The J Thomas McCallum Letter

advancing the understanding of income tax and valuation matters

Winter 2011

Fear Factor

I was recently approached by a CGA who was understandably confused by some sexy (by tax strategy standards!) descriptions that were being thrown around by advisers who were looking to convince his clients to change accountants. He was concerned he actually was missing something.

One was the "bump" strategy. As a descriptor that could refer to a number of things, so in isolation it meant nothing, but sounded good to the uninformed client's ear.

We could use "bump" to refer to a crystallization of the capital gains deduction, or we could use it to refer (where allowed) to increasing the paid-up capital of shares, or we could use it to capture the process of stepping-up (hey, there's another one![1]) the ACB of assets on a corporate takeover.

"Pipeline" or "pipelining" is yet another. It almost always refers to using inter-corporate dividends. For example, dividends from OPCO to HOLDCO via the "pipeline" which is the shares HOLDCO owns in OPCO. Doesn't the HOLDCO/OPCO relationship sounds a whole lot sexier when described as a "pipeline"?

Perhaps the classic one is the "Smith Manouevre". This strategy was around long before Mr. Smith wrote his book, but since that time the strategy has borne his name. Yet another is the Cheyenne Shuffle, also known as the Wyoming Shuffle, and there are many others.

Don't let these fancy name strategies confuse or intimidate you; they very often are just currently favoured descriptions of long-held conventional tax strategies, sometimes previously known by a different name or no name at all.

[1] we could name that "laddering"

Medical Flyer

In *Johnson v. The Queen, 2010 TCC 321* the Tax Court of Canada held that an "amount paid" includes payments made by a transfer of a right or thing where the value of the right can be expressed in money.

The taxpayer had used 76,000 Aeroplan points to fly to Chicago for medical treatment, and claimed the equivalent value of 3¢ per point ($2,280) as a medical expense.

Confusing Landscape

In adopting International Financial Reporting Standards (IFRS) the Canadian Institute of Chartered Accountants has adopted the term "fair value" in the accounting standard as, more-or-less, a synonym for "fair market value".

In my opinion this is unfortunate because its definition is not consistent with the long-held definition of "fair value" used by the courts in applying the fairness provisions of the *Business Corporations Act*, and will likely eventually be a source of confusion and contradictory outcomes.

English construction allows that the adjective qualifies the word that follows. So the "fair" in fair market value qualifies the market whereas "fair" in fair value qualifies value. So, if I can be so bold, to use "fair value" as a synonym for "fair market value" might be a misadventure.

Then again, by defining "fair value" in the CICA Handbook, the Institute might very well dodge the bullet. It defines it as *the amount for which an asset could be exchanged between knowledgeable, willing parties in an arm's length transaction*.

When compared to the accepted definition of fair market value, the following points are omitted:

- the highest price available,
- an open and unrestricted market, and
- parties under no compulsion to transact.

Double Up or Not?

There are a number of times American and Canadian spellings differ, but to me none is more fascinating than sometimes they use a double consonant whereas we use a single, and sometimes it's vice versa.

For example the American spelling is "installment" whereas ours is "instalment" and we use "enrol" and they use "enroll". But in the USA a person is a "medalist" whereas here they are a "medallist" and the same is true of "counselor" and "counsellor".

Why? As Lou Costello would say "I don't know".

When A Capital Loss Isn't

In the definition of "capital property" found in the *Income Tax Act,* depreciable property is set out separately from *"any property ... any gain or loss from a disposition ... would be a capital gain or capital loss"*.

The reason for that is there's no such thing as a capital loss on depreciable loss. Any loss on a depreciable property is a terminal loss under the capital cost allowance system (or has already been allowed as CCA). That makes it 100% deductible, not 50% and there's no limit on the kinds of income it can be deducted from. I was recently reminded that this is sometimes forgotten.

A person had purchased a condominium apartment to use as a rental property. After a couple of years of ownership she

sold it for a loss and her accountant showed this loss as a capital loss in his client's tax return. This was incorrect and amending the tax return resulted in a substantial tax recovery.

The accountant did though claim some 'logic' to his approach. His rationalization was that the client had never set the property up in her return as a depreciable asset as she had no intention of taking capital cost allowance, and so by his thinking, this wasn't a depreciable property.

The accountant's thinking was flawed. Not "setting this up" as a depreciable property in a CCA schedule is irrelevant as to whether the property is or is not a depreciable property.

A 'Form' Of Rollover

CCA "Classes" can be arbitrarily changed by Regulation revision and do not require Parliament passing amendments to the *Income Tax Act*.

Over the last several years we've seen brick buildings go from Class 3 (5% CCA) to Class 1 (4% CCA) and frame buildings go from Class 6 (10% CCA) to Class 3 and then to Class 1.

What can happen — if you're not careful — is that you can erroneously assume a CCA recapture applies where an 'old Class' building is sold notwithstanding that it is replaced with a 'new Class' building.

Say your client has sold his Class 3 building for $175,000 when the UCC was $75,000 and acquired a new building (Class 1) for $400,000. ***Do not*** report a CCA recapture of $100,000! An election should be filed under REG 1103(2d) to 'move' the old Class 3 property to Class 1, and thus avert the recapture.

Class 1 ('old Class' 3) UCC	$ 75,000
Additions	400,000
	$475,000
Disposals	175,000
Class 1 UCC	$300,000

Anyone else remember when union dues were only deductible as part of medical expenses?

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How Do They Stack Up?				
2011 Corporate Tax Rate on Small Business Income				
Province/Territory	Rate	Province/Territory	Rate	Notes
Manitoba	0.0%	Nfld, NWT, Nunavut, and Yukon	4.0%	The annual business limit is $400,000 in Manitoba, Nova Scotia and Yukon; $500,000 everywhere else.
PEI	1.0%	Ontario and Sask	4.5%	
BC	2.5%	NB and NS	5.0%	
Alberta	3.0%	Quebec	8.0%	

Make A Note to Attend

My Upcoming Presentations

Always Fun! Always Informative!

January 25	Income Tax Update	Oshawa	Evening
January 27	Corporate and Personal Income Tax Update and Refresher	Toronto	Full-day
February 4	Income Tax Update + OBCA For Accountants	Niagara Falls	Full-day
February 10	Advanced Tax	Mississauga	Full-day
February 12	Income Tax Update	Markham	Half-day
February 16/17	Personal Tax Essentials	Ottawa	Full-days
February 24/25	Personal Tax Essentials	Toronto	Full-days
March 2	Advanced Tax	Toronto	Full-day
March 15	Income Tax Update	Brampton	Evening
April 20	Use Of Holding Companies	Brampton	Evening

Additional presentations are scheduled for May and June; details will be in the next issue