Case #2

MARKING GUIDE
FRED AND NORA SIMPSON
ASSESSMENT OPPORTUNITIES

To: Fred Simpson
From: CPA
Subject: 2014 tax return

Assessment Opportunity #1

The candidate advises the client on the Notice of Reassessment.

The candidate demonstrates competence in Taxation

CPA Map Competencies:
6.3.1 – Advises taxpayer with respect to assessment, notice of objection, and appeals (Core – Level C; moves to Level B in Taxation Elective)

Notice of Reassessment

Canada Revenue Agency has demanded payment of $22,568. That amount is based on its reassessment of your return once the information you supplied was matched against tax information that CRA received from other sources.

If you think CRA has misinterpreted the facts or applied the law incorrectly, you have the right to object to the Notice of Reassessment. You have to explain why you disagree with the reassessment notice and include all relevant facts and documents. This has to be done by the later of 90 days from the date on the notice or one year from the filing due date, so if you decide to go ahead with an objection, it has to be filed by the end of April.

CRA has charged you interest and penalties on your return. Interest is assessed when any amount that is due has not been paid. Since there is still a balance owing, this interest will continue to compound at the CRA prescribed rate until the amount is paid. The normal filing due date, which is also the date your final payment is due, is April 30 each year. Even with the extension provided by CRA in 2015 due to their administrative error, you needed to have filed by May 5 to have been considered to have filed on time.

The fact that you have been charged a penalty in addition to interest suggests that your return was not filed by that date. You took all of your tax information to the mall kiosk during the last week of April but did not pick it up until May 18, thirteen days after the 2014 tax deadline. As a result, you have no proof of when it was filed. If you had opened the Notice of Assessment when it arrived in June, you would have noticed that you were charged interest and penalties on the balance that was owing at that time.

CRA assesses a penalty of 5% of the balance owing the first time you do not file by the deadline (this increases to 10% for repeat failures to file). That would amount to just over $1,000 in your case ($21,815 × 5%). Since you have been unable to contact the tax preparer by phone, you should see if you can find any contact information on the material they gave you or contact CRA to see if the agency has a list of authorized e-filers that worked in the mall.

You may also consider requesting taxpayer relief from CRA for the penalties assessed as a result of your tax preparer's errors. While CRA generally does not provide relief when they have already reassessed, given the circumstances they may be willing to be lenient, particularly if the preparer turns out to have been negligent.

Assessment Opportunity #2

The candidate advises the client on changes to his tax return on the Notice of Reassessment – RRSP.

The candidate demonstrates competence in Taxation

CPA Map Competencies:
6.2.2 – Determines income taxes payable for an individual in routine situations (Core – Level B; moves to Level A in Taxation Elective)

Unreported Income

There are two sources of income on the Notice of Reassessment that were not included in your original return: income from a registered retirement savings plan (RRSP) and from taxable capital gains. The tax payments made during 2014 are also different from those on your original return.

a) RRSP Income

The reassessment notice shows $90,000 in RRSP income. You received $65,000 in cash last year from the bank when you cashed in your RRSP, but you did not provide me with a tax slip to show the details of the transaction. Since the tax preparer did not ask you any questions when you took in your information, she would have simply filed your return with the tax slips you gave her.

RRSP contributions provide taxpayers with the opportunity to defer income tax on money they have earned until the amount is withdrawn from the investment. When a taxpayer withdraws funds from an RRSP, the financial institution has to withhold tax. The $65,000 you received in cash was net of tax. That accounts for the RRSP income of $90,000 on the Notice of Reassessment.

The difference between the tax payments shown on your return ($12,132) and on the Notice of Reassessment ($37,132) is $25,000. Both the income inclusion and the tax payment are reported on a T4RSP slip that a financial institution has to issue each year if taxpayers withdraw funds from their RRSP. This may be what they sent you at the end of the year. You should try to find the document to ensure the numbers tie in to my calculations.

Since your financial institution is required to withhold tax on RRSP withdrawals, this very likely accounts for the $25,000 difference in tax payments.

Assessment Opportunity #3

The candidate advises the client on changes to his tax return on the Notice of Reassessment – taxable capital gains

The candidate demonstrates competence in Taxation

CPA Map Competencies:
6.2.2 – Determines income taxes payable for an individual in routine situations (Core – Level B; moves to Level A in Taxation Elective)

b) Taxable Capital Gains

The amount of taxable capital gains shown on the Notice of Reassessment is 50% of the proceeds ((55,000 + 7,500) × 50%) you received from the sale of your shares in General Tire and the bonds you inherited from your father. Since you did not report the disposition of these investments on your tax return, CRA has used the details of the proceeds it would have received from the bank to calculate your taxable capital gain, assuming the cost was nil.

