

# The J Thomas McCallum Letter

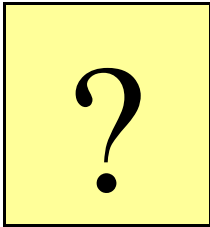
advancing the understanding of income tax and valuation matters

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Winter 2006

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## Question of the Year



A year ago Finance announced that the dividend tax credit would be enhanced to “level the playing field between corporations and income trusts”. Now that the new Minister of Finance has ‘moved’ on income trusts (beginning in 2011), will the dividend tax credit change also then be rescinded? Finance hasn’t said anything, but wouldn’t it be appropriate to make that change? After all, the change wouldn’t be needed anymore.

## Words, Words, Words

A portion of the recently introduced technical amendments to the *Income Tax Act* are described as “Amendments Related to Bijuralism”. *Bijuralism?* That sent me scurrying to my trusty Oxford dictionary, but alas, it wasn’t in my dictionary.

Bijuralism can be most simply explained as the art of drafting legislation so as to respect the co-existence of two major contemporary legal traditions such as (for Canada) civil law and common law. This is important because the *Act* is written in both English and French, and taxpayers should expect the same result no matter

which version is used and/or in which jurisdiction they find themselves.

Another *Act* change, which to me is a mind-boggling tongue twister, is that the word “twice” has been deleted (in certain provisions) and replaced by “*the fraction that is the reciprocal of the fraction in paragraph ... that applies to the taxpayer for the year, multiplied by ...*”. **Huh?**

## Multiple Failures Penalty

A taxpayer who fails to report an income amount and who also had the same failing in any one of the three prior years, may find themselves subjected to a [fairly new] penalty which I’m told CRA is readily imposing. The penalty is 10% of the unreported income (with an additional 10% levied by the province) and there is no requirement for CRA to establish either intent or negligence.

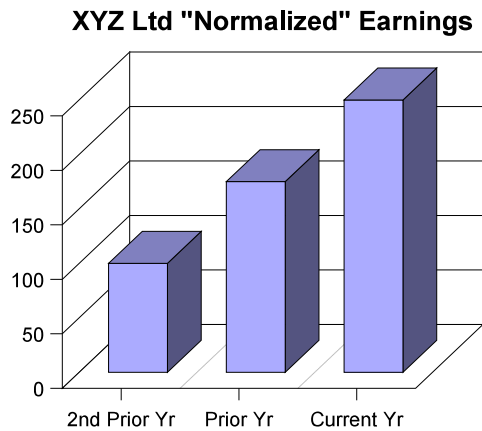
Given that the penalty is set at a percentage of income, it can apply whether income taxes are owed or not. So something as simple as honestly forgetting to include a T-slip with a tax return could trigger the penalty.

## Look Past The Trees!

Your client is embroiled in a marital dispute and the value of his business is

an issue. You act as his accountant and so he's engaged you to provide your opinion as to the fair market value of his business.

The past three years of the business show the following trend:—

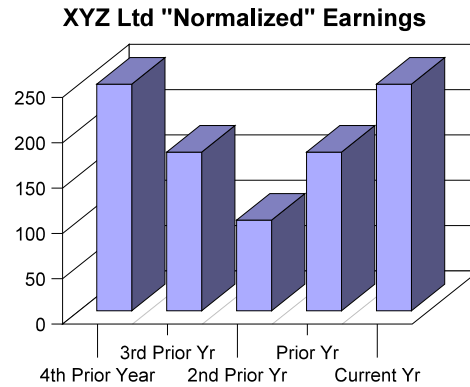


Given the upward trend in earnings you select the \$250,000 current year earnings as your estimate of maintainable earnings. After analysing the business organization, structure and financial position, you capitalize those earnings at 15% (6.67×). Your opinion is that the business has a value of \$1,650,000 (rounded).

Surprisingly, the wife's side does not dispute your finding and a settlement is made based on your opinion report.

A few weeks later you find yourself on the wrong end of a professional negligence lawsuit brought against you by your client. It seems your client is disputing the valuation advice you gave him.

