Taxation LAW 407, Fall 2014 Duff

INTRODUCTION TO INCOME AND TAXABLE INCOME

This course involves one simple exercise: determining which receipts go into, and which outlays come out of, the "**taxable income**" of a taxpayer, T, for a taxation year. Income under the Act is a net concept, so the two driving ideas are "**inclusions**" (i.e. money amounts which T must add to income) and "**deductions**" (i.e. money amounts which T may subtract from income).

The course lives within **Part I, Division B** ("Computation of Income"), **Part I, Division C** ("Computation of Taxable Income") and **Part XVII** ("Interpretation") of the Act.

An income tax consists of at least 4 basic elements: a **tax unit**, which is subject to the tax; a **tax base**, on which the tax is assessed; an **accounting period**, over which period of time income is computed; and a **structure of tax rates**, which are applied to determine the amount of tax payable.

- **2(2)** sets out the tax unit, tax base and accounting period for the ITA. Tax rates are contained in Division E **(117(2)). 248(1)** defines **person** – the tax unit for the ITA.
- In Canada the IT also includes **tax credits**, which operate to reduce tax otherwise payable or to provide direct payments in the form of tax refunds **(118**). **Deductions** come off the top – subtracted in computing income – versus most credits, which are subtracted in computing tax payable.
- **249(1)** defines a **taxation year** as a calendar year in the case of individuals. ITA allows other accounting periods for specific purposes. **111** allows Ts to 'carry over' unutilized losses from other taxation years to be deducted in computing a T's taxable income.

HOW TO COMPUTE TAXABLE INCOME: *INCOME TAX ACT* S 2(2)

$I_{taxable} = I + \left(\sum_{\alpha \in A} \alpha - \sum_{\delta \in \Delta} \delta \right)$	2(1) The taxable income of a taxpayer for a taxation year is the taxpayer's income for the year plus the additions minus the deductions permitted by Division C.

I represents the income of the taxpayer determined in accordance with section β, and A and Δ represent the additions and deductions, respectively, permitted by Division C. This course considers only certain deductions in s 110, and no additions.

In general, **s 3** requires Ts to add together income from all sources (a) as well as net taxable capital gains (b), from which they may then subtract subdivision e deductions (c) and specified losses (d).

- The ITA does not define **income**.
- The rules for computing income from the specific sources enumerated in (a) are found in subdivision a (**5-8)** and subdivision b (**9-37**) of Division B of Part I of the ITA.
- (b) indicates that allowable capital losses are generally deductible only against taxable capital gains, rather than other kinds of income. The amount determined in (b) cannot be negative.
- **Taxable capital gain** and **allowable capital loss** are defined in **38(a) and (b)** as one-half of a capital gain or capital loss. The concepts of a capital gain and capital loss are generally defined in paragraphs **39(1)(a) and (b)** as gains or losses from the disposition of property that would not be included or deducted in computing the T's income from a source under paragraph 3(a).
- **Listed personal property** (**LPP**) in defined in **54** as a type of 'personal-use property'. ITA allows deduction of losses from disposition of LPP on basis that these losses typically result from the operation of market forces rather than personal use.
- **Allowable business investment loss** (**ABIL)** is defined in **38(c)** as one-half of a business investment loss. **39(1)(c)** defines a business investment loss as a type of capital loss, resulting from the disposition of shares or debt of a private Canadian corporation.
- Losses from any of the sources under (d) occur whenever the total of allowable expenses that may be deducted in computing the T's income or loss from the source exceeds the total of amounts that are included in computing the T's income or loss from the source.

- If amount calculated under (e) is negative, then income is deemed to be zero and you have a **non-capital loss** defined under **111(8).**

How to Compute Income: *Income Tax Act* s 3

3 The income of a taxpayer for a taxation year for the purposes of this Part is the taxpayer's income for the year determined by the following rules:	
$a = \sum_{s \in S} income(s)$ $S = \{office, employment, business, property, \ldots\}$	*(a)* determine the total of all amounts each of which is the taxpayer's income for the year (other than a taxable capital gain from the disposition of property) from a source inside or outside Canada, including, without restricting the generality of the foregoing, the taxpayer's income for the year from each office, employment, business and property.
$A = \sum_{d \in (DoP \setminus LPP)} TCG(d)$ $B = TNG(LPP \cap DoP)$ $b = \max\{(A + B) - \max\{ACL - ABIL, 0\}, 0\}$ *ABIL* is added back in paragraph *(d)* below.	*(b)* determine the amount, if any, by which: (i) the total of (A) all of the taxpayer's taxable **capital** gains for the year from dispositions of property other than listed personal property, and (B) the taxpayer's taxable **net** gain for the year from dispositions of listed personal property, exceeds (ii) the amount, if any, by which the taxpayer's allowable capital losses for the year from dispositions of property other than listed personal property exceed the taxpayer's allowable business investment losses for the year.
$c = \max\{(a + b) - DNAT, 0\}$ where *DNAT* is deductions from Subdivision e not taken already under paragraph *(a)*	*(c)* determine the amount, if any, by which the total determined under paragraph *(a)* plus the amount determined under paragraph *(b)* exceeds the total of deductions permitted by **subdivision e** in computing the taxpayer's income for the year (except to the extent that those deductions, if any, have been taken into account in determining the total referred to in paragraph *(a)*), and
$d = \max\{c - \left(\sum_{s \in S} loss(s) + ABIL\right), 0\}$	*(d)* determine the amount, if any, by which the amount determined under paragraph *(c)* exceeds the total of all amounts each of which is the taxpayer's loss for the year from an office, employment, business or property or the taxpayer's allowable business investment loss for the year.
$I = d$	*(e)* where an amount is determined under paragraph *(d)* for the year in respect of the taxpayer, the taxpayer's income for the year is the amount so determined . . .

4(1)(a) reaffirms the fact that you compute income from each source separately, and then aggregate it under **3(a).**

Income can broadly be divided into: (1) income from sources (office and employment) – fully taxable; (2) capital receipts (return of capital – non-taxable; capital gains – fully taxable); (3) gifts/windfalls – non-taxable.

Interpretation of the ITA

- Under strict construction (see *MacInnes* for example), one presumption favours the T in cases of ambiguous taxing provisions, and another presumption favours the taxing authorities in cases of ambiguous benefit provisions.

MNR v MacInnes, [1954] Ex Ct
I: Does 'property substituted ∴' include property substituted for substituted property?
C: Provision of the ITA did not expressly extend liability to property substituted for substituted property – in favour of T.
R: There is no intention to tax other than that which its words express.

