WINTER 2017

THE Quarterly Dividend

Vol. 26 No. 1

Your guide to income tax & financial planning

FAST TRACK

Decision Making 101

In today's world, we are constantly told what tremendous value we will be receiving if we buy a particular product manufactured and sold by the advertiser. But can you really quantify "value"? It is highly subjective and what looks like a true "find" for one person may not be worth the time of day for another.

Academics will tell you that

In this Issue:

The Importance of Keeping Good Records

Owners of mutual funds that are held outside RRSP's can look forward to receiving a T3 from the institution with which the investment was made. This will happen even if they did not receive any cash distributions but had the earnings re-invested in the fund automatically.

The accompanying table shows the typical income generated from such investments. The information in all these categories must find their way on to the personal income tax return of the taxpayer (with the exception of Box 42).

Information from this box, termed a "return of capital", is not recorded on the income tax form but is "kept track of" separately by the taxpayer. When the investment is sold or liquidated the total amount of these distributions will either increase or decrease the cost of the investment against which the proceeds of sale are compared to determine the taxable income or loss on disposal.

For example: Rebecca has a mutual fund that her parents bought for her many years ago. The original purchase price was $10000 and every year the investment institution re-invested the distributions she earned by purchasing additional units

Year	$ Distribution	Year	$ Distribution		
1	500	6	460		
2	505	7	550		
3	515	8	555		
4	508	9	555		
5	NIL	10	NIL		
	2028		2120	Total	$4,148

When Rebecca sells the investment in early Year 10 for $16000 her capital gain will be ($16000 minus $10000 minus $4148) or $1852, one-half of which is taxable.

Had Rebecca failed to maintain proper records she would have shown a capital gain of $6000 and a taxable capital gain of $3000. She would have been taxed twice on the $4148.

Typical Incomes Shown on a T3 Slip

Box 21	Capital gains
Box 25	Foreign investment income
Box 26	Interest income
Box 32	"Other than eligible" dividend income
Box 34	Foreign taxes paid on investment income
Box 42	Return of capital resulting in tax cost adjustment
Box 50	"Eligible" dividend income

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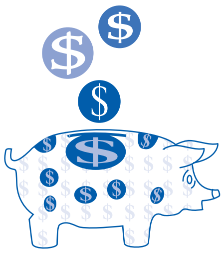
Neamtan & Associates
CPA Professional Corporation
Accounting, Tax and Financial Planning
Audrey L. Neamtan, B.Comm., C.A. CFP

361 Willowdale Avenue
Toronto, Ontario M2N 5A5
Phone: (416) 590-9382
Fax: (416) 590-9636
Email: audrey@neamtan.ca



CCA Tax Shield

Accountants are known to look at things a little bit differently. While most of us marvel at the architecture of a new building being built downtown, the accountant looks at the edifice as a "long-lived asset" whose costs must be allocated over its estimated useful life. It's not that he doesn't notice the marble walls of the building's interior and its high ceilings that seem to reach the sky, it's just that his training has taken away some of his enthusiasm for the aesthetics and replaced it with a twelve column spreadsheet outlining what costs can be deducted for income tax purposes as "soft costs" and what costs have to be capitalized.

One aspect of the building the accountant will consider is termed the "capital cost allowance tax shield". It is the income tax benefit the owners will realize by claiming capital cost allowance or depreciation on the building over time.

Here is how it works:

ABC Investment Corporation constructed a building in downtown Ottawa at a cost of $2040000. The cost of the land upon which it sits was $650000 and the building itself cost $1390000 to put up.

Capital cost allowance only applies to the cost of the building and can be applied by reference to regulations set out in the Income Tax Act. These can be summarized as an allowable rate of 4% per annum applied on a declining balance basis with only one-half of the allowable amount to be claimed in the first year.

Table A shows several things: (a) the maximum CCA that can be claimed each year for the first five years; (b) a simplified income statement for each of the first five years where revenue is constant at $1000000 and the only expense claimed is the maximum allowable capital cost allowance. This leaves (c) income for the year before income taxes; and (d) the determination of the income taxes at their applicable rate where CCA has been taken. Line (e) shows the income tax "bill" had no CCA been taken. Line (f) shows the annual income tax savings by claiming CCA as compared with not taking CCA. This is shown on line (g)."

At this juncture, the claiming of CCA is "ahead" by $103248.

Table B shows what would happen if the company sold the building in Year Six. The calculation of the capital gain is the same whether CCA had been claimed or not. But if it had been claimed in previous years, it must now be "recaptured" and brought into income.

