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TAXATION

Line 260

Line 260 is perhaps the most important line on the T1 tax form.

The federal income tax form is used by all provinces and territories except Quebec, which requires a separate return. The line and form numbers in this article do not apply to the Quebec return. However, the principles are the same.

Line 260 "Taxable income" not only states your taxable income but can also guide you to tax-saving strategies. The amount on Line 260 is the net derived from adding up your income from all sources and subtracting all allowable deductions. The accuracy of the number is extremely important because it is the basis for three important subsequent calculations:

1. your federal and, except for Quebec, provincial tax payable
2. any strategies for reducing the tax liability such as income splitting, spousal RRSP contributions or splitting of pension income, and
3. determining the amount of money you will need to set aside to pay your taxes when they fall due.

Arriving at the right number for Line 260 can be very difficult. Personal circumstances may change from one year to the next and what was included last year might not be available or allowable this year. Tax laws also change and the advice of your CA tax professional can be decisive in getting the amounts right under current legislation.

Know Your Lines

Although the federal tax for individuals is determined by federal rates, your province of residence will significantly impact the total dollar amount of tax you will have to pay. Regardless of your province of residence, however, it is important to ensure that all income from all sources is included in your calculations. Line 150 "Total income" normally includes employment income (T4) and a long list of other sources such as dividends (T5), interest (T5), taxable capital gains, partnership income, rental income, self-employment income, etc. From Line 150 are deducted items ranging from RRSP contributions to carrying charges and support payments to arrive at net "Taxable income" on Line 260. As soon as your tax advisor knows Line 260, it is possible to arrive at a reasonable estimate of the "Total payable" on Line 435.

Base Federal Rate

Provincial rates vary from province to province and territory. The basic federal rate, however, is standard across all jurisdictions and, for 2010, the basic federal rates break out as follows:

- 15% on the first $40,970 of taxable income
- + 22% on the next $40,971 of taxable income, i.e. on the portion of taxable income between $40,970 and $81,941
- + 26% on the next $45,080 of taxable income, i.e. on the portion of taxable income between $81,941 and $127,021
- + 29% on taxable income over $127,021

The job of your professional tax advisor is to reduce your tax liability to the lowest level permitted by law. Consider a single person with taxable income of $60,000. Based on the rates shown above, the actual federal tax paid on the $19,030 ($60,000 - $40,970) in

the second tax bracket (at 22%) would be $4,186. If the extra $19,030 could be shifted to another person in the lowest tax bracket, the federal tax (at 15%) would be $2,855 instead of $4,186 (at 22%), a saving of $1,331.

Provincial Tax Rates Vary

Provincial and territorial tax calculations vary in the rates, taxable income categories and deductions assessed to the taxpayer. For instance, Manitoba assesses 10.8% on the first $31,000 of taxable income, +12.75% on the next $36,000, +17.4% on the amount over $67,000; whereas Alberta assesses a straight 10% of taxable income *no matter what the amount*.

In addition to varying assessment rates levied by provincial tax policies, each province may offer different tax-deduction incentives or non-refundable tax credits on Form 428. For example, a taxpayer residing in Alberta has a basic personal non-refundable credit of $16,825, whereas in Ontario the credit (for 2010) is $8,943.

Although provincial and territorial jurisdictions impose differing taxation rates on resident taxpayers, except for Quebec, the determination of provincial tax liability is based on the taxable income calculated for the federal taxation authorities. Without a common denominator, calculating provincial taxes would be a daunting task.

Provide your CA with sufficient information about income sources and deductions.

Information is Key

Since the decisive figure for determining tax liability is the taxable income on Line 260, you need to provide your Chartered Accountant with sufficient information about income sources and deductions. Once the CA has projected total income and total deductions, he/she is in a better position to determine the need and the feasibility of reducing income taxes by using the tax provisions for income splitting, spousal RRSP contributions or splitting of pension income.

Calculate Early

Given that certain tax strategies must be completed before the end of the calendar year, a preliminary calculation of projected Line 260 taxable income as early as possible will serve you well. Since your eligible RRSP contribution amount for the year will be known from your Notice of Assessment for the previous year, it can be entered into the calculation immediately. Projecting taxable income for the calendar year as early as late October provides you with the opportunity to seek informed guidance from your CA. You will also have plenty of time to develop strategies to reduce your tax liability and find the funds for any tax you might have to pay. For those who were able to reduce personal taxes for 2010 with advanced planning we salute you! For those who were just too busy, October 2011 is only five months away!

