" rules, an NSULC may elect to be treated as a corporation for U.S. purposes if so desired.

Thus, in cross-border tax planning, an unlimited liability corporation is a "hybrid entity" which presents significant Canada-U.S. tax planning opportunities. While, under Canadian law, an NSULC is considered a corporation for both corporate and tax purposes, for U.S. tax purposes, it is a "flow-through" entity. Accordingly for Canadian tax purposes, an NSULC is a stand alone entity, but for U.S. tax purposes all of the NSULC's tax attributes, such as income, losses, interest expense and taxes payable, are considered to be those of the shareholder(s) of the NSULC.

Until recently, Nova Scotia was the only Canadian jurisdiction to allow these hybrid entities, so the NSULC became a cottage industry for Nova Scotia lawyers. Not wanting to be left out of the game, the mandarins in Alberta introduced similar legislation that was enacted in May 2005 and updated in December 2005.

Comparing an NSULC to an Alberta Unlimited Liability Corporation ("AULC") reveals some interesting differences.

Firstly, an NSULC is not required to have any Canadian directors, while at least 1/4 of the directors of an AULC must be Canadian resident.

Secondly, an NSULC has both an incorporation fee of $4,000 and a registration tax of $2,000, while the incorporation fee for an AULC is only $100. Also, an NSULC has an annual fee of $2,000 while there is no annual fee for an AULC.

Thirdly, migrating and converting a non-Alberta limited corporation into an AULC may be accomplished in a single step, whereas it is a multi-stage process for a non-Nova Scotia corporation to become an NSULC.

Fourthly, while an NSULC continues to be governed by antiquated law, AULC are governed by the Alberta Business Corporations Act, which is a modern statute. As such, mergers and other forms of corporate reorganizations tend to be simpler to undertake.

Finally, as the name implies, the debts and other obligations of unlimited liability companies can flow through to the shareholders. It is common for both Canadian and U.S. shareholders to insert a "blocker" corporation between the unlimited liability company and the ultimate shareholders. Although the shareholder of an NSULC is not directly liable to the creditors of the NSULC, both the past and present shareholders of an NSULC are responsible for any deficiency on the winding-up of an NSULC. Past and present shareholders of an AULC are jointly and severally liable for all liabilities of the company. However, a past shareholder of an NSULC who ceased to be a shareholder a year or more before the commencement of the winding-up has no liability. Although not initially part of the Alberta legislation, new rules provide that a former shareholder of an AULC is not liable for any amount unless the claim was commenced within two years from the date upon which the person ceased to be a shareholder of the AULC. Both an NSULC and AULC have rules that protect a former shareholder from liabilities that arose after they ceased to be a shareholder.

Generally, the tax planning opportunities that unlimited liability corporations ("ULC") present for U.S. investors in Canada include:

1. The ability to claim start-up and on-going losses from Canadian operations without having to carry on business directly or through a partnership. As these losses continue to be "warehoused" in the ULC for Canadian tax purposes, they are available to offset future income in Canada. Subject to the acquisition of control rules, any losses carried forward would be available to a future owner of the corporation even though the U.S. shareholder has already claimed them in the U.S.
2. Subject to certain limitations, U.S. shareholders of a ULC will be able to claim a direct foreign tax credit for any tax paid in Canada by the ULC. This is particularly valuable to individuals and trusts that hold shares of a Canadian ULC either directly or indirectly through an LLC or an S-corporation.
3. Subject to the thin capitalization rules, a ULC can be used as a very efficient financing vehicle in connection with the acquisition of a Canadian target by a U.S. investor. This structure may be used in combination with an election to step up the tax cost of the assets of the Canadian target for U.S. tax purposes.
4. A ULC can serve as a beneficiary of a Canadian trust.
5. U.S. investors may use a ULC to own an interest in a partnership that desires to remain a Canadian partnership.

Do not be surprised if, in the course of selling a Canadian corporation, there is a flurry of activity to transform the corporation into a ULC. This is a tax-free reorganization in Canada to accommodate the tax planning objectives of the U.S. purchaser.

As a result of recent changes announced to the Canada-U.S. Treaty, to be effective in three years, it may be necessary to rethink some of the structures involving ULCs. We will be monitoring this with great interest.