- More recently, the modern rule to interpretation has been used: words, context, scheme, purpose, intent
- Guidelines to interpretation: associated words principle, limited class principle
- Coherent scheme: presumption of economic use of language, presumption of consistent expression, presumption of implied exclusion, presumption of coherent structure
- Purpose of the Act: revenue raising, promoting behaviour, equity/fairness

Will-Kare Paving & Contracting Ltd v Canada, [2000] SCC
F: T owns paving company, constructs own asphalt plant to grow business and to be used in paving work Ks; sold excess asphalt to 3rd parties (25%), but used 75% themselves.
I: Should legal/technical definition of sale be used or should ordinary sense/meaning of word? Did using the plant to produce asphalt to be supplied in connection w/ paving services constitute use primarily for the purpose of manufacturing or processing goods for sale?
C: Use private law concepts of 'sale and lease'. Look at intent of provision. Plant was used primarily in manufacturing or processing of goods supplied through Ks for work and materials, not through sale. In favour of gov't. Dissent argued in favour of ordinary meaning of the word 'sale'.

Tax Avoidance and the GAAR

Legal efforts to order one's affairs to minimize tax. SCC decision *Stubart* signalled a reaffirmation of the traditional judicial approach to tax avoidance at the same time as it announced the demise of strict construction. Parliament effectively overruled *Stubart* by enacting the GAAR, which shifted the approach to substantive rather than formalistic.

1. Substance and Form Doctrine

Commissioners of Inland Revenue v Duke of Westminster, (1936) HL
F: Duke made agreement w/ gardener A to pay gardener 98 pounds annually in weekly payments for 7 years w/o prejudice to remuneration for services rendered instead of paying gardener salary. Payment under deed taxable to person signed over to – effect is a deduction to transferor. Duke deducts assignment from his income as allowed deductions for annual payments. Gov't goes after Duke for deductions as payments for services rendered which are not allowable deductions.
C: Deed is BF and has been given its proper legal operation.
R: Strict construction. Free to arrange affairs to pay less tax. **Legal substance over form doctrine**: **substance is that which results from the legal rights and obligations of the parties ascertained upon ordinary legal principles**. Courts may disregard the nomenclature used by the parties to a K in favour of the substance which results from the legal rights and obligations of the parties.

2. Sham Doctrine

In cases where docs are not bona fide nor intended to be acted upon, but are only used as a cloak to conceal a different transaction, tax is to be assessed not on the basis of the docs that are not intended to be acted upon, but according to the transaction that these docs are designed to conceal.

3. Ineffective Transactions Doctrine

Where Ts have failed to follow the necessary formalities through which specific legal relationships are established, courts may conclude that the transactions that they have endeavoured to carry out are legally ineffective or incomplete – in these circumstances, tax will be assessed on the basis of the transactions actually entered into and the legal relationships actually created.

4. Business Purpose Test [no longer good law]

Although overruled by GAAR, *Stubart* remains the most authoritative statement of judicial anti-avoidance doctrines in Canadian tax law. *Stubart* got rid of business purpose test. More appropriate to turn to an interpretation test which would provide a means of applying the Act so as to affect

only the conduct of a T which has the designed effect of defeating the expression intention of Parliament.

In response to laissez-faire approach by courts, Parliament adopted many **specific anti-avoidance rules (SAARs)**: rules mandating the inclusion of specific amounts; rules disallowing or limiting deduction; rules governing the timing of inclusions or deductions; deeming provisions.

- See in particular **6(3)** (p 10)**, 16(1)(a)** (p 58)**, 68** (p 95)

General Anti-Avoidance Rule (GAAR) under **245** enacted in response to *Stubart*, designed to prevent artificial tax avoidance arrangements.

Rule: 245(2) states that GAAR applies where a transaction is an avoidance transaction. **245(1)** defines transaction and **245(3)** defines avoidance transaction.

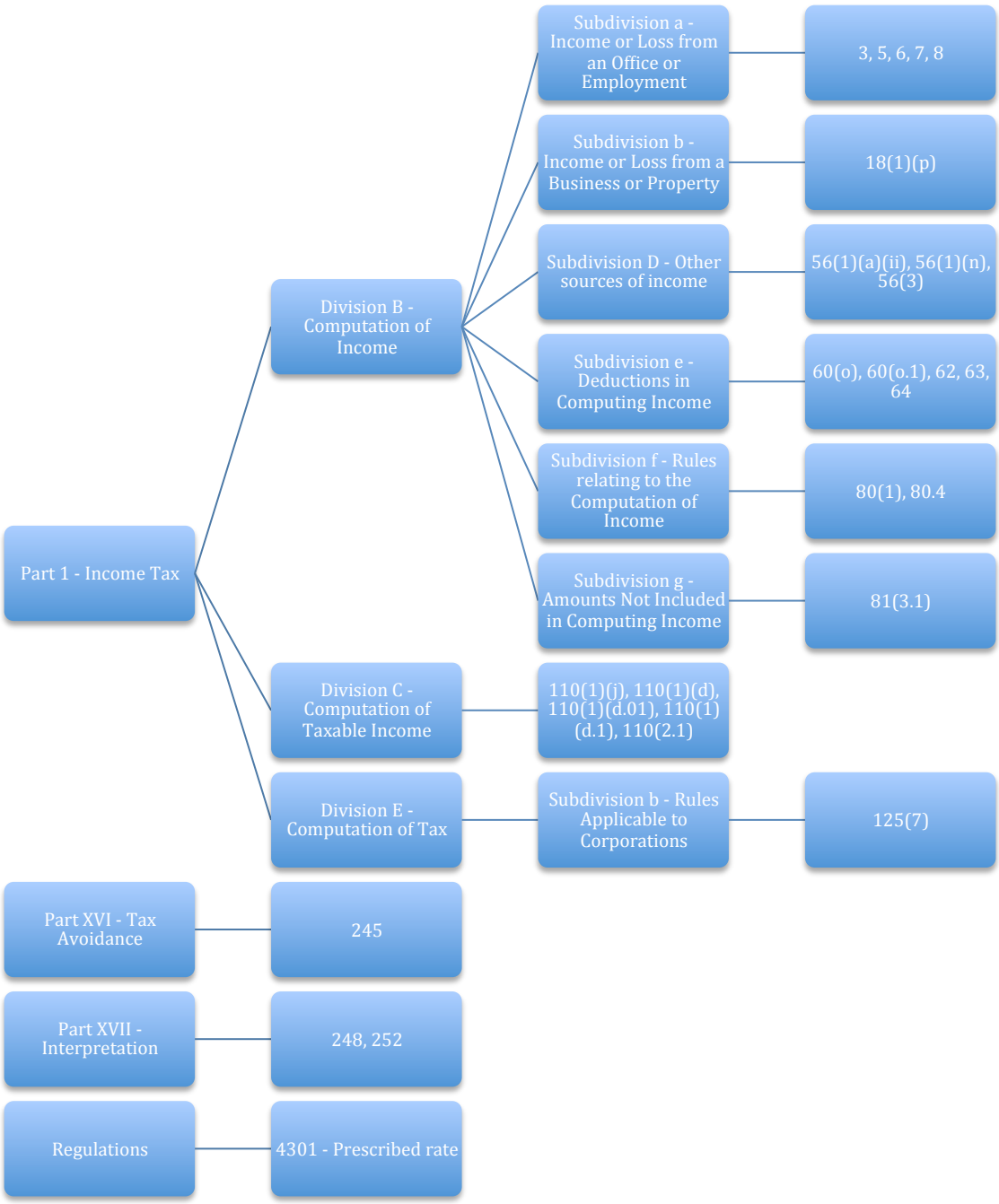
Test: To be characterization as an **avoidance transaction (245(3)**), a transaction:

