

Minding YOUR BUSINESS



S U M M E R 2 0 0 8

From The Desk Of

The Proliferation of Passwords

The trouble with passwords is that we need so many of them.

What is the Best Way to Create a Password?

The most secure passwords use a combination of alphanumeric and non-alphanumeric characters. Many applications support characters such as "&" or "~" in addition to the English alphabet and Arabic number set we are accustomed to using. Additionally, passwords are sometimes case sensitive; to the computer "a" and "A" are two different characters. The more random a password appears, the more difficult it is for someone to guess or for a program to crack using "brute force." The term brute force is used to describe a method of hacking that sequentially attempts various passwords until it eventually guesses the correct one.

Devise a password that is nearly impossible for someone else to figure out but easy for you to remember. A birth date or the name of your cat would be examples of weak passwords because subtle enquiries from friends, relatives or colleagues will quickly reveal this information to anyone determined to break into your system.

To protect your business and at the same time ensure that passwords are not forgotten, associate passwords with familiar or favourite numbers,

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Death of a Taxpayer

Benjamin Franklin's observation that the only certainties in this world are death and taxes is only half the truth; the whole truth is that we continue to pay taxes even when we're dead.

What will be taxed and what will be paid depends on a wide range of factors such as the deceased's portfolio, employment and marital status as well as a host of other factors. The following are the most common areas worth talking over with any member of our professional staff.

Principal Residence

The deceased's house is usually considered the principal residence and thus the increase in its fair market value from the date of purchase to the date of death is exempt from tax. It may be transferred to the surviving spouse or other beneficiary without creating an income tax liability. This generalization is premised, however, on the assumption that no other house such as a vacation property has been designated the principal residence.

Personal Items

Personal possessions are usually not taxable at the time of death. Items such as motorcycles, boats, household furniture, etc. will not be considered taxable unless they have increased in value. Care must be taken while planning the estate to ensure that the tax on personal property of high value, such as art, jewelry, coins, stamps and rare books is minimized.

RRSPs

If the deceased has a Registered Retirement Savings Plan (RRSP), contributions have been providing personal income tax deductions since the year the plan was created and all



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: "Always keep people in your life that charge your battery, :
: not those who will drain it!" - Unknown :
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Death of a Taxpayer

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capital gains, dividends and interest income generated within the plan have been sheltered from tax. The federal government has refrained from taxing these funds in order to allow the taxpayer to provide for his or her own retirement. If, however, the taxpayer dies before these funds have been deregistered and thus become taxable, the fair market value of the whole amount remaining in the RRSP at the time of death becomes taxable as income in the year of death. For most taxpayers this means taxation at the highest personal rate. If the deceased has chosen during his or her lifetime to use part of the allowable annual contribution to create an RRSP registered in the name of the spouse, that RRSP will not be subject to tax at the contributor's death.

When the surviving spouse or common-law partner has been designated sole beneficiary, the entire fair market value of the deceased's unmatured RRSP, i.e. not yet paying a retirement income, can be rolled over tax free into the spouse's or partner's RRSP. If the RRSP is mature and thus already paying an annuity, it remains in place but the annuity now goes to the surviving spouse or partner who receives it as taxable income.

RRSP amounts paid to financially dependent children or grandchildren will be included in their incomes and taxed accordingly. Unless the contrary can be established, a child is assumed not to be financially dependent if his or her income exceeded \$9,600 for the prior year. Children can transfer the RRSP amounts received into an annuity. The term of the annuity may not exceed 18 years minus the age of the child when the annuity is established. Such a transfer could be compared to a spousal transfer with a few notable exceptions.

- The transfer is allowed only for children under the age of 18.
- The annuity ends when the child reaches the age of 18.

- Annuity income is taxable in the hands of the child.

- All funds within the annuity must be distributed to the child before the child's 19th birthday.