If you can find the adjusted cost base (ACB) of these investments, you can reduce the amount of the taxable capital gain. Since you inherited these investments from your father, your ACB would be the fair market value of the shares and the bond on the date of his death in 1993.

Schedule 3 is used to detail the sale of investments to determine if the amount you received on disposition is more or less than the amount you paid for it. If it is more, the difference is a capital gain that is multiplied by 50% to determine the taxable capital gain. If it is less, the amount is also multiplied by 50%, but those losses have to be applied to taxable capital gains for you to be able to use them. If your losses exceed the capital gains in the current year, they can be carried back up to three years or forward indefinitely, to be applied only against capital gains.

I suggest you contact General Tire and the bondholder to try to get the market value from 1993. It may be possible to obtain this information online. To be able to reduce the taxable capital gain, you need the ACB on those investments.

Assessment Opportunity #4

The candidate advises the client on items that are missing from his non-refundable tax credits.

The candidate demonstrates competence in Taxation

CPA Map Competencies:
6.2.2 – Determines income taxes payable for an individual in routine situations (Core – Level B; moves to Level A in Taxation Elective)

Non-refundable Tax Credits

I did a quick calculation of your federal non-refundable tax credits, and it looks like you only claimed the basic personal amount for yourself, the spouse amount for Nora, and credits for both CPP and EI: ((11,138.00 + 11,138.00 + 2,425.50 + 913.68) × 15%) = $3,842.

Several things were missed. You had donations and medical costs in 2014, but they were not included. When Nora has no income, it does not make sense to have her claim things that are in her name if they are things that you are allowed to claim. The expenses should be claimed as credits on your tax return.

The family caregiver amount is available when an individual is claiming an eligible credit (the spouse amount is one of those credits), and it is added to the base of the credit if the individual is dependent on the taxpayer by reason of physical or mental infirmity. You must have a signed statement from a medical practitioner showing when Nora's impairment began and what the duration of the impairment is expected to be.

Wheelchair costs are eligible medical expenses.

The home renovation costs you incurred to give Nora more mobility in your home can also be included as medical expenses. To qualify, these expenses have to be reasonable and meet the following conditions:

- They would not typically be expected to increase the value of the dwelling; and
- They would not normally be incurred by persons who have normal physical development or who do not have a severe and prolonged mobility impairment.

Since you were working in 2014, you should also have claimed the Canada Employment Amount.

Meredith just finished university last year and has not been working. Up to $5,000 of her tuition, education, and textbook credits can be transferred over to you each year since she has been dependent on you for support. You need to get a copy of her T2202A and have her sign off to show that she agrees to transfer part of her costs to you for tax purposes.

Assessment Opportunity #5

The candidate recalculates the items that are missing from the client's non-refundable tax credits and advises on prior-year errors.

The candidate demonstrates competence in Taxation

CPA Map Competencies:
6.2.2 – Determines income taxes payable for an individual in routine situations (Core – Level B; moves to Level A in Taxation Elective)

Based on my calculations, your federal non-refundable tax credits should have been $7,560 (see below).

Personal amount	11,138	
Spousal amount	11,138	
Additional family caregiver	2,058	
CPP contributions	2,425	
EI premiums	914	
Canada Employment Amount	1,127	
Tuition and textbook amounts	5,000	
Medical costs	15,529	See Note A
	49,329	
	15%	7,399
Donations (total $650)		
First $200	15%	30
Remainder ($450)	29%	131
Non-refundable federal tax credits		7,560

Note A

Medical costs	Actual	12,700
	Benefits	(3,000)
	Wheelchair	8,000
		17,700
Less the lesser of:		
3% of net income	5,800	
Fix amounts	2,171	(2,171)
Medical expenses claimed		15,529

This would reduce your federal tax payable by $3,718 (7,560 − 3,842) and would also reduce your provincial tax. I do not have enough information to be able to do that calculation right now.

Tax Adjustments for Previous Years

Based on the information you have given me, there have been errors and omissions on your previous years' tax returns. Nora claimed donations that were made to the Cancer Foundation in memory of her father, and you did not transfer any of Meredith's tuition, education, or textbook tax credits to you while she was at university. You may also not have claimed any incidental medical expenses that your wife incurred before she was hurt.

I would like to see copies of both Nora's and Meredith's tax returns for the past few years to see what expenses may not have been claimed in the most advantageous way.

There is no benefit to having donations claimed on Nora's return if she is not able to use them during the five-year carryforward period.

