Tax Law Update

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INTRODUCTION

The purpose of this paper is to provide a brief overview of some of the typical tax issues facing a small or solo practitioner in general practice. I have also added a few new tax issues and some planning ideas that could be extremely useful and should be borne in mind for some specific situations.

CHOOSING A TAX LAWYER OR AN ACCOUNTANT TO ASSIST YOU

It is important to understand the difference between a tax lawyer and an accountant when tax advice is required. As a general rule, accountants work mostly in the area of tax compliance – that is, they assist taxpayers in preparing and filing the tax returns and other documents that are required by the Canada Revenue Agency ("CRA") to keep the taxpayer in compliance with the Income Tax Act (the "Act"). On the other hand, tax lawyers generally work in the area of tax planning – that is they put together plans and structures to assist the taxpayer in minimizing their tax liability. Some accountants specialize in tax planning and are very good at it but most accountants will refer tax planning work to tax lawyers or specialist tax accountants. Both accountants and tax lawyers will assist in resolving disputes with the CRA with accountants most involved at the audit stage tax lawyers mostly brought in when the possibility of litigation arises. Bear in mind, also, that lawyers generally have privilege over their communications with clients whereas accountants generally do not

FAMILY TAX ISSUES

Who are Spouses and Common Law Partners under the Act?

For the most part, the Act treats spouses and common law partners the same, including spouses and partners of the same sex. For ease of writing this paper, the term "spouse" includes a common law partner and "marriage" includes a common law partnership.

Common-Law Partner "means a person who cohabits at that time in a conjugal relationship with the taxpayer and (a) has so cohabited with the taxpayer for a continuous period of at least one year, or (b) would be the parent of a child [of whom the taxpayer is a natural parent] and, for the purposes of this definition, where at any time the taxpayer and the person cohabit in a conjugal relationship, they are, at any particular time after that time, deemed to be cohabiting in a conjugal relationship unless they were not cohabiting at the particular time for a period of at least 90 days that includes the particular time because of a breakdown of their conjugal relationship".

Should I give property to my spouse or children?

The transfer of property generally gives rise to a capital gain if the fair market value ("FMV") of the property exceeds what you paid for it ("adjusted cost base" or "ACB").

If a person gives property (e.g. cash, real estate, shares and other investments) to their child, the following consequences arise:

1. The transfer will be deemed to be a disposition with FMV proceeds. In other words, a capital gain of the deemed FMV proceeds less the ACB will be triggered and taxed in the person's hands;

2. Any income derived from that property (e.g. dividends from shares, rent from real estate, interest from cash invested in GICs) will be attributed back to the person (i.e. the person pays the tax on that income at his or her marginal tax rates) until the child turns 18;

3. If the child subsequently disposes of the property at any age, there is no attribution of the capital gains back to the person;

4. The child will have an ACB in the property of the FMV of the property at the time the gift is made.

If a person gives property to a spouse, the following consequences arise:

1. The transfer will be an automatic "rollover" to the spouse and no capital gains will arise at the time of the transfer.[1]

2. Any income derived from that property will be attributed back to the person until he or she dies or the marriage breaks down;

[1] A rollover means that the transferor is deemed to have disposed of the property at the transferor's ACB and the transferee is deemed to have purchased the property at that same ACB. The result is that the transferee effectively inherits the transferor's ACB and the accrued capital gain is not taxed until the transferee subsequently disposes of the property. For example: Mrs. Competent purchases a rental property for $200,000. Her ACB is $200,000. Ten years later she gives it to her husband on a spousal rollover when it is worth $500,000. Since the transfer is a rollover, Mrs. Competent is deemed to have disposed of the property not for the FMV of $500,000 but for the ACB of $200,000 and Mr. Competent is deemed to have purchased it for $200,000 and not $500,000. Therefore, his ACB is also $200,000. When Mr. Competent sells the property two years after that for $600,000, a capital gain of $600,000 - $200,000 = $400,000 arises. The $300,000 accrued gain at the time of the transfer from Mrs., Competent to Mr. Competent has been effectively deferred (or rolled over) to the time that Mr. Competent sells the property.