If there are financially dependent children or grandchildren with physical or mental infirmities, the rollover provision provides that the fair market value of the RRSP may be transferred to an RRSP, a life or term-to-90 annuity. The absence of the age restrictions that affect other financially dependent children or grandchildren permits long-term financial considerations to be addressed.

Investments

Investment assets are deemed to have been disposed of at fair market value at the date of death. The taxable amount is one-half of the difference between the fair market value at that date and the adjusted cost base, i.e. the purchase price adjusted for brokerage and other costs. Since no brokerage is paid on the deemed sale, the fair market value is considered to be the sale price.

- **Interest Income**

Interest income accrued to the date of death must be included in the deceased's income. For instance, if the deceased taxpayer had \$100,000 in a 5% Government of Canada bond that paid interest on June 1 and December 1 and died October 31, the \$2,500 interest payment received must be included in income plus the interest accruing from June 2 to October 31 of \$2,077 for a total income of \$4,577.

If the bond is not liquidated in the distribution of the estate, interest earned from the date of death becomes income in the hands of the beneficiary. Care should be exercised to not include amounts in income twice. The \$2,077 in the above example should be deducted from the next \$2,500 payment before it is included in the income of the beneficiary or the estate.

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Tax Tips & Traps

MEDICAL EXPENSES - RENOVATIONS

In a November 9, 2007 External Technical Interpretation, CRA notes that the Income Tax Act includes as a medical expense, renovations or alterations to a dwelling of an individual who lacks normal physical development or has a severe and prolonged mobility impairment.

This must be to enable the individual to gain access to, or to be mobile or functional within, the dwelling, provided that the alteration would not typically be expected to increase the value of the dwelling and would not normally be incurred by a person who has normal physical development or does not have a mobility impairment.

For example, CRA notes that power flush toilets could qualify as a medical expense for a taxpayer who has severe Crohn's disease and incontinence.

Other examples include bathroom aids to access a bathtub, shower or toilet.

CRA

eBay Demanded to Produce Documents and Information

In a February 13, 2008 Federal Court case (eBay Canada Limited et al vs. M.N.R.), CRA ordered eBay to provide various documents and information relating to "Power Sellers". eBay questioned the Court as to whether CRA was conducting a genuine and serious inquiry into the group identified as "Power Sellers".

eBay Loses

CRA's order to eBay was upheld. eBay was ordered to provide



the names, addresses, phone numbers, and email addresses. CRA is checking the 2004 and 2005 tax returns. (Globe and Mail, September 27, 2007, page B1)

Editor's Comment

In an October 24, 2007 CRA Release, CRA noted that persons who regularly use the Internet to make a profit must report the earnings on their tax returns.

STANDARDIZED ACCOUNTING

Effective April 1, 2007 a person will not be paid a net tax refund, an overpayment of net tax, a refund, or a rebate until the person files all returns under the Excise Tax Act (ETA), the Income Tax Act (ITA), or the Excise Act.

Also, any refund or rebate owing to a person may be automatically offset against a debt the person owes to the Receiver General under any of these Acts.

The Income Tax Act allows the CRA to offset an income tax debt of a person against any amount payable to the person by the Receiver General, such as the GST/HST refund or rebate.

For example, on July 31, 2007 ABC Corporation files a GST/HST Return with a net tax refund of \$5,000 for its monthly reporting period of June 1 to June 30, 2007. ABC is late in filing its Corporate Income Tax Return for the previous taxation year and it is filed on October 10, 2007. ABC has an unpaid balance of \$3,000 with respect to its Corporate Income Tax Return.

As a result:

(i) ABC will not receive its net tax refund until its outstanding Corporate Income Tax Return is filed in October, 2007.

(ii) ABC will receive prescribed interest equal to the basic rate, plus 2%, calculated on its net tax refund of \$5,000.

(iii) The interest on this net tax refund will accrue beginning thirty days after July 31, 2007, which is the day that ABC filed its return for that reporting period, and ending on the day that the refund is paid.

(iv) ABC will be paid an amount equal to the net tax refund of \$5,000, plus the accrued interest on this \$5,000, less the \$3,000 amount owing on its corporate taxes.