1. must be a transaction or a part of a series of transactions that, but for the GAAR itself, would result, directly or indirectly, in a tax benefit;
2. the transaction may not reasonably be considered to have been undertaken or arranged primarily for BF purposes other than to obtain the tax benefit.
    - Objective test. Whether or not a transaction is primarily tax-motivated is a factual determination.

Under **245(4),** GAAR applies only if it may reasonably be considered that the transaction would result in a **misuse or an abuse**. Jurisprudence has held that misuse and abuse tests are integrated into a single, unified approach – it's an **abuse** test – must show abuse rooted in specific provisions (*Canada Trustco*).

- **245(2):** the powers of the revenue authorities and the courts to determine the tax consequences of an avoidance transaction are limited in 2 ways: (1) the tax consequences must be reasonable in the circumstances, and (2) they must be determined in order to deny the tax benefit
- **You don't get to the GAAR unless the Anglo-Canadian judicial doctrines (legal substance, sham, ineffective transaction) aren't applicable – only if you satisfy the traditional anti-avoidance doctrines.
- **245(1)** defines a **tax benefit** – *Canada Trustco* (2005) held that the existence of a tax benefit is a factual determination – very broad scope.
- **248(10)** stipulates that for the purposes of the Act, a series of transactions or events is deemed to include any related transactions or events completed in contemplation of the series.
- Remedial powers of the GAAR are very broad – see examples under **245(5)**

INCOME OR LOSS FROM AN OFFICE OR EMPLOYMENT AND OTHER INCOME AND DEDUCTIONS



Note that **<u>timing issues</u>** in **employment/office** are pretty-straightforward – cash-based accounting – amounts are included or deducted when they are received/enjoyed or paid.

Characterization

Characterization means characterization of the source as being office/employment on the one hand, or business/property on the other hand.

2 significant tax consequences turn on <u>distinction between income from **employment** and income from a **business**</u>:

1. Deductions permitted under **s 8** in computing a T's income from employment are much less generous than those available in computing a T's income from a business under subdivision b;
2. Employers are required to withhold and remit income and payroll taxes in respect of amounts paid to employees.

∴ both workers and the persons hiring them will usually prefer that the source be characterized as business rather than employment.

EMPLOYEES VERSUS INDEPENDENT CONTRACTORS – IF T IS INDIVIDUAL

In employment law, the existence of an employment relationship was traditionally based on the legal right of one party to control and direct the manner in which the employee performs contractual obligations.

Test: The test considers the **total relationship** between the parties. Is the person who has engaged himself to perform these services performing them as a person in business on his own account? If the answer to that question is 'yes', then the K is a K for services involving independent contractors (business). If the answer is 'no', then the K is a K of service between an employee and an employer (employment). (*Wiebe Door*)

- If employee – continue under office and employment
- If independent contractor – move to business and property

Factors to consider:

1. Degree or absence of control, exercised by alleged employer;
2. Ownership of tools;
3. Chance of profit and risks of loss (entrepreneurship);
4. Integration of the alleged employees work into the alleged employers business [must be applied from perspective of worker] (*Wiebe Door*);
5. Method of remuneration;
6. Specific results test (contractor = specific results);
7. Whether individual works for a single person or a number of people (exclusivity of employment);
8. The individual's principal workplace;
9. Hiring of helpers;
10. Whether business already established;
11. Degree of responsibility for investment and management.

Wiebe Door Services Ltd v MNR, [1986] FCA
F: T is in business of installing doors and repairing overhead doors. It carries on its business through the services of a considerable number of door installers and repairers, w/ each of whom it has a specific understanding that they would be running their own businesses and would ∴ be responsible for their own taxes and any contributions for workers' compensation, unemployment insurance and CPP. T argues that they are independent contractors rather than employees.
L: Court also considers the control test, the entrepreneur test, organization test/integration test. Purported intention of parties is not determinative.

In a few recent decisions, courts have placed some weight on the **common intention** of the parties as expressed in their agreement – e.g. *Wolf v Canada*, [2002] and *Royal Winnipeg Ballet* – relevant but not determinative factor.

- ***Wiebe Door, Standing*** (FCA, 1992): specific understanding "not itself determinative"
- ***Wolf*** (FCA, 2002), ***Royal Winnipeg Ballet*** (FCA, 2006): But intention of parties relevant since it is "the essence of a contractual relationship"

Note: "K of service" = employment; "K for services" = independent contractor. Distinction between income from an office or employment is irrelevant for tax purposes. **Office** and **employment** are defined in **248(1).** Office typically denotes a subsisting, permanent, substantive position which has an existence independent of the person who fills it, and which goes on and is filled in succession.

Both office and employment refer to a position of an individual. Definition of employee includes officer.

INCORPORATED EMPLOYEES – IF T IS CORPORATION

Both **"office"** and "**employment"** are defined to be positions of individuals. **Individual** does not include a corporation. ∴ **corporate income must be from business/property**.

The case of *Engel v MNR*, (1982) TRB about the television journalist demonstrated how easy it was to get away w/ tax avoidance in an incorporated employee situation pre-GAAR/SAAR.

Personal Services Business (SAAR)

Persons whose relationship might otherwise be characterized as one of employment might endeavour to structure their affairs in order to avoid result of characterization as employment – e.g. by interposition of a corporation between the individual performing the services and the person contracting for the performance of these services. Because of definitions in **248(1),** payments to a corporation for services performed by an individual on its behalf = income from a business. This is now dealt w/ under SAARs.

- **125** and **18(1)(p)** enacted as SAAR to eliminate tax advantages available to incorporated employees – if an incorporated employee is found to be carrying on a **personal service business**, then the advantages available to them as a corporation rather than as an employee are eliminated.

Rule: A **personal service business** may generally only deduct the cost of wages and salaries paid, or other employment benefits provided, to the employees providing the services under **18(1)(p)**. A corporation is denied the low tax rate available to **Canadian-controlled private corporations** in respect of income from a **personal service business** under **125(7)**.

∴ the issue that arises when T has interposed a corporation between himself and the ultimate employer is whether the corporation so interposed is carrying on a **personal service business**.