Do Taxes Give You A Headache? Get Help Or Pay The Price!

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In 1997, the Canadian Taxpayers Federation called for simplification of the Canadian tax system, citing a survey that showed 81% of Members of Parliament sought help to complete their own income tax returns. Ten years later, the tax system has become even more difficult to navigate, with a myriad of new rules affecting individuals and corporations alike.

With all the increasing complexity, how does the average Canadian taxpayer cope? Some become overwhelmed and bury their heads in the sand, paying little or no attention to their income taxes. As the recent case of Christiane Le Tremble (2006TCC568) points out, however, this approach can invite significant penalties.

What follows is based on the official translation of the judgement, since the case was originally reported in French.

Christiane Le Tremble was a self-employed psychologist who worked long hours in a private clinic. Although she had someone who managed her files and prepared her billings, Ms. Le Tremble did not maintain accounting records for her business. She stated that she was not interested in anything to do with the accounting of her income; all that mattered was to have enough income to meet her obligations. Concerning her taxes, she did not have the interest, the knowledge, the will to understand or the time to do so, given the demands of her workload. Ms. Le Tremble collected all professional fees herself and deposited them in her personal bank account. As long as the deposits enabled her to cover her expenses, whether personal or professional, she did not ask any questions.

At year-end, she put documents concerning her fees and expenses into a plastic bag and submitted them to an accountant who completed her tax returns. While Ms. Le Tremble admitted that the accountant prepared her tax returns correctly, based on the information submitted, an audit revealed that significant income had been omitted. In 2001, only 43% of deposits were reported and her 2002 tax return included only 58% of deposits.

Ms. Le Tremble was assessed under subsection 163(2) of the Income Tax Act, which imposes a penalty equal to 50% of underpaid taxes where a person "knowingly, or under circumstances amounting to gross negligence, has made… a false statement or omission in a return."

With all the increasing complexity, how does the average Canadian taxpayer cope? Some become overwhelmed and bury their heads in the sand, paying little or no attention to their income taxes.

Ms. Le Tremble appealed the assessment, claiming in her defence, "I never had any intention of not reporting my income to the tax authorities and I find your claim that I 'knowingly'… made an omission in my returns is offensive, out of place and false." In her Notice of Appeal, Ms. Le Tremble stated, "I was never informed by anyone that the deposits were required to determine my income since the invoices and stubs from my clients' cheques seemed to be sufficient for my returns." She also pointed out that at the time of the tax audit, she and her new accountant promptly provided all the documents that were requested. She concluded, "I consider that if I had wanted to 'knowingly' make omissions, our work methods would have been very different."

The Court, however, upheld the penalties. In rendering his decision, Justice Alain Tardif said, "To conclude that there was gross negligence, it is not necessary to demonstrate the intentional or deliberate aspect or the setting up of a system designed to hide part of her income." He further stated, "However, commission of gross negligence can result from carelessness, negligence or simply unjustifiable disinterest in one's tax obligations, or, what often summarizes all of these qualifiers, very convenient voluntary blindness."

He noted that Ms. Le Tremble's discomfort with taxes did not diminish in any way her duty to report all of her income. Being unable to meet this obligation on her own, she had the responsibility to find an alternative that would have allowed all of her income to be reported. "Not being interested in the tax treatment of one's income, not understanding it or even not wanting to understand it is not, in itself, reprehensible. However, taxpayers are required to do what is necessary to compensate for this shortcoming by entrusting the task to a competent person and, in particular, provide that person with all relevant documentation required to prepare an income tax return corresponding with the actual revenues and expenses."

"Although … taxation can be complex, this is not different from other fields of activity. Indeed, automobile mechanics, construction, electricity and anything relating to good health are fields where it is necessary to rely on skilled individuals to solve certain problems."

Since we cannot rely on the tax system becoming simpler, it is essential to consult a qualified tax advisor if you do not have the time, expertise or desire to manage your own taxes. It is also important to maintain complete financial records and provide all relevant information to your advisors. As the Le Tremble case demonstrates, failing to do so could vastly increase your tax bill! ⬬

Non-Residents Buying Canadian Real Estate

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As the economy becomes more global, many people are buying real estate in other countries. The reason could be simply wanting a foreign vacation home, or diversifying an investment portfolio by owning income-producing property in another part of the world.

