CONTREN MANAGEMENT CONSULTANTS INC.
FALL 2006 NEWSLETTER

NEW DIVIDEND TAX CREDITS

As many Canadians are aware there has been an explosion in the amount of money invested into income trusts (IT) by Canadian taxpayers. The reasons for this change in investment strategy are simple, higher then average cash distributions and lower net tax paid on the disposition. The cash distributions are treated as a reduction of the cost of the IT investment thereby deferring tax liability until the IT investment is sold. The gain on the IT investment is a capital gain and only one half of the gain is taxable, a significant savings.

Canadian source dividends have a tax credit feature that reduces or eliminates the tax liability on this income. The pitfalls with this type of investment is the taxpayer incurs a tax liability in the year the dividends are received and at the highest incremental personal income level the taxpayer is paying over 30% tax on this income.

The other problem with the previous dividend situation is the double taxation of dividends. The dividends are paid out of **after tax** corporate profits to Canadian taxpayers who then **may** pay personal taxes. Canada is one of the few industrialized countries that has this double taxation system on income earned and paid out within the country itself.

The Federal government recognized the inherent disadvantage that traditional dividend paying Canadian corporations had when compared to IT's. To level the investing field somewhat the Federal government introduced new dividend tax credit rules this past spring. The Ontario government announced proposed legislation this summer, which is expected to be implemented for the 2006 taxation year. The Provincial legislation is on a four year phased in basis, fully parallel with the Federal tax credits by 2010.

Please remember that dividends received from Canadian Controlled Private Corporations (CCPC) will be taxed at the traditional tax rates.

Shareholders of CCPCs' will **not** benefit from the new legislation.

The mathematics of the dividend income and tax credit system will change when reporting Canadian public corporation source dividend income. The dividend income is now grossed up 45% instead of 25%. The applicable dividend tax credit (combined Federal and Provincial) is now increased to 32% from 20%.

The only real downside to this new dividend tax credit plan is the negative impact the new grossed up amounts will have on senior taxpayers. At $60,806 of total earned income the taxpayer experiences a clawback on the OAS received. This means that senior taxpayers will have a slight disadvantage with the new dividend tax credit process if their income is over $60,806 but under $98,846.

Assuming the Federal and Ontario governments' new dividend tax credits are fully in place the chart below shows the next tax impact for an Ontario taxpayer and the significant tax advantage dividends have over interest income.

	2005 DIVIDENDS	2006 DIVIDENDS	INTEREST
INCOME	100K	100K	N/A
CORP TAX	32K	32K	N/A
PAID TO INVEST	68K	68K	100K
AMT OF PERS INCOME	85K	99K	100K
PERS INC TAX (46%)	39K	46K	46K
DIVIDEND TAX CREDIT	17K	32K	0
NET PERS INCOME TAX	22K	14K	46K

STATUTORY (PUBLIC) HOLIDAYS

Please note that the following are Public Holidays in Ontario, Thanksgiving, Christmas, Boxing Day and New Years Day. A reminder that Remembrance Day, November 11, is **not** a Public Holiday.

If your employee works any Public Holiday they are entitled to either 2.5 times their regular pay **or** 1.5 times their regular pay **plus** a day off with pay.

OFFSHORE TAX SHELTERS

Recently the US branch of the accounting firm KPMG was convicted of tax fraud relating to off shore accounting and investing practices. KPMG, one of the worlds largest accounting firms, conspired to defraud the IRS by developing, marketing and implementing illegal tax shelters. At present the IRS has collected more then $3.7 billion dollars in taxes from its citizens as a result of this case.

In the past a few our clients have been approached with a variety of “tax shelter” opportunities. In fact our clients had been approached with a similar scheme as was operating for US taxpayers with the assurance that “KPMG has vetted this process with Revenue Canada as valid and will aggressively defend any action against the program”. It turns out the KPMG was wrong and ultimately the taxpayer is left with additional penalties and interest.

In this particular case the IRS was strict in the enforcement of penalties and interest as the taxpayers involved all had a sufficient level of investment and business knowledge to recognize the illegal nature of the activity.

As always, any tax shelter program that promises big tax savings is likely too good to be true!

PRIVATE HEALTH SERVICE PLANS (PHPS)

In Canada most health care plans are a tax free benefit to the employee. Larger employers usually use a large insurer to provide and administrate a health plan for their employees. Smaller employers who want to provide a health care plan usually find the cost prohibitive and/or a number of their employees are not interested. In some cases a number of the employees might already be covered by a spouse.

Revenue Canada has allowed that employee paid private health care plans, such as Blue Cross, are eligible as PHPS’s. This means that an employee can be reimbursed by the employer, tax free, for any premiums paid to a provider.

This ruling allows smaller employers to provide a health care package, tax free, to individual employees at their discretion.