TECHNOLOGY

The New World of Skimming

Skimming is more than just removing the cream.

Skimming, according to the dictionary, means to remove floating matter from the surface of a liquid. Over time, skimming became a slang expression meaning to take a portion "off the top" of a business's daily receipts, then adjusting the books to report a lower total. Naturally the "skimmed" difference went into the fraudster's pockets with the result that less income was received by the business owner and fewer dollars were paid to the tax department.

Electronic Skimming

Now, with electronic payment methods integrated into every aspect of our lives, skimming means copying the data stored on the magnetic strip from a debit or credit card. The data can be used to create a duplicate card.

I'll Be Right Back with Your Card

It is quite common, especially in eateries, to pay by credit or debit card. Although wireless card readers that allow the card to be swiped and the PIN entered at the table are now widely used, servers in many establishments still take your card to be processed

elsewhere on the premises. This processing period is often the time when the card is copied onto a private skimming device that transfers the information and creates a fraudulent card.

Your Card

All the information required to complete a credit or debit card purchase is contained on the magnetic strip. The embossed account number and client's name on the front of the card is no longer used to complete the purchase as was the case with the old charge-card system. Thus, the merchant does not necessarily know whether the name shown on the card is the same as the name coded in the magnetic strip. On genuine cards, the embossed name and number and the coded name correspond; on forged cards, rarely. Even if the merchant is suspicious about the card, a forged driver's licence bearing the same name as the embossed name on the forged card could alleviate suspicion.

Will That Be Debit or Credit?

For skimming purposes, debit cards tend to be favoured over credit cards simply because debit allows cash to be withdrawn directly rather than requiring that goods be purchased and then fenced to be converted to cash. The excerpt below from the Hamilton Police Service of Hamilton, Ontario, illustrates how an actual, widespread debit-card fraud scheme was perpetrated.

> *"Gas stations on Upper James St., Burlington St. and other areas throughout Hamilton and Niagara were used by two persons to operate skimming devices and steal banking information from hundreds of victims. The data was in turn used to steal approximately 1.2 million dollars from the victims' bank accounts. One male was arrested and charged with the skimming of the cards at the Burlington St. location. Another male was arrested using forged cards made as a result of the skimming at both locations. The HPS investigation linked these and numerous other locations in what has become the largest skimming investigation in Hamilton to date."*

Even cards with chip technology can be compromised.

So That's How They Did It

Whether at a gas bar, eatery or clothing store, skimming relies on the perpetrator's ability to capture your card information during a transaction. These three methods are common:

1. **Card Swipe:** The card is swiped once through the legitimate terminal and then again through a hidden card reader. The PIN is typically captured via a hidden camera positioned to have a view of the PIN pad.
2. **ATM Skimming:** Skimming devices can also be attached to machines such as an ATM or self-service gas pump. The devices are placed over the real card slot and "read" the card before it passes through to the machine. (*In 2010, 180 stations between Salt Lake City and Provo, Utah, less than one hour's drive apart, were found to be compromised!*).
3. **Counterfeit Devices:** Devices reconfigured to record card data and PINs can be substituted for legitimate point-of-sale card readers.

Even the cards with chip technology can be compromised, although usually only when the transaction is for merchandise purchases rather than for getting cash. If your credit-card data has been acquired by a fraudster, it is a relatively simple matter to confirm a false card by utilizing the three- or four-digit Card Verification Code (CVC) on the back of the card. This weakness is often exploited to obtain goods on line.

It does not matter which method is used to capture the data. The fraudster's objective is simply to determine your bank balance or credit limit and then drain your account.

Carding

A fraudster has little to gain by paying for information from a cancelled card or for a card where the PIN does not match. To determine the usefulness of a card, the fraudster will test the card's information on a website that has real-time transaction processing. It is normal practice to do something inexpensive that would raise little notice such as trying to subscribe to a magazine or place a small charitable donation. If the transaction works the thieves know the card and the provided PIN are correct. This process is called Carding.

Massive amounts of money have been spent by the credit-card industry and financial institutions to reduce their exposure to loss. Computer programs have been designed that review credit-card transactions unusual in the buying history of the cardholder. Program logic is aimed not just at large transactions but also at Carding transactions. For instance, if most of your transactions take

place in Cranbrook, and a one-dollar item shows up for a purchase in Halifax, your bank or credit-card company may flag this as a suspicious activity and contact you for clarification.