More and more non-resident clients have been buying Canadian real estate. As with all cross-border transactions, there are many tax issues with which they are required to comply.

This article outlines the Canadian tax legislation concerning non-residents who purchase and rent property in Canada, including possible ways to reduce tax.

Suppose we have a fictitious client, Robert, resident in London, England. He has decided to expand his real estate portfolio by purchasing a condominium in downtown Toronto that he plans to rent. He has no plans to live in the property, and hopes to sell it in future for a large capital gain.

As a non-resident of Canada, Robert is required to have 25% of the gross rental income withheld and remitted monthly to the Canada Revenue Agency ("CRA"), within fifteen days of each month-end, either by the tenant or by a Canadian agent nominated by Robert.

A summary of the gross rent paid to Robert and the tax withheld on that rent must be provided to the CRA by March 31 in each calendar year on form NR4 "Statement of Amounts Paid or Credited to Non-residents of Canada". If tax is not withheld, interest will likely be charged by the CRA from the date of each rent payment, plus a 10% penalty.

If Robert so wishes, this could be his only Canadian tax report. Robert would declare his rental income to the U.K. tax authorities, and use the Canadian income tax withheld as a foreign tax credit on his U.K. return. However, 25% of the gross rent is a considerable amount of tax. Depending on the level of expenses, it may exceed the eligible U.K. tax credit.

To reduce the Canadian income tax payable, Robert can elect to file a Canadian personal income tax return reporting only his Canadian rental income. The return, required under Section 216 of the Canadian Income Tax Act, is due two years after the year-end. By filing this return, Robert may obtain a partial or full refund of the tax remitted to the CRA.

Robert would report on the return his gross rental income and deduct expenses such as property taxes, repairs and maintenance, interest on debt used to purchase the property, condominium fees, depreciation, property management fees, etc. Tax will be calculated on the net rental income at graduated personal tax rates. The lowest personal tax rate in Ontario is approximately 20% on up to about $37,000 of annual taxable income.

Whether filing a tax return is beneficial will depend on Robert's expenses, which are deductible from net rental income. The top personal tax bracket in Ontario for an individual is around 46%. So, if the income is very high and the expenses are low, the election may not be beneficial.

By adjusting the level of debt financing, a break-even can be structured. The level of debt is a personal choice, but most non-residents will have difficulty borrowing in Canada more than 65% of the property value. The interest rate and the debt level may be negotiated with a Canadian bank. Interest will be deductible if paid on debt used to purchase the property, whether the lender is Canadian or foreign. However, non-resident withholding tax will apply on foreign debt secured on Canadian property. (Under recent proposals, the withholding tax may soon be eliminated on arm's length debt.)

The appropriate rent will best be investigated by a local real estate broker. The broker may also manage the property, find tenants and pay expenses as agent for a fee, which will be deductible.

If the property is residential, no goods and services tax (GST) is payable on the rental income, and no credit is given for GST paid. For commercial property, GST registration may be required, which will probably be beneficial.

To improve cash flow, Robert can file form NR6, requesting that tax be withheld at 25% on the estimated net income, rather than on the gross income. This form should be filed annually prior to receiving any rent for the year. A statement showing expected gross rent and expenses (other than depreciation) must accompany form NR6. Robert should provide the required information to his Canadian tax adviser by November or December of the prior year. By filing this form, Robert will reduce the tax initially remitted to the CRA. Form NR6 requires that the non-resident assign an agent to remit withholding tax and

continued...

to deal with the CRA. The agent is jointly and severally liable for the tax, which sometimes makes it difficult to find a volunteer agent. When form NR6 is filed, the Section 216 return must be filed by June 30th of the following year (18 months earlier than otherwise).

When Robert's property is sold, a 25% withholding tax will apply to the gross proceeds. This can be reduced, by requesting a special clearance, to 25% of the net capital gain. The gain is taxable in Canada. Under Canadian rules, 50% of the gain, and any depreciation previously claimed, will be reported on Robert's Canadian personal tax return and taxed at Canadian personal tax rates. Curiously, the return is filed separately from the Section 216 return.