At this juncture, the recapture add back has cost the company $92228.

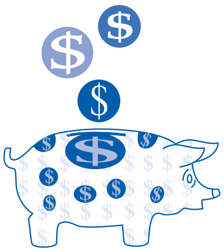
Table C compares the savings from Table A with the additional expense from Table B with the resulting overall CCA Tax Shield savings of $11021 in Year One dollars.

Table A Value of CCA Tax Shield Annually

	Year One $	Year Two $	Year Three $	Year Four $	Year Five $	Total $
(a) Max CCA	27,800	54,488	52,308	50,216	48,208	233,020
(b) Revenue	1,000,000	1,000,000	1,000,000	1,000,000	1,000,000	
(c) Income before inc taxes	972,200	945,512	947,692	949,784	951,792	
(d) Inc taxes with CCA	468,171	455,319	456,369	457,376	458,343	
(e) Inc taxes without CCA	481,558	481,558	481,558	481,558	481,558	
(f) CCA Tax Shield (d) - (c)	13,387	26,239	25,189	24,182	23,215	
(g) In "Year One" dollars	13,387	25,229	23,290	21,498	19,844	103,248

in the vast scheme of things, people should make decisions by looking at what it's worth. They describe it as "cost-benefit analysis". The benefits to be gained by accepting a certain course of action are compared with the costs to be incurred while following this same course of action. If the perceived benefits outweigh the costs then the decision maker can go ahead and pursue the considered idea or at least have a starting point to which other possible courses of action can be compared.

The same is true when it comes to individual decision making. Here the "value" associated with a particular choice is described as comparing "perceived satisfaction" with "perceived price". Unlike the cost-benefit analysis above, the model looks at perception rather than out and out dollars and cents. It allows for subjectivity and personal preference. Sometimes the decision maker just accepts his "gut feeling" about which way he wants to go and takes it from there.



By recognizing that what one person expects to gain from pursuing a particular course of action may differ from another, this will not be a problem as each individual is free to chart his own course of action.

When decision making is group based, however, the various expection levels on both the perceived satisfaction and perceived price will have to determined by some sort of consensus agreed to by all involved. Only then can the group go forward and act upon the decision that has been arrived at.

One common example is the situation where the last surviving parent of a family passes away and it is up to the children to decide how to proceed with the estate. It would not be surprising if there are divergent opinions among the heirs as to how they collectively should proceed. In the absence of a very detailed and thought-out will, there are likely to be beneficiaries who would argue for liquidation of the estate's assets and distribution as quickly as possible. Others may take the position that the estate's assets might

Table B Effect of Add Back of Recapture

	With Recapture of CCA $	No Recapture of CCA $	Difference $
Proceeds of sale allocated to building	2,000,000	2,000,000	
Adjusted cost base	- 1,390,000	- 1,390,000	
Capital gain	610,000	610,000	
Taxable capital gain	305,000	305,000	
Recapture (a) from Table A	233,020		
Taxable transaction	538,020	305,000	
Corporate income taxes	259,088	146,875	
In "Year One" dollars	212,944	120,717	92,228

Table C Final Determination of CCA Tax Shield

	CCA Claimed $	CCA Forgone $
Table A	- 103,248	
Table B	212,944	120,717
	109,696	120,717
Benefit of CCA Tax Shield	11,021	

Tranactions

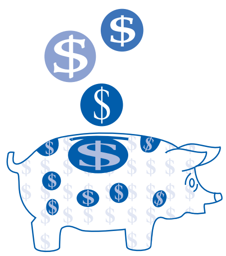
From time to time it is fun to go to the mall and watch store owners interact with shoppers as they go by their stores. See if you can figure out who has the "upper hand" between them. Does it belong to the purchaser with money in his pocket and perhaps the desire to spend it that day, or does it belong to the seller who need not do business with the first prospective buyer who comes along? Analyze what is going on between them in terms of the following:

Every transaction has a dynamic all its own. In some cases the "advantage" belongs to the seller. This is true in a "hot" real estate market where there are more potential purchasers than the number of properties up for sale. This leads to buyers entering into a bidding war amongst themselves trying to outdo each other in order to present the most attractive package to the seller and secure the deal.

In other cases, the "advantage" belongs to the buyer. Using the same real estate example, one seller may own a property that has fallen out of favour with potential buyers. Perhaps the residence is located in an area of the city that is deemed to be "undesirable", or maybe the owners have neglected to maintain the property that is consistent with current tastes or trends. Whatever the reason, the seller will now be willing to entertain all potential purchasers of the property and accept the "best offer" from what comes along.

