TAX NEWSLETTER Summer 2012

An Independent Member Firm of DFK Canada Inc. and DFK International

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Special points of interest:

- *Updated documentation requirements for input tax credits—refer to CRA Memorandum 8-4*
- *CRA's prescribed interest rate on shareholder loans remains unchanged at 1% for the 3rd quarter*
- *Personal tax instalments:*
  - *September 15, 2012*
  - *December 15, 2012*
  - *March 15, 2013*
  - *June 15, 2013*

Is That Hot Stock Tip Eligible for Your RRSP?

John Connolly, BBA, CMA, Senior Tax Manager, MRSB Chartered Accountants, Charlottetown, PEI, DFK Affiliate Firm

A recent Tax Court of Canada case serves as a reminder that not all investments purchased through your broker are qualified investments for a Registered Retirement Savings Plan (RRSP). In 2009, a taxpayer instructed his broker to use his self-directed RRSP to purchase the shares of several companies that people other than his broker had recommended to him. Some of the shares purchased were traded on over-the-counter markets, which are generally not qualified investments for an RRSP. Canada Revenue Agency (CRA) re-assessed the taxpayer's 2009 return for a penalty tax based on the value of non-qualified investments made in his RRSP.

Generally, publicly traded shares must be traded on a designated stock exchange in order to be qualified as investments for an RRSP. Non-qualified investments are subject to a penalty tax equal to 50% of the value of the investment at the time of purchase. In addition, any income or capital gains earned in the RRSP on the non-qualified investment are taxed at the top personal tax rate.

In the past, an investor with this problem could have saved a few dollars on the brokerage fees to rectify the error by exchanging the non-qualified investment with a qualified one of equal value from their non-registered account. However, depending on where you invest, that option may not be available. The 2011 budget introduced a 100% penalty tax on RRSP swap transactions that create an advantage for the taxpayer. In response to CRA's broad interpretation of what might constitute an advantage, some brokerages are prohibiting or tightly restricting exchanges between RRSPs and non-registered accounts in order to protect their clients.

Registered Retirement Income Funds (RRIFs), Tax-Free Savings Accounts (TFSAs), Registered Education Savings Plans (RESPs) and Registered Disability Savings Plans (RDSP) are all subject to similar rules regarding what is a qualified investment. A variety of penalty taxes apply to investments in non-qualified shares made in these types of accounts.

On a positive note, the taxpayer in this case won their appeal on a technicality. The Tax Court ruled in the taxpayer's favour because it was never clearly identified in the assessment or the reply to the taxpayer's appeal which shares were the non-qualified investments.

A complete list of designated stock exchanges is available on the Department of Finance web site at www.fin.gc.ca/act/fim-imf/dse-bvd-eng.asp.

New Baby = Tax Benefits?

Mecheliena Wilson, Tax Partner, Davis Martindale LLP, London, ON, DFK Affiliate Firm

Who knew that along with sleepless nights, your new bundle of joy could also bring you tax benefits? Below is a summary of a few federal tax benefits which are available to families to help offset the cost of raising children.

Medical Expenses

During and after pregnancy, you may feel like you live at the doctor's office, or in the waiting room, at least. Some medical expenses may not be fully covered under provincial health insurance or group benefit plans. Non-reimbursed medical expenses exceeding $2,109 (or 3% of net income) paid for any 12-month period ending in 2012 can be claimed as a non-refundable tax credit. Generally, to get the maximum credit, these expenses should be claimed by the lower income spouse.

Child Tax Credit

A non-refundable tax credit can be claimed for each child under the age of 18. For 2012, the tax credit is $2,191, working out to a tax reduction of $329 per child. In other terms, that's approximately four months of diapers! The full amount of the credit can be claimed in the year of the child's birth or adoption.

Adoption Expenses

Adopting parents may claim a non-refundable tax credit in the year an adoption is finalized. For 2012, the maximum credit is $11,440, or a maximum tax savings of $1,716.

Children's Fitness Tax Credit & Arts Tax Credit

If your future holds endless hours of cheering on sport field sidelines, or sitting through your child's piano lessons, there is some good news. In 2012, tax credits of up to $500 each are claimable for registration fees for eligible fitness and arts programs. These tax credits are available for each child under the age of 16 at the beginning of the year (under 18 if the child is disabled). This results in a reduction in federal taxes of up to $150 per child. To qualify, the program must be a minimum of eight weeks in duration or five consecutive days for camps. The list of eligible expenses can be found on CRA's website.

Child Care Expenses

If you are a working family, it can be scary to add up child care costs for the first five years of a child's life. Fortunately, child care expenses paid to allow you to earn income from employment or carry on a business can be claimed as a deduction from your income. This is a deduction from your income rather than a tax credit, thereby reducing your taxable income. Depending on your income level, this could mean a reduction of federal taxes at a rate of up to 29% compared to a federal tax credit of 15%.

