Collins Barrow

Chartered Accountants

Tax Alert

SPRING 2004

Tenant Inducement Payments (TIPs)

Tenant inducement payments (TIPs) are payments made by a landlord to attract tenants to a building. Some inducements are unrestricted cash payments. Others may involve specific payments for moving expenses or allowances for fixtures. Some inducements involve payments to other landlords (a "lease pickup") to take over or buy out a tenant's previous lease. Other payments are made to improve the premises to meet tenant specifications. Some inducements do not involve payments, but offer rent-free or low-rent periods or low-interest loans. Some of these benefits are immediate and others are longer term. The income tax treatment of TIPs varies with the nature of the inducement.

The income tax treatment of TIPs may differ from accounting treatment. This is particularly important for landlords who may deduct an inducement expenditure for tax, but have to capitalize it for accounting. Also, the treatment of an inducement by the tenant need not be symmetrical with that of the landlord.

Where an inducement payment takes the form of a cash payment to a tenant who receives such payments as a normal part of business, as might be the case for a chain-store retailer, the cash payment may be considered to be business income for tax purposes. Other tenants may have a choice of including the payment in business income or reducing the capital cost of an asset purchased with the inducement. If a TIP is to be used for a specified tenant expenditure, then it either is included in the tenant's income or reduces the cost of the expenditure, depending on its nature. For the landlord, the Supreme Court has held that TIPs are fully deductible and need not be matched with future benefits to obtain an accurate picture of a taxpayer's income for tax.

The income tax treatment of indirect or non-cash payments depends on the nature of the benefit. A "lease pickup" paid by the new landlord may result in a disposition of a leasehold interest of the tenant, possibly resulting in income for the tenant. The new landlord making the payment may have a deductible expenditure. Expenditures to improve a landlord's premises would have no impact on the tenant's income but the landlord must add the expenditure to the capital cost of the building. Rent reductions mean less deduction for the tenant and less income for the landlord. Low-interest loans are not considered to produce an income inclusion for the tenant. The lost opportunity to earn market interest does not provide for a landlord deduction.

The proper treatment of TIPs by both the tenant and the landlord requires careful analysis and thought based on the specific facts of the situation. Professional advice can be most beneficial, particularly when structuring or negotiating TIPs.

What's Inside

1 Tenant Inducement Payments (TIPs)

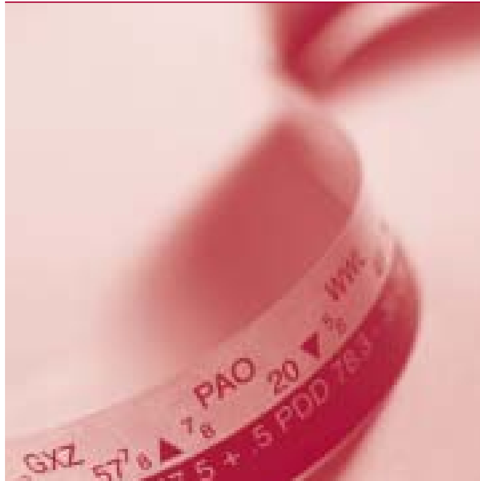
2 Losses on Share Transactions

2 Charitable Donations Tax Incentives Still Available

3 Health and Welfare Trusts

4 RRSP / RRIF Reporting for US Citizens Living in Canada

Losses on Share Transactions



Taxpayers should be wary of the superficial loss provisions when selling share investments with accrued losses. A loss will be denied if an individual purchases shares of the same company within 30 days preceding or following the disposition and still owns shares of the company (the remaining shares) 30 days following the disposition. The denied loss will be added to the adjusted cost base of the remaining shares and realized in the future when those shares are sold.

Example

Mr. A sells all of his 100 BCE shares at a loss of $1,000 on December 30th, 2003 expecting to use the loss against his 2003 capital gains. On January 15th, 2004, he purchases 100 BCE shares (within 30 days of the December sale) and holds the shares until they are sold in April 2004. The $1,000 loss is denied. The loss realization is deferred until the April sale of the remaining shares.

The superficial loss provisions apply not only to share transactions but can apply to any transaction where an individual realizes a loss on a property within 30 days of acquiring, or an affiliated person acquiring, the same or an identical property. An affiliated person includes a spouse or common-law partner and a corporation controlled by the individual alone or with a spouse or common-law partner. After March 22, 2004, it also includes a trust of which the person or an affiliated person (as described above) is a majority interest beneficiary. It may be possible to use the superficial loss rules in certain circumstances to transfer a loss to an affiliated person such as a spouse or controlled corporation by timing a repurchase within the 30-day period.

Charitable Donations Tax Incentives Still Available

In the Winter 2004 Tax Alert, we outlined certain donation tax shelter arrangements currently under attack by Canada Revenue Agency (CRA). However, donations of certain properties with accumulated gains are acceptable.

Normally, on the disposition of a property for a capital gain, one-half of the gain is taxed. However, for publicly traded securities and mutual fund units or ecological gifts that are donated to a public charity, only one-quarter of the gain is taxed. None of the gain is taxed on a similar donation of certified cultural property. Furthermore, a receipt is issued for the full value of the property.

Consider shares, now worth $1,800, that you bought for $1,000. If sold, the tax will be a maximum of about $186. Donating the $1,800 of cash proceeds results in a maximum tax credit of $835 for a net tax benefit of $649. On the other hand, donating the shares directly, results in a tax cost of only $93 for a net tax benefit of $742 for the same donation value, saving half of the tax.

Donating property to a charity that is prepared to accept it can provide you with these additional tax savings. Contact your tax advisor to determine your best course of action.

