



Tax Alert



Proposed Changes to the Canada Pension Plan

On May 25, 2009, the Department of Finance released an information paper on proposed changes to the Canada Pension Plan (CPP). The recommendations were made by federal, provincial and territorial Ministers of Finance and are meant to be affordable within the current CPP contribution rate of 9.9%. Questions and comments were permitted until July 31, 2009.

The major changes, the effective dates and the grandfathering provisions are outlined below. **Note that these changes are at the proposal stage and have yet to be tabled in Parliament.**

Removal of the Work Cessation Test

Currently, in order to take CPP before age 65, an individual must either stop work or reduce earnings for at least 2 months. The proposed change would eliminate this condition.

Increase in the general low earnings drop-out

The CPP benefit is calculated as 25% of an individual's average career earnings starting at age 18 and ending at the age of CPP take-up. The average of earnings is calculated by allowing for the elimination of 15% of the years in which earnings are low or nil. For example, if an individual begins to collect at age 60, this represents a 42 year period. Therefore, 6.3 years of low or nil earnings could be eliminated. The percentages will

be increased to 16% in 2012 and 17% in 2014.

Payment of CPP premiums

Currently, individuals who start to collect CPP are not required to pay premiums. It is proposed that individuals will be required to pay premiums if they continue to work and are under 65. This will be voluntary for anyone 65 or older. These contributions will result in increased benefits, even for those who are already receiving the maximum benefits.

Calculation of the benefit for early and late take-up

Currently, when CPP benefits are taken early, those benefits are reduced by .5% per month. Thus, an individual who applies at age 60 will see his or her benefits reduced by 30%. Conversely, for every month after age 65 and before age 70, the benefits will be increased .5% up to 30%. It is proposed to reduce early payout by .6% and increase late payouts to .7% per month.

For further information please contact your Collins Barrow advisor.

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Registered Disability Savings Plans

In the 2007 Federal Budget, the government added a considerable tool to aid in securing the long-term financial future of persons with disabilities. The Registered Disability Savings Plan (RDSP) allows Canadians who are eligible for the disability tax credit, or those legally authorized to act on their behalf, to contribute up to a maximum of \$200,000 to the plan. The RDSP has three main benefits that make it an attractive option: 1) tax deferral of investment income until withdrawal from the plan; 2) Canada Disability Savings Grants (CDSG); and 3) Canada Disability Savings Bonds (CDSB).

What is an RDSP?

The *Income Tax Act* describes an RDSP as an arrangement registered with the Canada Revenue Agency (CRA) between a licensed trust company (the issuer) and one or more of the beneficiary or a qualifying person(s) in relation to the beneficiary (the holder) under which contributions, grants and bonds are invested for the purpose of disbursing the amounts to the beneficiary.

Holder

The holder of the RDSP is the person who makes the decisions regarding the investments and establishes the RDSP on behalf of the beneficiary. If the beneficiary is a minor, the holder can be the legal parent, guardian or entity who has legal authorization to act on the beneficiary's behalf. Upon reaching the age of majority, a mentally competent beneficiary must become the plan holder. However, if the beneficiary is not mentally competent, then the holder may be the same as that of a minor with the exception that the parent must be legally authorized by the province to act on the beneficiary's behalf.

Contributions made to an RDSP

An RDSP is similar to a registered education savings plan in that non-deductible contributions are made to the plan by the holder along with contributions of government assistance by way of the CDSG and the CDSB. Only one RDSP can be established at any given time for each beneficiary.

Holder contributions

Contributions made by the holder, or someone with written consent of the holder, have no annual limit. There is a lifetime contribution limit of \$200,000. Holder contributions may be made at any time up to the end of the year in which the beneficiary turns 59.

Government assistance

There are two forms of government assistance for RDSPs. The first is the CDSG. This grant is based upon the amount of contributions made by the holder. The CDSG assistance in a year can be 100%, 200% or 300% of the holder contributions, depending on contribution amounts and "family income levels," up to an annual limit of \$3,500.

The second form of government assistance is the CDSB, which is independent of any holder contributions but is based on "family income." The annual maximum CDSB assistance contributed to the plan is \$1,000. Both the CDSG and the CDSB can be granted to the RDSP up to the end of the year in which the beneficiary turns 49.

The maximum lifetime CDSG available to any particular RDSP is \$70,000, and the maximum available CDSB is \$20,000. Along with the maximum holder contributions of \$200,000, the total maximum contributions to an RDSP are thus \$290,000.

To maximize the government assistance received, the holder contributions should be spread out over the eligible years to take advantage of the annual maximum grant amount.