Test: The test for a **personal service business** carried on by a corporation is set out in **125(7)**. A personal service business is a business in which:

1. Either:
   - An employee (**incorporated employee**) who carries on a business on behalf of the corporation; or
   - Any person related to the incorporated employee;

   is a **specified shareholder** within the meaning of **248(1)**, meaning he owns 10% of any class of shares in the corporation or a related corporation; and
2. But for the existence of the corporation, the incorporated employee would reasonably be regarded as an officer or employee of the person or partnership to whom or to which the services were provided; and
3. The corporation does not employ throughout the year more than 5 full-time employees (**125(7)(c)**).

Dynamic Industries Ltd v Canada, [2005] FCA
F: T is ironworker and only employee of D, a company he incorporated. From '88 to '95, D provided ironworking services to many different companies. In '95, D began subcontracting for SIIL and, because SILL was so successful in obtaining Ks from FC, SILL was the only source of income for D from '95 to '99. Transactions were motivated by union rule rather than tax scheme.
I: Is D a personal service business?
L: **Factors to consider:** level of control employer has over worker's activities, whether worker provides his own equipment, whether worker hires his own helpers, degree of financial risk taken by worker, degree of responsibility for investment and management undertaken by worker, degree

of responsibility for investment and management undertaken by worker, and worker's opportunity for profit in performance of his tasks.
A: Is T reasonably considered as employee of SIIL, but for existence of D? T not compensated for time spent working on estimates if it didn't result in K; no remuneration on regular or timely basis; costs of warranty work were required to be born by T; T providing services only to SIIL simply because SIIL was especially successful; T was substantially independent.
C: Not a personal service business.
R: Test: Is it <u>reasonable</u> to regard the individual as an employee of Corp A, but for the existence of Corp B? If you would be an independent contractor but for the existence of the corporation, then the SAAR doesn't apply and you can go ahead and incorporate and get the tax benefits.

Contrast *Dynamic* with:

533702 Ontario Ltd v MNR, (1991) TCC
F: Mrs B is only employee of 533702, whole only business is to manage the showroom of Mrs B's husband's plumbing and heating company.
C: Mrs B ought reasonably to be regarded as an employee of husband's company because the showroom service carried on by 533702 had no commercial independence from that business.

Inclusions

The general rule is that a T's income from office or employment is the salary, wages and other remuneration, including gratuities, received by the T in the year: **5(1).** None of the terms 'salary', 'wages', 'remuneration', or 'gratuities' are defined in the Act, and the courts have held that they take their meaning from ordinary usage. In the context of **5(1), gratuities** may be understood as amounts paid to an officer/employee an account of legally non-enforceable claims. The common element among all of the words is that they suggest **payment for services rendered**.

DEEMED REMUNERATION (SAAR)

Rule: Under **6(3),** certain payments from employer to employee are deemed to be remuneration for services rendered by the employee and hence taxable.

Test: According to **6(3),** a payment made in either of the following two circumstances:
(a) while the T was in the employment of the payer; or
(b) relating to an **obligation** owed by the payer to the T arising out of an **agreement** made either immediately before, during, or immediately after, the period in which the T was in the employment of the payer
is deemed to be **remuneration for services** rendered by the T to the payer <u>unless</u> T can establish that the payments cannot reasonably be regarded as fitting any one of the following three descriptions:
(c) consideration, or partial consideration, for agreeing to become an employee of the payer [i.e. inducement];
(d) remuneration, or partial remuneration, for services rendered under the K of employment; or
(e) consideration, or partial consideration, for a covenant relating to what the employee must, or must not, do after the end of the K of employment.

In considering paragraphs (c–e), the **courts are entitled to disregard the time that any agreement was made and the form or legal effect of such an agreement.** Note also the reverse onus on T.

REMUNERATION

Any receipt by a T can conceptually be placed into one of the following 3 categories:

1. Income (i.e. remuneration);
2. Receipts of a capital nature; or
3. Gifts and windfalls

Gifts, windfalls, and receipts of a capital nature are exempt from taxation. Income is not. ∴ one of the main analytical tasks is deciding into which category a particular receipt belongs. In this course, we looked at four example categorizations of receipts: (A) gratuitous payments; (B) strike pay; (C) tort damages for personal injury or death; and (D) inducement payments.

Gratuitous Payments

Included in **5(1). Gratuities are taxable according to test in *Goldman*.**

Test: A gratuitous payment to an individual, despite being voluntary from the POV of the person who made it, is taxable income if, from POV of individual receiving it, it represents a payment for services in context of existing source (*Goldman*).

Goldman v MNR, [1953] SCC
F: T served on shareholders' committee. Although service on committee was to be unpaid, members understood that committee lawyer would be paid sufficient fees so that he could distribute some of them to the committee members if he desired. T always intended to be paid for his service if he could. T convinced lawyer to charge $20K in counsel fees, and assigned $14K of this to T.
A: T is officer on committee. This was payment for services in connection w/ office. Voluntariness of lawyer is not to be confused w/ gift. That the services had been completed when payment was made or that there was no assurance from beginning that services would be remuneration do not prevent the amount in question being taxable income.
C: Taxable income.

Taxable	Not taxable
MNR v Gagnon [1965]: T received award of $170 after making recommendation under Gov't of Canada Suggestion Award Plan Regs. Immaterial that the particular services are not performed in the course of the execution of the normal duties of their positions. Payment for service. **Yaholnitsky-Smith v MNR* [1991]: T, teacher at group home, received financial assistance from employer in order to pursue educational program, had no obligation to return to former employer. Financial assistance is remuneration under **6(3)** – covenant. DD: Court got this wrong. T did not owe any consideration back to employer.	*Heggie v MNR* [1985]: T received gratuitous payment equivalent to former salary for 5 months after employment was terminated when shares of company were sold to another company. Payments were made by purchaser of company, not by T's employer, so not taxable as income. **Seary v MNR* [1979]: T denied tenure at U of T, threatened legal action, received monthly payments of $1K. Monthly payments not taxable since T held no office or employment at time when they were paid. DD: Payments were in context of employment relationship – should have applied **6(3)(e).**

Strike Pay

Context: Strike pay provided by a union or affiliated organization is typically paid in respect of the non-performance of services by the employee. An employee can deduct union dues under **8(1)(i)(iv)** and income earned by the union itself is exempt from taxation under **149(1)(k).**

There were a few cases prior to *Fries* dealing w/ strike pay. In *Loeb* the court held that strike pay was employment income – employees were providing services to union during course of strike. In *Ferris*, the employees of a newspaper published their own newspaper while they were on strike and received income from this publication – court characterized it as business income. In *O'Brien*,

where the unions also published their own newspaper, the strike pay was not taxable. **No clear rule on whether strike pay is taxable as income.**

Canada v Fries, [1989] FCA
***The following judgment was reversed by SCC who said only: **We are not satisfied that the payments by way of strike pay in this case come within the definition of income… from a source within the meaning of s 3. In these circumstances, benefit of doubt must go to T.**
F: Liquor Board Branch went on legal strike in support of negotiations going on w/ another union. Union paid T strike pay equivalent to net income during strike period. T agreed to go on strike subject to guarantee that members of union would be provided pay for days off job – more than regular strike pay. MNR argued that Liquor Board had K w/ union in exchange for payment, or income from unspecified source.
A: As soon as dues are received by union, they go into a common fund, w/ no right of withdrawal by paying members – they lose their identity so far as each contributing member is concerned. Does not have characteristics of capital or gift/windfalls, does have characteristics of income. Periodical payment which substitutes for employment income.
C: Taxable income from unspecified source.
R: Strike pay is taxable under **3(a)** as income from an unspecified source (overturned by SCC).