Since Meredith has been at university, she would have received a T2202A each year showing the cost of her tuition and the number of months she was a full-time or part-time student. These costs can be transferred to you (up to $5,000 per year), and the residual amount would remain as a carryforward balance on her tax return. Once she starts working, these non-refundable tax credits will reduce the amount of income tax she has to pay.

I need to review her tax return to see if these costs have been shown on Schedule 11. If she transfers the maximum amount over to you for each year she was at university, it will reduce your taxes payable each year. This is beneficial to your family because you can use these credits today, but she will not be able to use them until the future, when she has income.

Since these adjustments relate to more than just your tax return, I need to make sure that your wife and daughter agree with the changes. I will have to prepare T1 adjustments for each of you, asking CRA to reallocate amounts amongst your family members. All three of you will have to sign engagement letters and authorizations for our firm to make the tax adjustments.

Based on some of the issues I have identified in my report, you may want to amend 2014 and even some of the prior years' returns well before the April deadline for the Notice of Objection. Personal tax returns can be amended up to three years from the date the original notice of assessment was mailed.

Assessment Opportunity #6

The candidate discusses tax planning opportunities – credits associated with Nora's disability.

The candidate demonstrates competence in Taxation

CPA Map Competencies:
6.2.4 – Advises on specific tax planning opportunities for individuals (Core – Level C; moves to Level A in Taxation Elective)

Tax Planning

In addition to ensuring that all medical expenses and donations are shown on your return, you should also think about other ways to minimize your tax liability.

a) Disability Tax Credit

Nora may be able to claim the disability tax credit if her doctor believes that her injuries are affecting her ability to lead a normal life and that this will continue for more than 12 months.

To apply for the disability tax credit, you need to fill out the basic information on T2201, have the doctor complete a short medical assessment of Nora's condition, and send the application to CRA. To qualify for the tax credit, the impairment must have a "marked" restriction of the activities of daily living or a "significant" restriction in more than one activity. Based on the doctor's comments, CRA will make a ruling, and if the form is approved, Nora will be notified.

Since Nora has no income, she could transfer this non-refundable tax credit to you because you would qualify as a supporting person. This would increase your non-refundable tax credits by another $7,766, which would reduce your federal taxes by 15% of that amount. If CRA allows the tax credit back to 2014, when she was injured, we will have to advise CRA in writing of the need to make another tax adjustment, adding this amount to your non-refundable tax credits.

b) Attendant Care

Based on your comments about not wanting to leave Nora alone while you are out, you may want to consider the need for attendant care. Now that Meredith has finished university, she may be ready to move out on her own, and this would leave you as the sole support for your wife. There is a financial cost to this, but there are some tax benefits to offset that cost.

Since you told me that you have some benefits at work, check to see if that plan covers any of the related costs. This may help out in the short-term, but since you are planning to retire next year, it may just be a temporary solution to an ongoing situation.

The cost of having someone come into your home to help with food preparation, housekeeping, laundry, or health care for your wife is considered attendant care and can be claimed as a medical expense, provided Nora is eligible for the disability tax credit.

If Nora is approved for the disability tax credit, you will have to make a choice. If you want to claim the disability tax credit, you are limited to $10,000 per year for attendant care. This would be included in medical expenses. If you choose not to use the disability tax credit, you can claim the full amount of the attendant care.

Assessment Opportunity #7

The candidate discusses tax planning opportunities – pension income splitting and partnership investment.

The candidate demonstrates competence in Taxation

CPA Map Competencies:
6.2.3 – Determines income taxes payable for an individual in non-routine situations (Taxation Elective – Level B)
6.2.4 – Advises on specific tax planning opportunities for individuals (Core – Level C; moves to Level A in Taxation Elective)

Pension Income Splitting

Most retired couples benefit from splitting pension income because it can reduce their overall tax burden by transferring up to 50% of pension income to the spouse with the lower tax rate. You did not provide me with any information about the pensions you expect to receive once you retire. Both you and Nora will receive Old Age Security, and you will receive Canada Pension Plan (CPP) as well, since you have been employed. I do not know if you are eligible for a company pension, but if you are, this could be split between the two of you to save your family taxes.

You will also have the option to share CPP at its source. When you begin to collect CPP (which may be an option to you already – see my discussion in the last section of this memo), you can request that Service Canada allocate a portion to Nora and pay it to her directly. This will lead to it being taxed in her hands, not yours, yielding a lower effective tax rate.

This is an area we can discuss further. If money were not so tight, you could also consider contributing to a spousal RRSP. This would allow you to contribute to an RRSP and claim a deduction for the contributions. Nora would then eventually withdraw, after a minimum holding period, money from the RRSP and include the withdrawals in her own income.