A quick perusal of the rationale shows quite a different picture as to the value of the business.



The valuator has used a straight arithmetical average of five years earnings in determining her \$190,000 estimate of maintainable earnings. She too used a 15% (6.67×) capitalization rate in opining a \$1,250,000 (rounded) value for the business.

The difference between the two valuations is that the latter captured — correctly — a business cycle. Your valuation was based only on the tail end of a normal business cycle, hence maintainable earnings were over-estimated.

### **Two Favourite Tax Quotes**

Bonner, TCJ *"A cow does not become an aircraft simply because an accountant so describes it"*.

Finch, J *"It surpasses my imagination that anyone considers language such as this to be capable of intelligent*

*understanding, or that such language is thought to be capable of application to the events of real life, such as the sale of a business”.*

### **Regulations Re-Visited**

It's well known that capital cost allowance (“CCA”) on rental property is limited to profits otherwise. That is, CCA can only be used to bring the net rental income to zero.

Less known though is an *exception* to that rule for a corporation whose principal business is leasing, rental, development or sale of real property owned by it.

The CCA available via that exception can be a handy little tax shelter against other income in a REALCO which holds the real property used by OPCO.

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From time to time Finance is fond of moving depreciable property to a new CCA Class. What then when you dispose of property in the old Class, which leaves you with a recapture of CCA, but you've replaced the property?

Rather than bring that CCA recapture into income, you can elect — in the year the old property is disposed of — to transfer the undepreciated capital cost of the old Class into the new Class, thus avoiding the recapture.

### **Coming Soon?**

This past summer the Canadian government spent several million

dollars in evacuating some 15,000 Canadians from Lebanon. Turns out that most held dual citizenship and were full-time residents of Lebanon.

It's estimated that around 2.5 million Canadian citizens are living outside Canada; and most of these hold dual-citizenship.

There is a move afoot — rightly, I suggest — to re-examine Canada's income tax system, which solely uses residency as its main basis, and add citizenship as an additional basis (*à la* the USA). Makes sense in today's global economy doesn't it?

### *The J Thomas McCallum Letter*

Published periodically as information for the accounting, legal and other professional firms who are clients of or referral sources for the tax and valuation practice of

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**Merry Christmas  
and  
Happy Chanukah**

Comparison of Provincial/Territorial Dividend Tax Credit (2006 on)					
Province Territory	Eligible Dividend	Ineligible Dividend	Province Territory	Eligible Dividend	Ineligible Dividend
B.C.	12.0%	5.10%	N.B.	12.00%	3.7%
Alberta <sup>1</sup>	10.0%	3.50%	N.S.	8.85%	7.7%
Saskatchewan	11.0%	8.00%	Nfld/Lab	6.65%	5.0%
Manitoba <sup>2</sup>	11.0%	3.67%	NWT	11.5%	6.0%
Ontario <sup>3</sup>	7.7%	5.13%	Nunavut	4.0%	4.0%
Quebec	11.9%	8.00%	PEI and Yukon Territory have not yet announced any changes		

<sup>1</sup> phased-in 2006 - 2009 (the rates shown are for 2009)  
<sup>2</sup> phased-in 2006 and 2007 (the rate shown for ineligible dividends is for 2007)  
<sup>3</sup> phased-in 2006 - 2010 (the rate shown for eligible dividends is for 2010); if subject to surtax, the tax credits are up to 56% larger than indicated (12% and 8% respectively)



## My Upcoming Presentations

**Always Fun! Always Informative!**

December 14	Business Valuation	Oshawa	Evening
January 23	Income Tax Update	Oshawa	Evening
February 8 & 9	Personal Income Tax Fundamentals	Toronto	Two Full Days
February 22	Income Tax Beyond The Basics	Toronto	Full Day
March 3	Income Tax Update	Barrie	Morning
March 7	Income Tax Update	Mississauga	Evening

Tentatively scheduled to give a Tax Update in Sudbury and North Bay in January (dates not confirmed yet). Also tentatively scheduled to present Corporate Re-organizations *Plus* in Red Deer, Alberta on June 22, 2007