How to Protect Yourself

Regardless of technology and security provisions, debit- and credit-card fraud will not disappear overnight. Following a few simple best practices may keep you from becoming a victim. The complete reliance on debit and credit cards puts each user at risk every time an electronic transaction occurs. Following the doctrines of card and password safety certainly reduces the loss of funds through careless security but in the final analysis, users must lessen the probability of compromised cards by increasing awareness of their surroundings, establishing protocols that limit access to singular accounts and staying up to date about the constantly changing methods used by crooks to undermine card security.

MONEYSAVER

Insurance for Life

Life insurance should be a key element of everyone's financial plan.

The earlier life insurance is purchased the more secure one's financial future, yet many consider life-insurance premiums an unnecessary expense. Not having insurance, however, could drastically affect the rest of a person's life.

Purchasing life insurance when you are young usually means:

- lowest premiums
- unlikely rejection for health reasons
- opportunity for additional insurance without additional medical tests
- purchased coverage continues even if you become injured or ill.

The main reasons for buying insurance are to:

1. replace business or family income in the event of death
2. pay debts or taxes
3. pay out former business partners
4. pay the tax if a large RRSP is included in an estate if the bequest is made by a deceased without a partner
5. pay for funeral expenses
6. provide funds for education of surviving family members
7. provide funds for a charity
8. ensure adequate funds to continue the lifestyle of a surviving partner or children.

There are three types of policies offered by the more than 100 insurance companies in Canada: term life, whole life and universal life.

Term Life

Term life is the simplest and least expensive. It has no cash value and, at term, you must pay for another year or you are not insured. If you die, your family or other survivors will receive the face value of the policy.

What is a Term?

Insurance companies usually structure the "term" of your premiums as Five-year, 10-Year, 15-Year, 20-Year or Term to 100. A term is usually "renewable" and "convertible."

Renewable means that after the first term you will be able to continue the policy for another term by continuing to pay the premium (more than likely higher because you will then be older). **Convertible** means the policy can be converted to one that provides insurance and savings. As you age, conversion may be advantageous since the premiums on straight term will become more expensive. **Term to 100** insures you for life. Your premium does not change and, when you attain an age specified in the policy, premium payments cease but the policy still pays the face value on your death. Some policies allow partial face-value redemption (appropriately called compassionate advance) in the event of a diagnosed terminal illness.

Whole Life

Whole life insurance pays a death benefit to your beneficiaries while allowing tax-free cash accumulation. There is no "dividend" withdrawal in whole life as there is in universal; however, you can borrow on the cash value of the policy. Since the cash-value build-up depends on interest rates, it usually takes years before funds are available for borrowing. When you die, the amount borrowed is deducted from the face value. If you have not borrowed any money, at your death the accumulated cash value is added to the face value for payout.

Universal

Universal life insurance is a value-added term policy that pays a death benefit to your beneficiaries. There is usually a fixed premium managed by the insurance company to provide not only the insurance payout in the event of your death but also a cash-value build-up in your policy. After a number of years of contribution and cash-value build-up, it may also offer the option of applying dividends received in your policy toward your premiums to reduce the cost of the yearly premiums.

This type will generate a cash value payable tax free as part of the death benefit. The investment part is handled separately inside the policy and can be withdrawn by the insured. As the investment grows the funds that can be used to pay future premiums obviously depend on the amount saved within. This payment feature could be extremely important if you fall on hard times but wish to keep the insurance policy in force.

The insurer can invest the additional funds in mutual-fund-type investments to allow greater growth potential. Other advantages include:

- The savings portion has been structured to allow tax-sheltered growth.
- The absence of foreign-content restrictions on investments allows greater diversification.
- Tax-sheltered investments can be customized.
- Funds may be withdrawn tax free if you become disabled.
- The policy may be leveraged to obtain tax-free income.

Caveat Emptor

Simplified explanations of the benefits of the various life-insurance types may make it appear as if purchasing insurance is easy. If you want term, it may be a simple matter of choosing the payout amounts, determining the premium and signing the policy. Whole life and universal policies, however, should consider other factors such as your income, how best to care for your tax-sheltered investment, and the cost. Your Chartered Accountant and insurance agent can determine the impact of insurance on your long-term tax strategies.

Understand the cost and options available before signing.