As will be appreciated from the foregoing, owning Canadian rental real estate is complicated. The CRA has been much stricter recently in applying these rules. Penalties for late filing, or for failure to withhold, will be applied by the CRA. Consequently, care must be taken to follow all the rules.

IN BRIEF

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Canada - U.S Treaty

On September 21, 2007, the Fifth Protocol to the Canada-U.S. Income Tax Convention was signed by the Minister of Finance and the U.S. Secretary of the Treasury. The Fifth Protocol will enter into force on the later of the date it is ratified by both governments or on January 1, 2008. Key aspects of the treaty are as follows:

1. It eliminates withholding tax on cross-border interest payments to both arm's length parties and non-arm's length parties. There will be a phase-in for non-arm's length interest, reducing the rate from 10% to nil over three years.

2. Treaty benefits will be extended to limited liability companies ("LLCs"). This has been a significant issue for many years, since LLCs are so prevalent in the United States. If the shareholders of an LLC are U.S. residents, the treaty will apply to them.

3. Taxpayers will now be able to settle certain issues, such as transfer pricing disputes, through binding arbitration.

4. New rules attempt to avoid double taxation when a taxpayer moves from one country to the other.

5. The taxation of stock options between the two countries is clarified, in an attempt to avoid double taxation of the benefits.

Foreign Investment Entities ("FIE")

The Bill that incorporated the changes to the FIE draft legislation received first reading in the Senate on June 18, 2007.

The FIE legislation is supposed to be effective from January 1, 2007. However, the Parliamentary session ended without the Bill becoming law, so the Bill dealing with FIEs (and non-resident trusts) will have to be re-introduced. This delay could result in the legislation not being passed by the time the first FIE reports are due next April. We shall have to wait and see.

Pension Income Splitting

When filing their 2007 personal income tax returns, Canadian residents will be able to split pension income with their spouse. The pension income that can be split is defined as "eligible pension income", being:

a. The taxable part of annuity payments from a superannuation or pension fund or plan; and

b. Amounts received by a surviving spouse or a person 65 years or older from

i) Annuity and RRIF payments

ii) RRSP annuity payments

In order to split the eligible pension income, Form T1032 must be completed by the recipient of the pension and their spouse.Tax withheld from eligible pension income will be allocated in the same proportion as the pension income.

This is a significant tax savings opportunity for those receiving eligible pension income.

SR&ED Discussion Process

The Canada Revenue Agency and the Department of Finance recently issued a Consultation Paper asking for input concerning ways to improve the SR&ED tax incentive program. The government is trying to identify "priority areas" where the program needs improvement. They request suggestions about how to streamline the program administration.

The Trouble With Stock Options

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a capital loss. Except in limited cases involving Canadian-controlled private corporations that have predominantly Canadian assets used only in an active business, the capital loss will not be deductible against other income, except against capital gains. If the employee has no capital gains, there may be no way to apply the loss.

Carrying forward the example above, suppose that the shares were sold for $4 a share. Economically, the employee has $2 of net gain. However, depending on the circumstances, the employee may be taxable on $5 of income or even $10 (if the 50% deduction is not available). In the latter case, the tax can exceed the economic benefit to the employee. In such a circumstance, the employee would be well advised to continue to hold the shares, as selling them will result in more tax than the cash gain.

The second disadvantage of stock options follows from the above, that is, the demotivating effects of a declining stock price on employee morale. Rather than motivate, a declining stock price may leave employees fixated on their own personal misfortunes and discontent may become widespread. The more the stock option program is promoted, the greater the damage to employee morale in a down market.

The third disadvantage concerns the company. In Canada, no tax deduction is given for stock option benefits, even though they are taxable to the employee. Also, no expense may be taken into account for R&D tax credit purposes. However, under new accounting standards, the stock option benefit may need to be expensed in the financial statements, depressing earnings per share.

Take these points into account before putting a stock option program in place. While stock options do have considerable benefits, like everything they also have disadvantages. ●

TAX PERSPECTIVES

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