Health and Welfare Trusts

Health benefits for employees are normally provided through an insurance company. However, a viable option may be a trust arrangement called a health and welfare trust. Under this arrangement, the trustees of the trust receive contributions from the employer, and in some cases from employees, to provide the health benefits for employees. The types of benefits managed through a health and welfare trust are restricted to group sickness or accident insurance plans, private health services plans, group term life insurance policies, or any combination of these. Advantages of this type of arrangement include reduced administration fees and additional coverage for a select group of employees such as top executives. For example, group plans usually cover neither all medical services nor do they pay 100% of the costs incurred by the employee. Using a health and welfare trust can cover say 100% of an expanded list of medical services for a select group of employees.

Health and welfare trusts are an administrative concession by the CRA. While they have set out certain conditions that have to be met, the CRA does not have a formal registration procedure. To prevent abuse, they have a number of requirements to establish one of these trusts. The funds contributed to the trust cannot revert back to the employer or be used for any purpose other than providing the health benefits agreed to. To prevent excess tax deductions, the employer's contributions to the fund must not exceed the amounts required to provide current benefits. The payments by the employer to the trust must be legally required under the trust document and cannot be made on a voluntary basis. The trustees should act independently of the employer to avoid having the employer retain control over the funds.

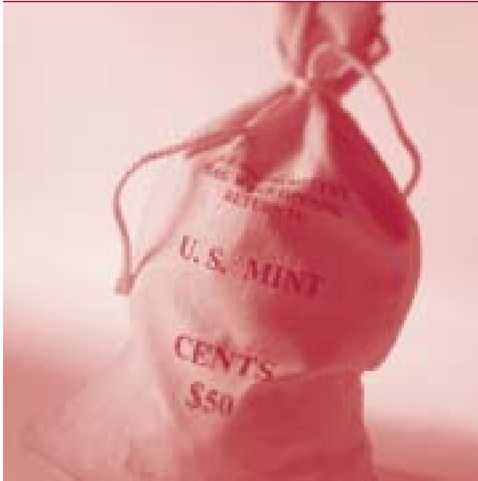
Employer contributions to a health and welfare trust are deductible to the extent that they are reasonable and incurred to earn income. For employers using the accrual method of accounting, the payments are deductible in the year in which the legal obligation to make the contributions arose. For the employees, their taxable benefit will be determined in the same way they would if this trust arrangement were not used.

The trust itself does not pay tax on the payments received from the employer and none of the payments made by the trust to the employees are deductible. However, any investment income earned in the trust will be taxed at the top marginal rate for individuals so there are no tax rate advantages to this arrangement.

An interesting issue is whether the employer can deduct payments that are not needed to fund current expenses but are needed to pay for future liabilities. For example, if an employer makes a payment to the trust for 100% of the estimated cost of all current and future claims for long-term disability, would this lump-sum payment be deductible to the company? The CRA's position is that the portion of the payment required for the current expenses is deductible now and the portion required for the future expenses is classified as a prepaid expense and will be deductible in the future year to which the expense relates.

While there may be some interesting benefits from using a health and welfare trust, there are also some costs. Along with the costs related to its ongoing maintenance, there will be professional fees incurred for establishing the trust, maintaining financial records, filing tax returns, reporting to employees and ongoing management of the trust. In addition, depending on the type of benefits covered by the plan, actuarial valuations may be required to establish the liability that is to be funded by the company.

RRSP / RRIF Reporting for US Citizens Living in Canada



U.S. citizens living in Canada are required to file an annual personal tax return (Form 1040) with the IRS. Where the individual has a Canadian RRSP or RRIF, the income earned within the plan is included in worldwide income for U.S. tax purposes unless an election is filed as allowed under the Canada/US treaty. The election defers taxation until withdrawals are made from the plan.

In November of 2003, the IRS issued a notice indicating that annual reporting requirements for RRSPs and RRIFs would be simplified for tax years beginning after 2002. Previously, Forms 3520 and 3520-A were filed with the return to meet reporting requirements. As new forms are not ready for filing 2003 returns, interim-reporting requirements will apply.

Where the taxpayer elects to defer U.S. tax on the accrued income, a page must be attached to the return to indicate that the election is being made and identify the total balance of the plan at year-end. The taxpayer must also report the taxable amount of any distributions from the plan as "other income" on the return.

Where the taxpayer chooses not to elect, a page must be attached providing the taxpayer's name, address, social security number, the plan custodian's name and address, the amount of contributions and distributions during the year, the balance at the end of the year and a breakdown of undistributed income in the year segregated into interest, dividends, capital gains and other income. The undistributed income retains its character and must be included in income on the return.

The decision of whether to elect will depend on the circumstances of the taxpayer. In some cases, it may be beneficial for a taxpayer not to make the election because capital gains and dividends are generally subject to lower U.S. tax rates than other income. Your tax advisor can assess which option is better.

Collins Barrow Office Locations:

Banff	Hearst	Sarnia
Bobcaygeon	Kapuskasing	Sebringville
Calgary	Kingston	Sturgeon Falls
Cambridge	Leamington	Sudbury
Canmore	Lindsay	Toronto
Carleton Place	London	Vancouver
Chatham	Manotick	Vaughan
Chelmsford	Montreal	Wallaceburg
Drayton Valley	North Bay	Waterloo
Edmonton	Orangeville	Winchester
Elora	Ottawa	Windsor
Exeter	Peterborough	Winnipeg
Fenelon Falls	Red Deer	

Contact Information:

Internet: www.collinsbarrow.com
Email: info@collinsbarrow.com
Careers: careers@collinsbarrow.com

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.