TAXADVISOR

No Slip, No Excuses …

Sometimes it's better to guess than leave out information

COURT REPORT

BY JAMIE GOLOMBEK

As clients clamour to finalize their tax returns by the end of the month, it may be a good time to remind them that just because they may be missing a slip or two, doesn't mean they should avoid reporting the income on that slip on their tax returns.

According to the Canada Revenue Agency, "even if you are missing information that is needed to complete your tax return, you should still file your return on time." The filing date for most individuals is May 1, 2006.

If clients owe tax for 2005, they must file their returns on time and pay any amounts owing by the filing due date, to avoid paying interest and a late-filing penalty.

Advise clients that may still not have received their information slips that the first step is to contact their payer. If they still don't expect to receive their slips by the May 1st deadline, encourage them to use their pay stubs, bank statements, or other financial records to estimate the income required to reported.

Clients who file a paper return should attach a note to the return telling the CRA which slips are missing. If they file electronically and the CRA asks for the slips at a later date, a simple explanation will suffice.

A recent tax case decided in January (*Samson v The Queen*, 2006 TCC 15) emphasizes the importance of reporting all one's income, despite a lack of slips, and the dire consequences of failing to do so.

Steve Samson found himself in court challenging the imposition of penalties assessed by the CRA for his 1998 and 1999 taxation years. The penalties were assessed for the failure "to report an amount required to be included in his income for a taxation year and who has failed to report an amount required to be included in his income for any of the three preceding taxation years." The CRA brought evidence that income was not reported by Samson in 1997.

For 1998, Samson omitted to report amounts totalling over $24,000 withdrawn from his RRSP. For 1999, Samson filed a nil tax return. In that year, he withdrew amounts from his RRSP with Sun Life and did not report them. He also failed to report employment income of over $163,000 from his employer.

Samson argued that "he did not receive the T4 and T4 RSP slips and that he had thought it better not to declare anything than to estimate amounts of income." As the judge said, "this obviously was not a good argument."

Samson further maintained that the slips were mailed to his old address. The judge countered, "it is the taxpayer's responsibility to take action to collect all the necessary information in order to be able to report his income correctly in his tax return.… He has the same responsibility with regard to his change of address. It is his duty to advise the payer of this change so as to ensure that the information slips are sent to the right address."

The judge ordered that the penalties be upheld, concluding: "that it was (Samson's) responsibility to report all his income and take the necessary steps to ensure that he had all the documents in hand that he needed in order to fill in his tax returns correctly, and that he did not take all these steps as he did not advise the payers of his change of address and did not try to estimate his income."

This case serves as a valuable lesson worth sharing with your clients as we approach the tax-filing deadline. AER

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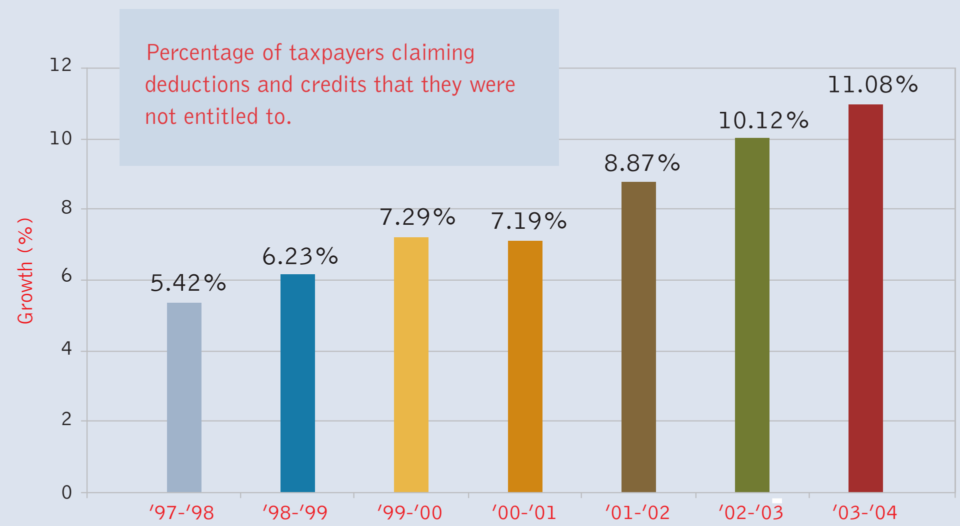
ERRONEOUS DEDUCTIONS DOUBLE SINCE 1997-1998



Source: Auditor General of Canada

Tipping Your Hand

What triggers the CRA

BY STEVEN LAMB

The deadline for filing taxes is rapidly approaching, yet what is and what isn't an acceptable tax deduction remains as vague as ever. What prompts the Canada Revenue Agency to question a return – or worse, launch a full-blown field audit – remains equally mysterious.

