

# Minding YOUR BUSINESS



F A L L 2 0 0 8

From The Desk Of

## Ways to Ensure Privacy

*The need for business to protect data maintained for clients and employees should rank higher than the need to protect company operational data and / or business secrets.*

Individual and business clients demand that data not be shared either intentionally or accidentally. Indeed, business is required to follow the Personal Information and Electronic Documents Act (PIPEDA) that came into full implementation January 1, 2004.

The best security starts with policies and procedures communicated to all employees. Instilling a sense of the importance of security issues into the corporate culture is important not just because security is the law but also because it is good business and recognized as important by all stakeholders. No matter what rules, regulations, or physical attributes may be built into a system, the human element always remains the weakest link.

Your company should review and implement four areas: physical security, data management, staff involvement and management concerns.

The list of policies and procedures is beyond the scope of this article. Please contact Dan, Barrie or Sandy to go over these policies and procedures with you and assist you with training and implementation.

*Dan Majewski*  
*Barrie Shaler*

## Transfer of Insurance Policies

Many tax and financial planners recommend that clients purchase life insurance through existing corporations, rather than personally. This allows premiums to be funded with corporate cash, rather than tax-paid personal cash. With the changes in the dividend rules and corporate tax rates motivating increased retention of corporate income, this strategy will only become more popular in future years.

However, it is common for issues to arise with respect to such corporate insurance. In order to avoid taxable benefits, the beneficiary must be the corporation, not the shareholder. This means that the policy, and any death benefits, are exposed to creditors of the corporation.

What happens when a shareholder is bought out, or when the business is sold? The purchaser likely has no interest in maintaining coverage on the former owner. Meanwhile the former owner has aged, and may be subject to higher premiums to replace this coverage, if he is insurable at all. Commonly, the parties wish to transfer the policy out to the individual insured.

However, the Income Tax Act can make this transfer a costly proposition. Where insurance policies are transferred between non-arm's length parties, the Act deems the transfer to take place at an amount equal to the policy's Cash Surrender Value, regardless of the actual value of the policy. To the extent the Cash Surrender Value exceeds the Adjusted Cost Base of the policy, this will result in income to the transferor. Where the policy has no Cash Surrender Value, it is deemed transferred for nil proceeds.

Unfortunately, this provision only governs the results of the disposition of the policy. Where the fair value of the policy is other than its Cash Surrender Value, the transfer of the policy to an employee or shareholder can result in a taxable benefit in the event the recipient of the policy pays less than fair market value to the transferor.



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: **"Science may never come up with a better office**  
: **communication system than the coffee break."** - Earl Wilson  
: .....

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## Transfer of Insurance Policies

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The fair market value of the policy depends on numerous factors, including the age and health of the insured and his/her ability to obtain equivalent coverage at an equivalent cost. This can result in considerable uncertainty, and potentially significant tax costs, where an insurance policy is transferred from a corporation to a shareholder or employee. In some cases, these consequences are so significant that they render a sale of shares impractical.

Acquiring the policy in a holding or investment company, with limited business risks and no prospect of a future share sale, can avoid these issues. However, this requires consideration be given to this issue when the policy is first entered into.

What about the opposite situation, however? These rules do not apply only on transfers from a corporation to an individual. They are equally applicable where an individual transfers a personally held policy to

a corporation. Assume Mr. A has a personal life insurance policy with no Cash Surrender Value. Due to his age and health, the policy has a fair value of \$500,000. Mr. A also has a holding company, ACo, with significant equity.

If Mr. A transfers this policy to ACo, it will be deemed to transfer at a value equal to Cash Surrender Value, so nil. However, as the policy is worth \$500,000, ACo can pay Mr. A the amount of \$500,000 without any income tax consequences, just as a transfer of a similar policy from ACo to Mr. A would require him to pay \$500,000 or be subject to a taxable benefit. Of course, when the policy matures, the death benefit will increase ACo's capital dividend account.

This may provide a significant opportunity for corporate shareholders with personal insurance policies to access equity held in their corporations on a tax-effective basis.