Tort Damages for Personal Injury or Death

Where a T receives tort damages for personal injury/death, this compensation typically includes special damages in respect of lost earnings. Before *Cirella*, courts had concluded that **general damages were not taxable**, but it was unclear whether special damages were taxable.

Rule: Although somewhat unclear, *Cirella* seems to indicate that **both general damages and special damages are not taxable.**

Cirella v Canada, [1978] FCTD
F: T is a welder. After car accident, T is unable to do heavy welding work. As a consequence, T won a judgment of $34.4K, of which $14.5K is special damages (assessed on basis of loss of income from time of injury up to time of trial) and remainder general damages (loss of income earning capacity).
I: Are special damages for loss of income taxable as income?
A: There is no 'source' from which the amount given as damages can be said to come as income – it represents not so much loss of earnings as loss of future earning capacity, which is capital value.
C: These damages are not of an income character. Amount is not assessable as income of T's business, not income from employment because T was not performing any services, not income from property because T cannot be regarded as an asset of his own business. Distinction between general and special damages is artificial – it is all loss of income-earning capacity.
R: Has been interpreted as providing that we **don't tax damages payments** (may be misinterpretation, but is supported by CRA).

Induced Payments

Where a T is paid an amount as an inducement to accept an office or enter into a K of employment, it is arguable that the payment is not remuneration for services rendered under the office or employment, and ∴ not taxable under **5(1). 6(3)(c)** is SAAR against inducement payments. BUT on a strict reading, **6(3)** does not apply where an inducement payment is made by someone other than the recipient's current/future employer.

Curran v MNR, [1959] SCC
F: T initially worked as a geologist for IO. B, who was a substantial shareholder, as well as president and general manager, of FPL, offered T the general manager's position at subsidiary of FPL. T refused. B then agreed personally to pay $250K to T in consideration for T resigning from IO. The $250K comes from CAL, which is another company owned by B. Original idea is that T will end up

working for FPL. T then separately entered into an agreement w/ subsidiary of FPL to act as general manager. T argued that $250K was not taxable – received it before entering into K of employment w/ company controlled by payor of the money, rather than payor himself.
A: Payment of $250K was for personal service only. Economic substance is acquisition of services.
C: Taxable under **3,** not **6(3).**
R: If the true substance of the agreement under which the T is paid is the engagement of the T to work for the employer or a related person, then the payment is for personal service and is income under 3.
D: Somewhat unclear what the basis of the court's decision here was.

PAYMENTS ON TERMINATION

In a series of cases, the courts held that payments by an employer to an employee to compensate him for loss of employment (i.e. anything but payment of wages or salary due under the employment K) were not taxable income from office or employment, either under **6(3)** or under **5(1)** generally, and that they were not income from a non-enumerated source under **3(a)**. In response, Parliament opted to make such payments taxable, not as income from office or employment, but rather as income from an "other source" under Part I, Division B, Subdivision d. In 1981 the *ITA* was amended to add the "retiring allowance" – reverses *Atkins*.

Rule: Under **56(1)(a)(ii)**, a **retiring allowance** received during the taxation year must be included in a T's income.

Test: Under **248(1)**, in order to qualify as a **retiring allowance** the payment must be in respect of T's loss of office or employment, and T must have suffered a loss of office or employment. The amount must be included regardless of whether it was received as, on account of, or in lieu of payment of, damages or under an order or judgment of a competent tribunal.

There are two major issues in retiring allowances:
1. When is a payment in respect of a loss of employment?
2. Was there a loss of employment?

Relationship to Office or Employment

Mendes-Roux v Canada, [1997] TCC
F: T worked for Gov't of NB. Right after T returned from maternity leave, her employer informed her that if she didn't immediately relocate to different office, she would be terminated for "Abandonment of Position". T was wrongfully dismissed. T sued and subsequently negotiated a $25K settlement w/ her employer in agreement that she would not pursue further damages. Although the settlement agreement stated only that the money was "payment of special damages incurred, general damages, legal costs and interest", T convinced the court that 50% of the amount was employment-related, while the other 50% represented damages for mental distress and costs. MNR claims $25K is retirement allowance.
A: Words 'in respect of' have very broad meaning. Court here takes narrower view of 'in respect of' – the taxable payment must be linked to amounts that would have been taxable. Factors such as damages for mental distress and costs are not taxable because they do not enter into the definition of retirement allowance as defined in **s 248(1).**
C: 50% that is employment related is taxable retiring allowance. Remaining 50% is not – **nexus is to personal injury (tort damages) rather than loss of employment.**

Merrins v MNR (1994)	**The words 'in respect of'… ought to be given the widest possible scope.**
Stolte v Canada	If the payment is based on salary, that does not necessarily label it as a retirement allowance.

(1996)	
Anderson v Canada (1997)	Retirement allowance may be damages received by T arise from loss of employment, and incidental damages related to that loss of employment [i.e. reimbursement for loss on house].
Overin v Canada (1997)	A payment may be regarded as having been received in respect of the loss of an office or employment where the **payment would not have been received but for the loss of the office or employment** – in addition to the 'but/for' test, **where the purpose of a payment is to compensate a loss of employment it may be considered as having been received w/ respect to that loss.**
Ahmad v Canada, (2003)	Primary purpose test to distinguish between taxable amounts received in respect of loss of an office or employment and non-taxable damages received in respect of infringement of other legal rights.