To shed some light on what attracts the CRA's suspicion, Sandy Cardy, senior vice-president, tax and estate planning at Mackenzie Financial, called her contacts at the agency as well as a few tax lawyers and compiled a top ten list of items that could spark an audit.

Capital gains and losses: For all investments, the onus is on the individual to keep track of their adjusted cost base. When it comes to real estate, the CRA can be especially picky.

There is no set definition of "principal residence," Cardy warns, and frequent buying and selling, may lead the CRA to ask for more information. If the taxpayer is employed in construction, remodeling or real estate, it may not matter that they lived in the house – the CRA could deem each sale as an "adventure in the nature of trade."

Cardy points out that the acronym says it all: If the sale of real estate is deemed an AINT, it ain't treated the same as a principal residence sale.

Interest deductibility: Cardy says the rules governing interest deductibility have not kept pace with innovation in the investment industry. Investments which pay a return of capital, such as some income trusts or T-series mutual funds, will erode the deductibility of interest. Investments in flow-through limited partnerships will likely be disallowed.

The CRA applies the "reasonable expectation of return" test to investments made with borrowed cash. Investing with an eye toward capital gains will not pass this test.

Interprovincial tax planning: If a taxpayer has lived their entire lives in Ontario, but suddenly file as an Alberta resident, coincidentally, the same year they claim a dramatic increase in their income, CRA will be probably want to talk to them about their move.

Cardy says clients who are, for example, selling a business may want to consider transferring ownership to an Alberta trust first, which only requires that the majority of trustees be residents of that province. The capital gains from the sale would then be subjected to the lower Alberta provincial tax rate.

Self-employment and business expenses: CRA will pay close scrutiny to claimed expenses that carry a personal benefit to the filer, such club dues and meals. The taxman is also likely to frown on an interest-free loan that hasn't seen a repayment in five years, or on paying a five-year-old daughter $24,000 a year to collate files.

Childcare costs: Childcare costs are deductible, but only if the parents either work full time or are full-time students. Just because your child's soccer camp receipt says "For tax purposes" across the top, it doesn't mean the CRA will accept it. But Cardy says a taxfiler can legitimately claim the cost of paying an adult child to take care of a sibling under the age of 16.

Mining, oil and gas investments: These instruments give the investor a full deduction over time, while their adjusted cost-base is reduced by the amount of the deduction (eventually to zero), and they can defer their capital gains to a later year.

But along with these benefits come a restriction. If the investor uses these investments to make a charitable donation in kind, they will not be able to claim the reduced inclusion rate.

Tuition and education expenses: Since most students do not have sufficient income to claim the tax credits offered on education expenses, the credits should either by transferred to supporting family members (parents, grandparents) or carried forward to be claimed later.

Cardy warns that once the student decides to carry the credits forward, they lose the right to change their minds and transfer them to family members. She offers the example of a dentistry student studying in the U.S. who carried forward his credits. The student died before he was able to claim them and his father, who had paid the son's tuition, was unable to claim the credits either.

Disability and medical expenses: Cardy says many people are missing out on a fair refund because they are not aware of what qualifies as a medical expense. She says all payments to doctors or dentists may be claimed, as well as bills from naturopaths or chiropractors.

The cost of a tutor for a child with a learning disability is deductible, as are all costs associated with maintaining a seeing-eye dog, including food and veterinarian bills.

Foreign tax credits: If the tax credit is on business income, Cardy says it can be carried forward for up to 10 years. On non-business income, however, she says the taxfiler must "use it or lose it" as it is only available in the year the income is repatriated.

The client may need to sell some non-registered investments to generate a capital gain against which to apply the foreign credit.

Charitable donations: While the government encourages donations by offering taxcredits toward them, the CRA is most likely to investigate large donations in excess of $20,000. Donations in-kind may also attract scrutiny, as the taxman will want to ensure proper calculation of fair market value. AER