Payments made from an RDSP

Three types of payments may be made from the plan. They are:

1. disability assistance payments (DAPs), including Lifetime Disability Assistance Payments (LDAPs);
2. a transfer from one RDSP to another; and
3. repayment of government assistance.

Disability assistance payments

Any payment made to the beneficiary or the beneficiary's estate is considered to be a DAP. The payments are partially tax free and partially taxable, based on the proportion of holder contributions to the plan and the fair market value of the plan. The ability to make a DAP is subject to limitations for the assistance holdback amount, as discussed below.

Lifetime disability assistance payments

The RDSP must provide for LDAPs to be made from the plan. The LDAPs must begin by the end of the taxation year in which the beneficiary turns 60. The maximum LDAP that can be withdrawn from the plan in any year is determined by a formula based on the fair market value of the assets and the age of the beneficiary. The goal is to allow equal payments from the plan over the beneficiary's remaining life.

Special rules apply to accelerate the withdrawals for beneficiaries with shortened life expectancies of less than 5 years.

Repayments of government assistance

Under certain circumstances, the issuer must repay CDSGs and CDSBs that were received by the plan over the preceding 10 years. The specific events that can trigger such repayments are:

1. termination of the RDSP;
2. the beneficiary loses the eligibility for the DTC;
3. a DAP is made from the plan; and
4. death of the beneficiary.

To ensure the repayment amount is covered by assets in the plan, the RDSP issuer must ensure an "assistance holdback amount" is available. This amount is not available for a DAP and is equal to the government assistance over the last 10 years up to a maximum of the fair market value of the plan. This is intended to encourage long-term savings.

Termination of the RDSP

An RDSP may be terminated for various reasons: 1) the holder can terminate the plan voluntarily with a DAP; 2) the death of the beneficiary will trigger the collapse of the RDSP; and 3) non-compliance with the conditions of eligibility will result in termination of the plan.

Once the RDSP is terminated non-voluntarily, the assets of the plan

must be paid out to the beneficiary, less any assistance holdback amounts that need to be repaid to the government, by the end of the following tax year.

Taxability

There are some exceptions to the tax free status of the earnings in the RDSP. If the trust has a loan balance outstanding at the end of the year, then all the income of the trust is taxable for that year. As well, any business income or income from non-qualifying investments will be taxable in the year in which it is earned, but will not affect the non-taxable status of qualifying investment income.

Other disability benefits and programs

There are many other benefits and programs accessible at both federal and provincial levels that use either income- or asset-based thresholds to determine eligibility.

For federal benefits from the tax system, income from an RDSP need not be included as “adjusted income” for calculating eligibility. As well, the provincial governments allow full exemptions from including RDSP assets and income in income tested programs, except in Quebec, New Brunswick and P.E.I., which allow partial exemptions. In Ontario, this means that having an RDSP will not affect payments received under the Ontario Disability Support Program.

Summary

The RDSP provides significant advantages to encourage investment and long-term savings to aid in financial security for persons eligible for the Disability Tax Credit. Contact your Collins Barrow advisor to determine whether these advantages are available and appropriate for you.

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Medical Expense Tax Credit and Alternative Medicine

More and more individuals are seeking alternative medical treatment outside of traditional medical professions, from practitioners such as naturopaths, acupuncturists and massage therapists. In addition, they may also use vitamins, herbs and other supplements recommended by their medical professional instead of pharmaceutical drugs. Many of the costs associated with these treatments and supplements are not covered under provincial or private health plans. The question then becomes: can the Medical Expense Tax Credit (METC) be claimed for the out of pocket costs incurred for these services and substances on one's personal income tax return?

Fees paid to a medical practitioner

The *Income Tax Act* allows an METC for fees paid by an individual in respect of medical and dental services provided by a “medical practitioner,” dentist or nurse, or an institution. Thus, in order to claim the METC one must ensure the definition of “medical practitioner” is met.

A “medical practitioner” generally is a person who is authorized to practice medical or dental services pursuant to the laws of the jurisdiction in which the services are rendered. Not all provinces authorize the same alternative medicine disciplines under their respective Health Professions Acts. For example, acupuncture treatment is authorized in Alberta, but is not authorized in Ontario. Therefore, individuals who get treatments from an acupuncturist in Alberta can claim an METC, while someone who obtains the same treatment in Ontario cannot claim the METC. The same would apply to fees paid for massage therapy, which is authorized in Ontario and British Columbia

but not in New Brunswick.

Thus, eligibility for the METC for any particular alternative medicine depends upon whether that service is authorized under the laws of the province in which the service is provided.