Once you and your family have signed T1013s authorizing our firm to contact CRA on your behalf, I will write a letter advising them of the outstanding issues and our request to object to the Notice of Reassessment. T1 adjustments can be prepared when we get the necessary documents from your wife and daughter.

Partnership Income

George offered you and Nora a partnership unit in a business he recently joined. While I have recommended against acquiring it (see my discussion in the next section of this memo), if you do decide to proceed with this, you should consider the tax implications.

Whoever acquires the unit will be allocated their portion of the partnership's income or loss for tax purposes each year. Since there will be at least one individual (as opposed to a corporation) member in the partnership, it will have a calendar-year fiscal period. Therefore, whether you or Nora acquires the unit will depend on whether or not it should be profitable.

In this case, you are expecting a $2,000 loss in the first year. Since you (or Nora) would be entitled to one-tenth of this, you would be entitled to claim a $200 business loss on your tax return. Since Nora has little to no income, from a short-term perspective it would be preferable for you to acquire this unit yourself rather than for her to acquire it. However, assuming your income stays above the lowest tax bracket, there would be an advantage to having Nora hold it if it is to be held long-term — your intentions for this investment should be considered before making this final decision.

Assessment Opportunity #8

The candidate evaluates sources of financing.

The candidate demonstrates competence in Finance

CPA Map Competencies:
5.2.3 – Evaluates sources of financing (Core – Level B)

Payment of CRA Account

At this time, I cannot estimate the actual amount of tax owing for 2014. You may want to make a good faith payment to CRA, knowing that it will be refunded once we have provided all of the information relating to this taxation year. This would stop the compounding interest on the late payment, and if you have overpaid, this amount will be refunded to you by CRA once all the information is provided and your returns have been reviewed.

To come up with the cash, you have a few options.

- You could approach the bank for money, since you told me that your home was appraised at $425,000 before the renovations were done and there are no mortgages associated with that property. Current interest rates are around 4.5% on short-term loans. Since you have dealt with this bank for several years and have good collateral, you would be seen as a good credit risk and may be able to negotiate a short-term loan at just over the bank prime rate.

  If you need $22,000 for a few months, you should be able to negotiate interest around 5%. The interest cost for three months would be minimal ($250), but there would be some paperwork involved in setting it up.

- Alternatively, you could ask CRA to accept instalment payments on the account because of the uncertainty of the tax liability. The current balance of over $22,000 appears to be too high based on the information you have provided. You would still pay interest at 5% (the prescribed rate) on the outstanding balance, but the balance would be lower because instalments were applied ($187.50 for the first three months if the principal dropped to $15,000).

  The downside of this alternative is that you would have to look for financing for the instalment payments, although you may be able to finance them out of your regular cash flows if they can be deferred over a long enough period of time. If you offered to pay in quarterly instalments, you could suggest to CRA that you could pay a lump-sum amount (say, $5,000) up front and then make smaller instalments until the taxes are reassessed to correct the items discussed above.

- I hesitate suggesting you use your credit card because it has had a balance on it since you used it to pay your 2014 taxes in May. If you took a cash advance on the card and couldn't pay it back right away, the compounding interest at 28% per year would be excessive (minimum of $350 for three months on $5,000).

- Your friend offered to lend you $20,000 at 8%. If this was outstanding for three months, you would incur costs of $400. There is less structure to this arrangement, but borrowing money from a friend could potentially affect your friendship if you were unable to pay it back right away. The interest rate also appears to be higher than the interest that a bank would charge you.

- You could ask George for a loan. This might be the lowest-cost alternative, but your hesitation to involve your son's extended family in your affairs is something you need to consider when you make your decision. However, since he is suggesting investments, perhaps he is willing to help you with resolving your financial situation.

- George has asked you and Nora to contribute $1,000 to a partnership he is involved in. While it may be helpful to support your son in this venture, given your cash flow shortage, this is not advisable. Acquiring this $1,000 unit will mean you have $1,000 less to pay off your tax liability. In addition, this partnership is expected to lose significant money in its first year. While there may be the potential for growth (in other words, these losses will eventually turn into long-term appreciation in the value of the units, allocated income, or both), the return is unlikely to come in the near term. Given that you are very near to retirement and do not have the cash available to make this purchase, making risky investments like this is not advisable.

- While this will not cover the entire balance, you could elect to start receiving CPP payments early. You can commence taking CPP payments as early as age 60, so you already qualify. The downside of this alternative is that you will receive lower monthly payments for the rest of your life if you start collecting CPP before age 65. This option should only be selected if there are no other alternatives.

It seems that asking the bank for a short-term loan has the lowest cost, as well as the least impact on existing relationships.