RATIO

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LAW ▸ BUSINESS

Quarterly legal newsletter intended for accounting, management, and finance professionals

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IT'S TIME TO SPLIT YOUR INCOME

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The current financial crisis has forced central banks around the world to reduce interest rates. The Bank of Canada is no exception and has reduced its policy rate to a level never seen before.

Consequently, the prescribed interest rate under *the Income Tax Act* for loans between related parties is at its historical minimum and will be set at 1% for the second quarter of 2009.

ATTRIBUTION RULES

When money is lent or property is transferred to a minor or a spouse, the attribution rules may apply with the result that the person who lent the money or transferred the property, rather than the minor or the spouse, will be taxed on the income derived from the money lent or the property transferred. In the case of spouses, the attribution rules apply not only to income (i.e. interest, dividends, etc.) but also to capital gains.

There is a notable exception to the application of the attribution rules when property is transferred at its fair market value. Furthermore, where indebtedness results from such a transfer, interest must be charged at a rate at least equal to the prescribed rate at the time the indebtedness arises. All the interest that is payable in respect of the indebtedness must be paid no later than 30 days after the end of the calendar year in which it became payable.

The prescribed rate for the second quarter of 2009 will be 1% and, consequently, income splitting opportunities and tax planning possibilities abound. In addition, given that there is no specific requirement that loans made by individuals be repaid within any particular time period, the 1% rate could be frozen indefinitely when the loan is properly documented.

INCOME SPLITTING

Beginning in the second quarter of this year, the very low prescribed rate allows a family to shift taxable income from the high-income earners to those who pay little or no tax and, by so doing, reduce the family's overall tax burden.

However, certain specific types of investments would have to be made in order to avoid the income splitting tax commonly known as the "kiddy tax".

The foregoing rules are but a brief summary of a highly complex aspect of the income tax legislation. Any planning in this regard should be carried out in consultation with a tax adviser. ◂

THE NEW RULES FOR PUBLIC SECTOR CONTRACTS

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Since October 1, 2008, the date on which *An Act respecting contracting by public bodies* (the "Act") and its regulations came into force, new rules govern the awarding of supply, construction and services contracts in the public and parapublic sectors.

Under the new system, the process to be followed by Quebec public bodies when awarding such contracts has been standardized and the thresholds for calls for public tenders have been harmonized with those provided for in Quebec's intergovernmental agreements on the liberalization of public procurement. In addition, the process for awarding contracts applies from now on to the education, health and social services sectors.

The system also applies to government corporations such as Hydro-Québec, the Société des alcools du Québec and the Société des loteries du Québec. Thus, government corporations must adopt, and make available to the public, policies concerning the terms of their contracts that take into account the principles of sound contract management set out in the Act and comply with the intergovernmental agreements on the liberalization of public procurement that are in force. It is important to consult these policies before doing business with government corporations.

Generally, contracts of $100,000 or more awarded by government departments, public bodies and educational, health and social services establishments are subject to the system. However, it should be noted that in the case of supply contracts awarded by government departments and public bodies the threshold is only $25,000.

It remains possible to enter into a contract by mutual agreement with a Quebec public body, even if it involves an expenditure exceeding the public tender threshold, in certain cases, such as: if there is an emergency; if there is only one possible contractor because of the existence of a guarantee; if it involves an ownership right or an exclusive right such as a copyright or a right based on an exclusive license or patent; or if it involves information the public disclosure of which could hinder the public interest.

Certain rules also govern the award by a public body of a contract involving expenditure below the public tender thresholds. Essentially, in these cases, the public body must comply with the fundamental principles set out in the Act and consider the possibility of having recourse to one of the alternate methods of adjudication that it provides for, such as a call for tenders by invitation or using a rotation system among the competitors.

Lastly, the new system contains a succinct statement of the public call for tenders process in cases of public-private partnerships ("PPPs"). Any PPP contract is subject to the Act, irrespective of its value, but the general rules are relaxed with respect to these contracts, in particular as regards the possibility of dividing a project into different stages. A competitive dialogue with the selected bidders is also permitted for complex projects.

The new system simplifies doing business with bodies in the public and parapublic sectors but it is important to be well informed before undertaking the preparation of a bid or the negotiation of a contract. ◄

THE QUEBEC TAX AUTHORITIES SHOW THEIR CLAWS!