Vitamins, herbs and other supplements

There is a misconception when it comes to the ability of a taxpayer to claim the METC for the expenses incurred to purchase vitamins, herbs and other supplements prescribed or recommended by medical practitioners. The *Income Tax Act* allows an METC for expenses incurred to purchase drugs, medications or other substances as long as they cannot lawfully be acquired without a prescription from a medical practitioner, and as long as the prescription is recorded by a pharmacist in a prescription record. The vitamins, herbs and other supplements recommended or prescribed by alternative medicine practitioners are often over-the-counter items which can be acquired without a prescription and are not recorded by a pharmacist. As a result, most of these expenses cannot be claimed as an METC.

Contact your Collins Barrow advisor for assistance in determining whether your expenses for alternative medical services and substances qualify as METCs under the *Income Tax Act*.

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Voluntary Disclosure – Providing Tax Closure

If you have not filed all of your income tax, GST or other tax returns, or have filed them incorrectly by claiming ineligible expenses or failing to report all of the income you received, the following information may be of interest to you.

The Canada Revenue Agency (CRA) has a program that is designed to encourage taxpayers to come forward voluntarily to correct previous omissions in their dealings with the CRA. The program is called the Voluntary Disclosure Program (VDP). If the CRA accepts a disclosure under the VDP, the taxpayer will still have to pay the taxes and related interest charges, but will not incur the penalties or possible prosecution to which he or she would otherwise be subject.

The VDP received significant press recently when it was disclosed that former Prime Minister Brian Mulroney had used the program to report payments that he had received in a previous year and failed to report as income. Some of the features of the VDP from which Mr. Mulroney was reported to have benefited are no longer available, but the main purpose and benefit of the program remain.

To be accepted under the VDP, a valid disclosure must meet the following four conditions:

- It must be voluntary, which means that the submission must be made before the CRA or any other authority has initiated contact with the taxpayer.
- It must be complete and accurate. If full disclosure is not provided, the penalties may not be waived.
- It must involve a penalty. A late filing penalty is the most common, but this could also include discretionary penalties for omissions or gross negligence.
- It must include information that is at least one year past due.

A submission under the VDP must be made in writing and must be mailed or faxed to the CRA tax service office that has jurisdiction over the area in which the taxpayer resides. This can be done using Form RC199 or by a letter containing similar information as is required by Form RC199. The information to be submitted includes such things as name and address of the taxpayer, disclosure of the reason for the submission, and an explanation of how the four conditions for a valid disclosure (noted above) have been met. The date that the CRA receives the written submission becomes the effective date of disclosure. From this date forward, provided that the submission is determined to be a valid disclosure, the taxpayer is granted protection against penalties and possible prosecution regarding the

issues identified in the disclosure. It is therefore important to make the submission as soon as possible; waiting could result in the CRA initiating contact, rendering the taxpayer ineligible for the program.

There may be circumstances in which the taxpayer cannot submit all of the information or documentation immediately. The CRA generally will provide additional time of up to 90 days after the effective date of disclosure in which to complete the submission. If the information is not provided within the required time period, the CRA may commence action and the submission would not be a valid disclosure, and penalties and possible prosecution may result.

The CRA will review the submission and determine if the four conditions have been met for a valid disclosure, and will then assess the tax and interest owing.

The submission can be made on a "named" or on a "no-name" basis. A no-name submission is made by a representative of the taxpayer with the taxpayer's identity withheld initially. In such cases, the taxpayer may be undecided as to whether to proceed with the disclosure. Informal, non-binding discussions are undertaken with a VDP officer to provide the taxpayer with a better understanding of the possible tax consequences of his or her situation and the relief available under the VDP. The taxpayer will then have to decide either to come forth on a named basis or not to proceed with the submission, in which case he or she would remain at risk of the CRA discovering the omission and applying the related penalties and possible prosecution. If the taxpayer decides to come forth on a named basis, his or her identity must be provided to the CRA within 90 days of the effective date of disclosure or the file will be closed.

The tax system has become extremely complex and it is not uncommon for taxpayers to make inadvertent errors or to miss filing an information return. The returns required for reporting foreign assets, subcontractor payments made in the construction industry, and non-profit information returns are common examples. When filed late, these forms carry penalties of up to \$2,500 per year, but if filed under the VDP the penalties can be waived.

If you become aware of an omission in your dealings with the CRA, contact your Collins Barrow representative to determine if the Voluntary Disclosure Program can help you avoid the possible penalties.

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Collins Barrow regularly publishes Tax Alert for its clients and associates. It is designed to highlight and summarize the continually changing tax and business scene across Canada. While Tax Alert suggests general planning ideas, we recommend professional advice always be sought before taking specific planning steps.