## When is a Business *in* Business?

The answer to this apparently simple question is complicated by a number of factors involving the Income Tax Act and the subjectivity of timing. It should be noted, however, that, because the Act does not provide specific rules dealing expressly with start-up costs, the tax planner must be aware of both the administrative practices of the CRA and the guidance provided in this area by the courts.

The Act indicates that an expense is deductible only if incurred for the purpose of earning income. Thus, if money were spent to earn income, these expenditures are deductible only if it can be shown that the taxpayer was carrying on business in the fiscal period. This means the taxpayer will have to establish the date the business began and be able to show the expenditures were made as a first step to the start of normal operations.

### When Does Business Commence?

Establishing the moment when a contemplated business actually becomes a functioning business is a matter of judgement, since "the moment" depends on the determination of when normal operations begin.

It may be fair to assume that a restaurant, for example, has started business before the doors opened, if the lease arrangements are in place, capital assets are being installed, or the owners are running ads and interviewing for staff. In such a case, the Canada Revenue Agency would want to determine that significant organizational indicators were already in place to support a planned opening date.

If, on the other hand, the aspiring restaurateur spent money only researching the potential of a restaurant at a certain location, it is likely the CRA would consider

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# Tax Tips & Traps

## CORPORATE TAX

### Small Business Deduction

In a 2007 Advance Income Tax Ruling, CRA Ruled that where a Partner of a Professional Partnership creates a professional corporation through which professional services are provided to the Partnership, the professional corporation will generally be eligible for the small business deduction, if certain conditions are met.

The primary objective of this proposed transaction was to restructure the professional practices of the Partners such that each Partner can choose, without any adverse tax consequences to any other Partner, the appropriate structure from which to satisfy his/her professional obligations. Advantages include:

- (a) minimizing exposure to joint and several liability;
- (b) providing each Partner with an opportunity to become an independent contractor;
- (c) permitting greater control over expenditures;
- (d) providing greater control over Estate and financial planning;
- (e) easing the entry to and exit from the Partnership;
- (f) enhancing the Partnership's ability to retain current Partners and admit new Partners.

CRA Ruled that this will not constitute a disposition of a Partnership interest. The annual professional service fee payable by the Partnership to the contracting company will be deductible by the Partnership. The contracting company will



not be considered to be carrying on a personal service business assuming that the owner would not reasonably be regarded as an officer or employee of the Partnership.

### REMUNERATION OF OWNER-MANAGER

#### Shareholder Benefit

In a June 5, 2008 External Technical Interpretation, CRA notes that where a corporation's single purpose is to hold say vacation property for its shareholder paid for with an interest-free loan to the corporation by the shareholder, the taxable benefit conferred on the shareholder should be calculated according to the instructions in Paragraph 11 of Canada Revenue Agency Interpretation Bulletin IT432R2.

Based on that Paragraph, an interest-free loan to a single-purpose corporation that can be specifically identified as a reimbursement of the cost of a particular property may be deducted from the amount that is the greater of the cost and the fair market value of the property

before a normal rate of return is applied to the remaining amount for calculating the imputed rent associated with the property.

## ESTATE PLANNING

### Life Insurance

It was noted in an article in the June 12, 2008 issue of the Globe and Mail by Tim Cestnick that a parent with excess funds could acquire an insurance policy on the life of his/her son/daughter such that he/she is the owner of the policy but the son/daughter is the contingent owner and, the insurance is on the son/daughter's life.

When the parent dies, the policy automatically goes to the child as the contingent owner with the result that the child has accumulated investments inside the policy (a universal policy, for example). The policy is transferred to the son/daughter free of tax and probate fees. The son/daughter could withdraw funds from the accumulating investments.

Having the child as the contingent owner on the policy permits the tax-free transfer of the policy at death and, subsequently on the death of the child the assets will go to the beneficiary tax-free.

### Executor's Compensation

In a May 27, 2008 External Technical Interpretation, CRA notes that when an Estate pays compensation to the Executrix, the amounts are considered employment income of the Executrix. Therefore, the Estate will be required to withhold tax, prepare and issue a T4 Slip and obtain a business number.