We have even heard of a situation where a corporation had filed its last three years of T2 returns however, its GST/HST refund was held up because there was an unfiled T2 for the stub period (4 years ago) of 15 days from the date of incorporation to the date operations started.

- **Equity Investments**

Taxable capital gains, if any, are calculated by netting out the gains and losses of the equity portfolio as at the date of death. This is done by subtracting the original cost of the investment plus brokerage fees etc. from the fair market value of the investment at the date of death. Only half the capital gain is subject to tax. The best way to ensure payment of only the correct minimum level of tax is to keep an accurate record of all investment transactions including the date of purchase, number of shares, price paid and brokerage fees. Other investment tax considerations may come into play that will require the expert advice of a chartered accountant.

If the deceased has named the surviving spouse as the beneficiary, investments are transferred to the spouse at the deceased's adjusted cost base. Alternately, the executor could elect out of this rollover, on a security-by-security basis, to pay tax on the capital gain in the deceased's final return. There are two choices:

- Have the gain included in the deceased's income and transfer the assets with an adjusted cost base equal to the fair market value of the securities at the date of death.
- Transfer the assets at the adjusted cost base attributable to the deceased at the time of death. There is no capital gain or loss in this case.

The consequences of these alternatives are best explained by an example.

Assume the following:

- Many years ago the deceased purchased 100 shares at \$10 per share for a total investment cost of \$1,000; and
- At the time of death, the 100 shares have a fair market value of \$200 per share for a total of \$20,000

Scenario 1

At the time of death, the executor elects to report a capital gain of \$19,000 for the deceased and \$9,500 is included in the deceased's income for the year of death. The surviving spouse inherits the shares at an adjusted cost base of \$20,000 since the deceased has already paid the tax on the capital gain. If the surviving spouse disposes of the shares at a later date, a capital gain will be calculated as the difference between \$20,000 and the disposal price less brokerage.

Scenario 2

The surviving spouse inherits the investment at the adjusted cost base of \$1,000 even though the investment is worth \$20,000 at the date of death. The spouse pays no tax until he or she sells the shares. If the shares are sold for \$20,000 shortly after the date of death, the spouse records a \$19,000 capital gain and pays income tax on \$9,500. If the shares are sold for, say, \$25,000, some years later, the spouse will realize a \$24,000 capital gain and take \$12,000 into taxable income.

Capital losses occur when the deemed or actual disposal price is below the adjusted cost base. Tax treatment of losses will vary depending on the marginal tax rates and other factors of both the deceased and the surviving spouse.

The Bottom Line: Be Prepared

People of all ages find it hard to contemplate their own death and its consequences. As a result, when death occurs, survivors are often left unprepared for the effects of taxes on themselves or on the deceased. Reviewing your personal financial position, planning your estate and discussing your options with Majewski Shaler & Co. is a positive step toward eliminating unpleasant surprises for your loved ones as they face one of the most distressing events of their lives — your death.

names or addresses and use variables of the key identifiers.

For instance, if you use your initials as a primary building block, you can add a series of variables that are easy to remember. Now you need only to remember the variables. By using a base familiar to you, it is possible to build hundreds of passwords that are difficult to crack but not difficult to remember. By way of example:

- Your initials are ABC
- Your work address is 456 Main Street
- Your home address is 123 York Street

By using your initials ABC, a few of the possibilities would be ABC123, 123ABC, ABC456, 456ABC 654CBA, A456BC etc. The beauty of this simple method is that the same characters and letters may be used in a myriad of situations wherein passwords are required without having to remember a completely different and unrelated combination for each application.

This simplified algorithm allows changes to be made on a recurring basis without the need to worry about remembering the specific password. A simple change of familiar base sequence of numbers and letters will reduce the chance of forgetting a string of random numbers or letters that have no associative meaning for you. With this method, if you try one password and it doesn't work you simply enter the limited range of variations until the system opens.