Other Considerations

No matter the type of policy, you must understand that the contract states exactly what you can expect. It is most important to understand the cost and options available before signing. Ask about administration fees and any available riders with their additional costs that may cover, for example, accidental death, accidental death and dismemberment, premium waivers, children or may provide guaranteed insurability in the future.

How Much Do I Get?

How much insurance will be needed later depends on financial, family or business situations that can only be anticipated in the most general way.

Should You Seek Advice?

It is always best to sit down with an insurance representative who can match the policy to your needs, discuss costs and explain how to modify coverage as your life changes. The insurance agent is an important person when you or your beneficiaries have questions.

In the end, insurance is as much about providing security and taking care of present needs as it is about taking care of those you leave behind.

MANAGEMENT

PHSP Anyone?

There is more than one way to provide employee health benefits.

Owner/managers are often reluctant to provide medical coverage to employees because of the initial cost and the increased cost of premiums that occurs when employees use all their entitlements. As a result of these indeterminable expenses, not only do the employees do without, but also the employer and his/her family are more often than not, denied any medical benefits.

Private Health Services Plan

An often overlooked method of providing medical coverage is the Private Health Services Plan (PHSP), which enables corporations and the self-employed to provide health, dental and vision tax-free benefits to employees and their dependents. The amount paid out as a claim and any third-party administrative costs related to the PHSP are tax deductible. Section 248(1) of the Income Tax Act requires that the terms of the PHSP should be written up as a contract between the employer and a third-party administrator for the benefit of the employees.

Certainly the ability to write off medical costs along with the administration cost is a benefit to both the employee and the employer. The ability to run one's own plan controls costs, removes some of the restrictions an insurance company may place on a small business, removes obstacles to obtaining coverage if employees or shareholders have pre-determined medical issues that may not be covered, and allows the owner/manager to offer benefits that may be limited or not available through an insurance company.

For payments of shareholder medical expenses to be accepted, the shareholder must receive the benefit in his/her capacity as an employee, not as a shareholder. The shareholder cannot be a passive participant but must be actively engaged in the business activities of the corporation, although not necessarily collecting a salary.

An initial registration fee may be required. After that the administrator normally charges an administration fee equal to a percentage of the amount submitted for a medical claim.

Incorporated?

Incorporated businesses are not limited as to the PHSP amount that can be reimbursed. It should be noted that as long as the premiums paid are reasonable and all benefits extend equally to all employees and not simply to the owner/manager(s) and his/her immediate family, medical expenses should not be challenged by the Canada Revenue Agency. Conversely, if the medical expenses are deemed excessive or if it were established that arms-length employees were not receiving equal consideration, then undoubtedly there would be a change in the CRA's attitude. In this event, the payout for owner/managers could end up a taxable benefit in their hands with the possibility that the deduction to the corporation would not be allowed. The CRA would reason that the benefits were incurred as a shareholder to the company and not as an employee actively engaged in the activities of the company.

Small business can now provide competitive benefits.

Positive Incentives

The medical expenses covered are too numerous to list but follow the medical expense definition as indicated in the Income Tax Act subsection 118.2(2). It may surprise the reader to know that many expenses referred to in the Act may not be covered by traditional providers of medical insurance.

Since payments made by the business are not perceived as a benefit to the recipient, the business does not have to make additional remittances for CPP, UIC, health tax or be concerned about remittances to the CRA.

An employer can establish differing ranges of benefits for different groups of employees. Thus, the employer is able to determine for budgeting purposes the maximum cash-flow drain that could occur if use were maximized.

Most external plans require the payment of a monthly premium regardless of whether a claim has been made. The PHSP incurs premiums only in the case of a health, medical or dental expense. This approach allows the owner/manager to control not only the cash flow but also the "premium" that ultimately is paid each year for those who are covered.

How Does It Work?

Assume, for example, an employer agrees that the company will reimburse an employee up to $2,000 for medical costs for the year. The employee visits the dentist, receives a bill for $400 and submits it to the employer, who then submits it to the PHSP administrator along with payment of the $400, plus the administration fee. The PHSP administrator writes a cheque to the employee. The employer expenses the $400 plus the administration fee.

Although the PHSP may not be for everyone, it does allow the small-business owner to provide competitive benefits when trying to attract new employees while at the same time controlling the cost. To ensure that the owner/manager's interpretation of the deductibility does not run afoul of the Income Tax Act, it is certainly advisable to work with an experienced administrator and review the plan with a Chartered Accountant.

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