Loss of Office or Employment

Schwartz v Canada, [1996] SCC
F: T, who was previously a partner at a law firm, made an agreement w/ D under which T would quit partnership to come work for D at salary of $250K plus stock options. After T had already given notice, D informed T that his services would no longer be needed. T then went to work for a third firm at salary of $175K. T negotiated a $360K settlement w/ D, plus $40K for legal costs. T says that for the $360K, losses on stock options, salary, embarrassment, anxiety and inconvenience resulting from breach of employment K by D were considered, but no specific allocation among such losses was made.
A: No evidence here to establish what portion of the $360K was allocated to which head. ∴ damages received by T cannot be taxable under **3(a)** as income from employment K.
Obiter: T had not yet come under obligation to provide personal services to D – **no loss of employment** so not a retiring allowance. The fact that Parliament enacted a specific provision on the taxability of retiring allowances indicates that it **did not intend this type of payment to be taxable under the general provision** of **3(a).**
R: Loss of intended employment not taxable under 56(1)(a)(ii).
D: Strict construction approach – DD thinks it should fall under retiring allowance. Everything beyond narrow employment K issue here is obiter, so it is **arguable that question of whether a pre-employment termination payment is income from a non-enumerated source is unresolved.**

Compensation for Breach or Waiver of Contractual Obligations

According to **6(3),** compensation received from an employer for the breach or waiver of a contractual obligation may be deemed to be remuneration.

Moss v MNR, [1963] Ex Ct
F: T is food broker. T then became employed by Prairie. Under agreement, T was entitled to specific payment and had right in event of sale/assets of Prairie to purchase the assets/shares at a discounted price and had interest in life insurance policy. Another company subsequently bought Prairie, and T agreed to be paid $34K in exchange for waiving rights under agreement.
A: Rights T was given under K were as much part of consideration for accepting office and entering into K of employment and as much remuneration for his services as an officer or under K of employment as any other payments in the agreement. $ was received by T from Prairie while he was an officer and in employment of Prairie. $ can be regarded as having been received by T as partial consideration for his acceptance of the office of sales manager of Prairie and entering into K of employment, or as partial remuneration for his services as an officer or under his K of employment.
C: Taxable under **6(3).**

Blanchard v Canada [1995]	Payment arising from satisfaction of obligation that arose under this agreement was received as consideration or partial consideration for entering into K of employment.	Taxable remuneration.
Trottier v MNR [1981]	T worked for Quebec Hydro, received lump-sum payment when employer discontinued service providing free transportation to work sites.	Gratuity.
Markin v MNR [1996]	T, who had acquired rights to a share of his employer's profits pursuant to an employee incentive program, received $ in consideration for cancellation of these rights on termination of employment.	Taxable under **6(1)(a)** as benefit from employment or under **6(3)** as remuneration.
Choquette v Canada [1974]	T received $ in consideration for releasing employer from irrevocable K.	Taxable under **3** or **6(3).**

In cases in which employees have received **compensation as arbitration awards or in settlement of a grievance against an employer under a collective agreement,** payments were characterized as salary, wages or other remuneration under **5(1)** or as a benefit under **6(1)(a).**

GENERAL BENEFITS

Rule: Under **6(1)(a),** the value of board, lodging, and any other benefit of any kind whatever received or enjoyed by the T, or by a person who does not deal at arm's length w/ the T in the year in respect of employment must be included in the T's income from office or employment (subject to some statutory exceptions).

- **Arm's length** is defined in **s 251.**

Test: Some particular thing will be taxable under **6(1)(a)** if:

(1) it is possible to characterize the thing as a benefit;
(2) there is a relationship between the benefit and the T's employment; and
(3) the benefit can be valued in monetary terms.

Characterization as a Benefit

Test: A T received a taxable benefit within meaning of **6(1)(a)** if:

(1) T received something of value in the economic sense (a material advantage);
(2) The primary purpose of the thing is not to benefit the employer, and the T's personal advantage or enjoyment of the thing was more than incidental (*Lowe*)

Lowe v Canada, [1996] FCA
F: T is account exec for insurance company. His job is to encourage independent insurance brokers to sell company's policies. Company runs an incentive program for brokers, under which the best brokers win trips to New Orleans. Company paid to send T and wife on such a trip. T did not believe they could refuse to go. They stayed in hotel and went on various tours etc., but always accompanied brokers for express purpose of promoting company's insurance policies. T's wife was expected to build rapport w/ brokers. Had less than 1 hr to themselves. MNR said that primary purpose of trip was personal pleasure.
L: **6(1)(a)** is intended to equalize the tax payable by employees who receive their compensation in cash w/ amount payable by those who receive compensation in cash and in kind.
A: Determined by the facts. Any pleasure derived by T here is merely incidental to business purposes having regard to fact that overwhelming portion of T's time was devoted to business activities. Spouse also devoted vast percentage of time to business activities.
C: Not a taxable benefit.

Material Advantage:

YES (Taxable)	NO (not taxable)
• *Pellizari v MNR*: T, her husband and a corporation of which she was employee, sole director and sole shareholder were charged w/ fraud. Corp paid legal expenses. • *Gernhart v Canada*: T, American employee, received tax equalization payment designed to provide equivalent after-income tax. • *R v Poynton* (1972): T, while officer and employee of corporation, fraudulently obtained $ from employer. Money obtained by fraud is benefit under **3(a)** and **6(1)(a)**.	• *Guay v Canada*: T received $ as reimbursement for tuition fees incurred in order to send children to private French school in Ottawa because children would need to attend one of the private school's locations when T was posted abroad. • **Huffman v MNR*: T, plainclothes police officer, received $ for reimbursement of clothing expenses. Puts him back where he was.

Primary purpose is to benefit employer, or T's enjoyment is no more than incidental:
(Some conflicting case law here w/ *Lowe*, room to make an argument)

NO (Taxable)	YES (not taxable)
• **Cutmore v MNR*: T's employer paid for senior employees to have their income tax returns prepared by professional accountants to protect corporation's reputation. • **Deitch v MNR*: T, legal aid lawyer, sought to exclude in computing income $ in professional liability insurance that his employer had paid on his behalf. • *McGoldrick v Canada*: T worked at Casino, which provided one free meal per shift to all employees at employee cafeteria. • **Dunlap v Canada*: Annual Xmas parties hosted by employer valued at $300/person. T didn't want to go to parties, but that would have been anti-social. • *Clemiss v MNR* (1992): Company incurred legal expenses to defend T against criminal charges of conspiracy to defraud the company and theft of company property. • *Paton v MNR* (1968): T travelled to Winnipeg and Regina w/ wife who accompanied him at bank's request and expense and attended meeting. Spouse's travel expenses were taxable benefit because she did not have expertise to contribute to business.	• *Rachfalowski v The Queen*: Employer-paid golf membership. T was not golfer, but didn't want to appear to be a rebel. [Compare w/ *Dunlap*]

The CRA maintains a list of **administrative exceptions**, in Interpretation Bulletin IT-470R, of practices which it says it will not treat as a taxable benefit. The list says the Minister will not assess the following:

- transportation provided by the employer from pick-up points to the location of employment where, for security or other reasons, public and private vehicles are either not welcome, or not practical;
- airline passes available to airline employees (unless the employee both travels on a space-confirmed basis and pays less than 50% of the economy fare for that trip, in which case the

Scholarships, Fellowships and Bursaries

S 56(1)(n) requires Ts to include the amount, if any, by which the total of all amounts received by the T in the year… as or on account of a scholarship, fellowship or bursary exceeds the T's scholarship exemption for the year under **s 56(3).** The exemption for scholarships, fellowships and bursaries under s **56(3)(a)** is not available for scholarships, fellowships and bursaries that are received in respect of, in the course of or by virtue of an office or employment (in which case taxable as employment income) or in the course of business (in which case taxable as business income).