Who has the advantage in any given transaction depends upon (a) the item to be exchanged between the parties, (b) the relative resources between purchaser and seller, and (c) the timing of the deal.

(a) If the item to be purchased and sold between parties is one that the purchaser can easily obtain elsewhere, the advantage clearly is in his favour. This is sometimes referred to as the law of supply and demand. Here the purchaser need not only deal with this one seller to procure his desired item. He can afford to look around and



increase in value over time and that holding on to them for awhile might result in a larger "payout" down the road.

These two perceptions of the current "value" of the estate must be reconciled before any action can be taken. The preceived satisfaction of getting the funds earlier rather than later must be compared to the perceived costs of distributing family assets now versus at some later date. When a consensus is reached, the heirs can address the decision that has been taken. When a consensus is not reached, however, it is not impossible that one will have to be imposed upon the group if they are to proceed at all. This is where lawyers get involved and everyone loses.

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bargain for the best price, quality or terms of delivery between prospective sellers. He can determine what suits him best and push his advantage as far as it will take him. Perhaps there is a seller out there who needs the transaction to be completed more than others. This will force him to make concessions in order to do the deal;

(b) All things being equal (and they rarely are), the relative resources of the purchaser vis a vis the seller can also come into play. As alluded to above, the "desperate" seller wanting to complete the transaction is in a much poorer bargaining position than one who is in a position where he need not deal with the first purchaser who comes along. If the seller can make his product somehow look different from others available in the marketplace and make it seem more desirable than what others are selling, he can begin to tip the scales in his favour. In many cases, this is the goal of advertising. It is the seller's desire to level the playing field by informing his potential customer that although what he is selling looks very much like what he can get elsewhere, it is worth the purchaser's time and effort to investigate what this particular seller has to offer. But do not forget that advertising is not cheap and the seller will have to spend money to get his message out. A seller with deep pockets can afford to hire a top notch advertising agency and employ their expertise on his behalf;

(c) they say that in life, timing is everything, and in many cases this is very true. The purchaser who has "time on his side" and does not need the item to be purchased "yesterday" can watch the marketplace and enter it at his leisure. He does not need the item today and can wait to purchase it at later date. For example, the media is replete of stories about customers who do their Christmas shopping on December 24. What these purchasers gain in avoiding long lines of shoppers in earlier days, they will lose when offerings at this last hour are greatly diminished.". They will have to choose from whatever is still available, in the colour and style that nobody else seemed to have wanted.

As consumers, we want to take away any advantage enjoyed by the seller that will make us pay a higher price than need be for the goods we purchase. We must not be in a hurry to buy everything in sight and succumb to impulse buying.

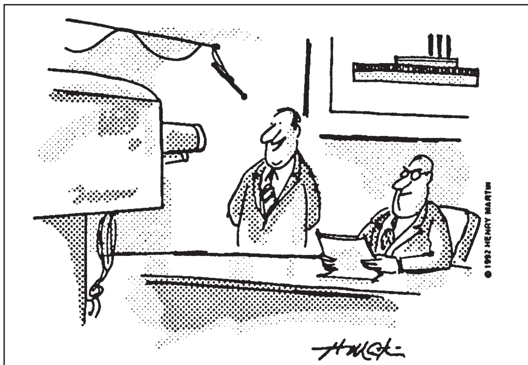
As sellers we must be patient and have confidence in our wares and their desirability in the marketplace, This will prevent at jumping for the first offer that comes along just to make sure that we generate some cash to offset our costs.

QUALITY PRICE SPEED

Remember every transaction consists of three elements. These are: (i) the quality of the item, (ii) the price that will be negotiated between the seller and the purchaser, and (iii) the speed of delivery of the item between the parties.

Do you want top-notch quality or are you willing to settle for something a bit less? Do you want the lowest possible price available in the marketplace? Do you have the time and resources to determine what that really is? Or are you willing to pay a little more in the interest of convenience? Finally, do you need/want immediate delivery to meet a deadline, or can you wait awhile to secure the purchase?

You can only have two out of the three factors that make up a transaction. Which one are you going to sacrifice to obtain the other two on your next transaction? How about on the transaction after the next?



"Join us next week on the Executive Stress Show when we'll visit the office of CEO Edward T. Muson and learn how he delegates to his personal secretary the responsibly of buying his wife a birthday present."