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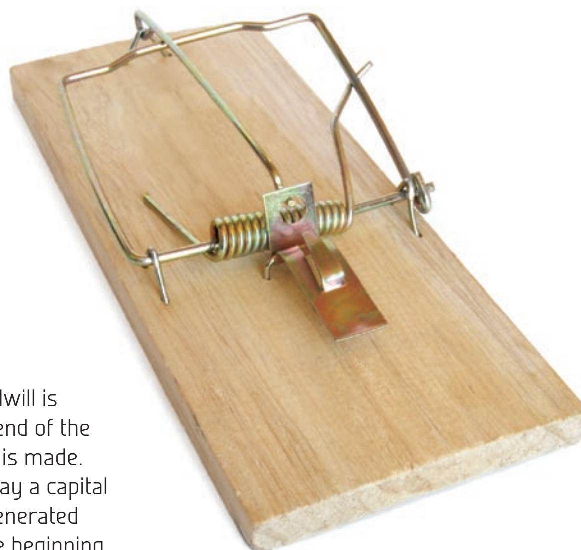
For some time, the Quebec tax authorities have been expressing their concerns regarding aggressive tax plans ("ATPs"). Moreover, the Quebec government has demonstrated its disagreement with certain ATPs by enacting legislative provisions having a date of coming into force prior to the date on which they were publicly announced (i.e. retroactive legislation), which is exceptional in the history of Canadian taxation.

On January 27, 2009, and with the aim of countering the proliferation of ATPs, Quebec's Minister of Finance, the honourable Monique Jérome-Forget, submitted a green paper proposing legislative provisions previously unseen in Canada. These measures may be summarized, in general, as follows:

- An obligation on any taxpayer subject to Quebec income tax to disclose his involvement in an ATP to the Ministère du Revenu du Québec within 30 days from the beginning of the implementation of the ATP. For this purpose, an ATP would be defined as a plan in respect of which the taxpayer has agreed to a confidentiality undertaking with an advisor or in respect of which an advisor's remuneration is conditional on the success of the plan. This obligation would be accompanied by penalties and a suspension of the limitation period in the event that it is not fulfilled;
- A three-year prolongation of the normal limitation period in the case of any plan involving the application of the general anti-avoidance rule;
- A penalty on the taxpayer equal to 25% of the additional income tax resulting from the application of the general anti-avoidance provision to a tax plan. A penalty on the advisor involved in the plan equal to 12.5% of any remuneration received.

A taxpayer can avoid the application of the latter two measures by disclosing the potential application of the general anti-avoidance provision to the plan, to the tax authorities, no later than on the statutory date for the filing of his income tax return for the taxation year during which the plan is carried out.

The Minister of Finance is encouraging taxpayers to submit observations regarding the measures proposed in the green paper and it is expected that several groups of taxpayers will submit their comments. Moreover, the Association de planification fiscale et financière (APFF) has formed a committee for this purpose, of which the undersigned is a member. Despite this public consultation, it can be expected that the measures that will finally be adopted will closely resemble those that have been proposed. In addition, although the green paper does not mention a date for the coming into force of the new rules, it should be in the near future. ◄



SALES OF GOODWILL AND CAPITAL DIVIDEND ACCOUNTS: WATCH OUT FOR THE PITFALLS!

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The capital dividend account ("CDA") of a private corporation enables it to pay tax-free dividends, commonly referred to as capital dividends, to its shareholders resident in Canada.

The CDA is made up of various elements including, in particular, the non-taxable portions of capital gains less the non-deductible portions of capital losses, the non-taxable portions of gains made on sales of goodwill, the amounts of capital dividends received from other corporations etc.

Generally, tax professionals advise their corporate clients to pay a capital dividend as soon as the corporation's CDA is positive, in order to avoid the amount of the CDA being subsequently reduced. However, this approach may lead to undesired results.

Normally, a corporation's CDA increases as soon as it makes a capital gain or receives an amount as a capital dividend. However, the non-taxable portion of a gain made by a corporation on a sale of goodwill is included in its CDA only at the end of the taxation year in which the sale is made. Thus, the corporation cannot pay a capital dividend coming from a gain generated by a sale of goodwill before the beginning of the taxation year following the year in which the sale is made.

If a corporation pays a capital dividend coming from a gain made on a sale of goodwill during the taxation year in which the sale is made, the corporation may be liable for a penalty corresponding to 75% of the amount of the capital dividend paid.

In addition, another problem may arise when a corporation acquires certain assets during the taxation year in which the sale is made. Indeed, such an acquisition is likely to reduce the amount that can be included in its CDA at the end of such taxation year and thus reduce the capital dividend that can be paid during the following taxation year.

Also, it should be noted that certain planning may enable a corporation to bring forward the date of the end of the taxation year during which the sale is made, in order to advance the payment of a capital dividend.

Be that as it may, vigilance is called for when you advise your clients to pay a capital dividend, particularly when its source is a gain made on a sale of goodwill. ◄

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