DiMaria v Canada, [2008] TCC
F: T's employer is Dow Chemical Canada Inc, which paid $3,000 directly to T's 21-year-old son to attend the University of Waterloo and to recognize his academic achievement.
A: Personal satisfaction does not translate into economic advantage. This should have been included in son's income under **56(1)(n).** To consider in determining whether a grant of money is a scholarship: limited number; assessment/selection process; objective criteria; awarded based on merit.
C: Money paid to son provided no material advantage to T because T was under no obligation to send son to post-secondary school. Our tax system taxes individual legal entities, not families.
R: Scholarships paid to a non-minor child of an employee not taxable under 6(1)(a).
D: BUT 2011 amendment to **6(1)(a)** reverses ratio by including benefits received or enjoyed by a person who does not deal at arm's length w/ the T. BUT THEN amendment **6(1)(a)(vi)** somewhat exempts scholarships to children of employees – codifies decision in *DiMaria*.

Jones v Canada (2002)	T received scholarship which offset tuition that would otherwise have been payable.	Value of scholarship was an amount within meaning of definition in **s 248(1),** which was constructively received by T when his account at College was credited.
Simser v Canada (2004)	T received $2K grant which was used to pay for sign language services for bar admission course, most of which was included in computing his income under **56(1)(n).**	Payment was a bursary w/ clear connection to academic program.

Relationship to Office or Employment

Test: Whether the benefit received by is T 'in respect of… office or employment' within meaning of s **6(1)(a)** depends on if the benefit was conferred on the T as an employee or simply as a person. It will be rare that a benefit is conferred on an employee in his personal capacity, since the phrase 'in respect of' has a very broad scope.

R v Savage, [1983] SCC
F: T's employer, a life insurance company, offers $100 per course to employees who complete courses that improve their knowledge in the life insurance field. T voluntarily took three courses and did not include payment from company ($300) in computation of income. Employer deducted the $300 and reported it as 'other income'.
I: Benefit under **6(1)(a)** or prize under **56(1)(n)?**
A: **Payment does not have to have character of remuneration for services.** T took course to improve knowledge and efficiency in company business and for better opportunity of promotion.
C: T received payments in respect of employment.

TAXABLE BENEFIT	NOT TAXABLE
**Mindszenthy v Canada* (1993): T worked for public	*McNeil v Canada* (1986) and *Segall v*

relations company. After boss learned of presentation that T made for purpose of which he had purchased as a prop an imitation Rolex watch, boss gave T a gold Rolex watch. Boss then deducted cost of watch. **Where it is contended that a gift made to an employee by the president of a company is not given to him in his capacity of an employee but rather qua personal friend, it would require fairly cogent evidence to that effect.**	*Canada* (1986): Accommodation differential allowances paid to 2 anglo air traffic controllers who were transferred from Montreal to Ottawa to diffuse tensions w/ franco air traffic controllers.

Benefit from Third Party:

**Waffle v MNR* (1968)	T was a co-owner and employee in Ford dealership. T was awarded free trip from Ford.	Taxable benefit. **Benefit can be 'in respect of' office or employment even if it doesn't come from employer.**
**Giffen v Canada* (1995)	Free travel from frequent flyer points obtained through business travel.	Taxable benefit because it was available only to employees who travelled and who were members of a frequent flyer plan. Where a benefit is received by reason of employment it is **of no consequence that some other condition unconnected w/ employment must also be met.**

Valuation

Test: General rule is that value of benefit is its FMV (*Spence*).

Detchon v Canada, [1995] TCC
F: T is teacher at private high school. School policy is that teachers are obligated to send their children to that school. Teachers' children attend school for free. MNR valued benefit as equal to tuition fees that parents of other students were required to pay to school.
A: School received benefits by having children of employees attend the school. 'Value' in **6(1)(a)** does not always = FMV. Salaries of Ts are insufficient to meet the tax assessed on value of benefit added to their incomes. BUT this does not justify giving them a tax-free benefit.
C: Average cost to school of education a student should be used as valuation.
D: No longer good law.

**Spence v Canada* (2010) (Replaced *Detchon*)	Ts were teachers at Montessori School who received 50% discount on tuition for children.	Applied reasoning from *Schroter.* What is in issue here is not the cost for the employer of granting the benefit to the employees. It is the value of the benefit received by the employees. This is the **FMV of the benefit they received**, minus the amount they paid for the tuition.
Bartley v Canada (2008) and *DiMaria v Canada* (2008)	Ts employer paid $ to each of Ts children under Higher Education Award Program.	No material advantage to T because no obligation to send children to post-secondary.
Waffle v MNR (1968)	See above.	Value is cost of award to Ford. [Overruled by *Spence*?]
Giffen v Canada (1995)	See above.	Price which the employee would have been obliged to pay for a revenue ticket entitling him to travel on the same flight in the same class of service and subject to the same restrictions as are applicable to reward tickets.

In some cases, the courts may discount the value of the benefit:

Wisla v Canada (1999)	Gold ring given to all employees.	Reduced value because it was stamped w/ corporate logo.
Jelles v Canada (1996)	Ts employed as resident caretakers of apartment building. Occupied suite 5 nights/week, required to be on call 24 hours/day and stay in suite.	Benefit should not be valued at suite's full rental value.

ALLOWANCES AND OTHER BENEFITS

Allowances

6(1)(a) is directed mainly towards benefits of a non-monetary nature (but can also include specific sums of money), while **6(1)(b)** is designed mainly to capture money payments that are 'allowances' (*MacDonald*).

*For the purpose of s **6(1)(b),** CRA distinguishes among (a) an allowance; (b) a reimbursement and; (c) an accountable advance (requires return of amount not spent).

- Allowance is generally taxable, but reimbursement or accountable advance are generally not taxable unless it represents payment of the employee's personal expenses.

Rule: In computing a T's income from an office or employment **6(1)(b)** requires Ts to include, subject to specific exceptions in **6(1)(b)(i) to (ix),** all amounts received in the year as an allowance for personal or living expenses or as an allowance for <u>any other purpose.</u>

- Exceptions in **6(1)(b)(vii)** and **(vii.1)** for reasonable allowances for travel and motor vehicle expenses.
    - Note rule in **6(1)(b)(x)** deeming allowance for use of motor vehicle not to be reasonable where not based solely on km driven for work.
    - Note also distinction between travel and sojourning in *Blackman*.