Generally, the deduction must be claimed by the lower income spouse. The maximum deduction is the lesser of the amount of eligible expenses, two thirds of your earned income, and $7,000 for each child under the age of seven, $4,000 for each child between the ages of seven and 15 (at any time in the year), and $10,000 for each child with a disability.

Universal Child Care Benefit

Regardless of your income, all families with children under the age of six are eligible to receive a monthly, taxable payment of $100 per child.

Canada Child Tax Benefit

Depending on your income, you may be eligible to receive a monthly, tax-free payment if you have children under the age of 18.

Like every child, each personal situation is different and requires careful planning. Contact your tax professional to discuss your individual circumstances.

Will Planning and Personal Affairs Checklist

Sharon Gross, CA, CFP, Tax Manager, Kenway Mack Slusarchuk Stewart LLP, Chartered Accountants, Calgary AB, DFK Affiliate Firm

As the saying goes, "Nothing is certain in life but death and taxes." While you can't necessarily control either of these life events, you can certainly organize your estate by creating a will. This will help ensure that your estate is managed according to your wishes. The executor of your will should be familiar with your affairs to help ensure that your estate is managed appropriately and efficiently.

Without a valid will, you would be considered to have died intestate. In cases such as this, an administrator is appointed to serve as executor of the estate and provincial law decides how assets are distributed without regard to your wishes. Any assets distributed to minor children are administered by a bonded guardian or public trustee. The process of appointing these administrators may be expensive and time consuming.

Not only should your will be reviewed on a regular basis to ensure it reflects your current wishes, it should also be revisited at times of major life changes such as marriage, divorce or the birth of a child. Our firm has encountered situations where the provisions in the will did not accurately reflect the deceased's current wishes.

In one situation, the deceased had divorced his first spouse and was in a common-law relationship at the time of his death. He and his first spouse had wills prepared during their marriage bequeathing their assets to each other. As he did not update his will subsequent to their divorce, his assets were left to his first spouse as opposed to his common-law partner.

Another situation involved a will being put in place 50 years prior the time of death when the individual in question was 20 years of age and was required to have a will upon becoming a member of the armed forces. At a time when he owned minimal assets and presumably had no spouse, he quickly appointed one of his "army buddies" as executor. Fast forward 50 years, he was not married and had no children, but he did have surviving siblings, nieces and nephews. However, as the only will on record was the initial one created 50 years prior, all of the assets were left to the Society for the Prevention of Cruelty to Animals (SPCA). As the two friends had parted ways upon leaving the army, the executor, once located, was not familiar with the deceased's affairs resulting in the administration of the estate being a time-consuming and costly process.

In addition to preparing and updating a will, consideration should be given to completing and maintaining a personal affairs checklist (PAC). A PAC is a record of where your personal records, assets and papers are located. Once complete, the PAC includes information on the following:

- **Key advisors:** Accountants, lawyers, investment advisors
- **Financial affairs:** Bank and brokerage accounts, credit cards, real estate, life insurance
- **Other information:** Location of documents, details of employment and company pension plans, computer passwords to access any digital documents such as online bank or brokerage accounts

As ever, legal and financial counsel should be consulted to assist with the preparation of your will. Making sure that your will and PAC are up to date will assist the executor with managing your estate when the time comes. Investing a little time now to complete these items could save a great deal of effort and expense in the future.

Also, don't forget to update your named beneficiaries on other assets, such as RRSPs, RRIFs, and life insurance policies, etc.

You may access a copy of our PAC on our website at www.kmss.ca/Resource-Centre/Publications.

Financial Planning Considerations for Your 18-year-old Child

Hugh Faloon, CA, CFP, TEP, Partner, Ginsberg Gluzman Fage & Levitz, LLP, DFK Affiliate Firm

Your child is now eighteen and getting ready to go to university in another city. Legally, they are now adults, and you, as a parent, cannot sign for them anymore.

Things to Consider Before They Leave:

Consider getting them their own credit card. Most children are very computer savvy and should be able to make their own credit card payments online and on time. It will also help them establish their own credit rating.

What about a will? If your child has significant net worth from gifts and savings, they should consider having a lawyer prepare a very simple will.

Consider having a lawyer prepare a Power of Attorney. This is very common in financial planning, and it allows you to legally act on your child's behalf. You should keep a copy of the Power of Attorney and other important documents at your home for safekeeping, such as their credit card number, health card number, driver's licence, etc. Without the Power of Attorney, their bank, the CRA, or their credit card company will not release your child's confidential information to you when you are trying to assist them in taking care of their financial matters.

What about health care protection? If your child is incapable of making his or her own medical decisions, doctors will generally listen to the parents' wishes. However, to protect your child, he or she should sign a Living Will or Power of Attorney for Health Care. This would give you the legal right to advise the medical team and make decisions for your child, should they not be in a position to make these decisions on their own.