Test: Allowance is not defined anywhere in the Act. ∴ the test comes from *MacDonald*: Under **6(1)(b),** an allowance is:

(1) An <u>arbitrary amount</u> in that it is a predetermined sum set w/o specific reference to any actual expense or cost. The amount of the allowance may be set through a process of projected or average expenses or costs;
(2) Usually paid to T for a <u>specific purpose</u>;
(3) In the <u>discretion of the recipient</u> in that the recipient need not account for the expenditure of the funds towards an actual expense or cost.

MacDonald v Canada (AG), (1994) FCA
F: T is member of RCMP who was transferred from Regina to Toronto. After transfer, T was paid $700 each month as a housing subsidy. MNR said $ should be included in T's income.
I: What are characteristics of an allowance for purposes of s **6(1)(b)?**
A: None of exceptions of **6(1)(b)** apply. Housing subsidy is a hidden/concealed increase in remuneration.
C: Subsidy is taxable as an allowance.
D: If employer had requested that T give employer rent cheques, which employer would pay for, that would be a reimbursement which would be taxable as a benefit.

Lepine v MNR (1978)	T received 'isolation bonus' of $700/month when he was sent to Guinea.	Falls under **6(1)(b)**

Canada v Demers (1980)	Cost of living adjustment paid for relocation to Haiti	Remuneration
Sheldon v MNR (1998)	T received $ as housing subsidy in compensation for decrease in resale value that his home would suffer as a result of mine (where he worked) closure.	T, who had not actually sold house, had received taxable allowance.
**North Waterloo Publishing Ltd v Canada* (1988)	T received meal allowance – excluded from income on grounds that it reimbursed him for evening meals consumed while at work at newspaper office.	Payment was an allowance because characterization as reimbursement requires submission of detailed receipts.

Home-Related Relocation Assistance

Rule: Under **6(23),** an amount paid or the value of assistance provided in respect of an individual's employment in respect of the cost of, financing of, use of, or right to use a residence must be included in the T's income from office or employment.

Taxable benefits were found in the following two cases:

**Pezzelato v Canada* (1995)	T transferred to Toronto, received $ as reimbursement of interest expenses on money that T had to borrow in order to buy home in Toronto while unable to sell former home.
**Phillips v MNR* (1994)	T received relocation payment after transferring from Moncton to Winnipeg. Payment enabled T to acquire a more valuable asset and increased his net worth.

However, **6(23)** does not address reimbursement of ordinary **moving expenses** by T's employer. *Pollesel v Canada* (1997) and *MacInnes v Canada* (2003) held that reimbursement for moving expenses were not an economic benefit under **6(1)(a)**. Where moving expenses are neither paid by T's employer nor reimbursed in a non-taxable form, T may deduct expenses under **s 62.**

6(23) effectively overrules *Splane v MNR* and *Canada v Hoefele*, in which the FCA had held that **mortgage interest subsides** paid by T's employer after the employer required the Ts to relocate were not taxable benefits.

- BUT it is possible that these cases could fall to be valued under **6(9)** or **80.4(1).**

Housing Loss Compensation

In *Ransom v MNR*, T received $ from his employer as partial compensation for a loss on the sale of his old residence when he was transferred from Sarnia to Montreal, which the Minister assessed as a taxable benefit under **6(1)(a).** Court characterized payment as a non-taxable reimbursement for a loss incurred in the course of T's employment.

- Rationale for introducing **6(19)-(22):** Exclusion from income of these amounts provides a significant tax advantage to employees who are reimbursed by their employer for such expenses compared to those who must bear the costs themselves – overrules *Ransom*.

Rule: An amount paid to or on behalf of a T in respect of an "**eligible housing loss**" and also in respect of the T's employment is deemed to be a taxable benefit whose value for tax purposes is the amount by which ½ of the amount, if any, by which the total of amounts each of which is paid in the year or in the preceding taxation years exceeds $15K exceeds the total of all amounts each of which is an amount included in computing the T's income because of this subsection for a preceding taxation year in respect of the loss.: **ITA 6(20).** If the amount is in respect of a "**housing loss**" which

is not an "**eligible housing loss**", it is deemed to be a taxable benefit whose value for tax purposes is the entire amount paid: **ITA 6(19).**

6(20) is drafted in a long-winded fashion because the section contemplates eligible housing loss compensation being split across years. e.g. If a T receives a payment from their employer in 2007 AND 2008. In 2008, the amount included under **6(20)(a)** is one half of the amount by which [payment from employer in 2008] plus [payment from employer in 2007] exceeds $15,000.

Test: According to **ITA 6(22),** an "**eligible housing loss**" is:
1. a "**housing loss**", as defined in **ITA 6(21),** meaning for our purposes the cost of the house minus the proceeds of sale, as contemplated by paragraphs **(a) and (c);**
2. in respect of a residence designated by the T, provided that only one such residence may be designated; and
3. in respect of an "**eligible relocation**", as defined in **ITA 248(1),** meaning a relocation:
   - done to enable the T to carry on business or be employed at a location in Canada: paragraph **(a)(i);**
   - where both new and old residences where the T ordinarily resided are in Canada: paragraph **(b);** and
   - where the new residence is at least 40km closer to the new work location than the old residence: paragraph **(c).**

Requirement that T relocate in order to enable him to carry on business or be employed has been construed quite strictly against T:

Thomas v Canada, (2005) FCA
F: T moved from Ottawa to St John to work for J D Irving Ltd. He spent $850K to buy land and build a house. A year later, T was fired. He moved back to Ottawa because there were no work opportunities for him in St John and all his ties and contacts were in Ottawa. As part of the termination "package", J D Irving Ltd agreed to buy the house from T for $850K, despite the FMV having fallen to $760K, and this deal was not contemplated in the employment K. T did not start working again until about 1 year after he returned home to Ottawa. When the Minister assessed tax on the entire $90K ($850K – $760K – housing loss as defined in **6(21)),** T argued that (1) the payment was not in respect of employment" – it was a separate agreement w/ the employer; or (2) in the alternative, the money was paid in respect of an "eligible housing loss". T also argues he did not receive any economic benefit.
A: Not relevant that not part of initial employment K. Economic benefit will be conferred if what is received increases the recipient's net worth. T clearly had resale value in mind when he acquired the property: purchase of property was not an expense required by employer but was more in nature of a personal consumption expense.
C: (1) The payment was certainly a benefit in respect of employment; and (2) T's loss does not qualify as an "eligible housing loss" because he did not sell his house to enable him to carry on business or be employed in Ottawa but <u>because his employment was terminated</u>.
D: Court says that housing loss had to occur to enable you to carry on business – this is not in the statute. BUT under **6(22)** you could argue that the compensation was in respect of termination, not eligible relocation.

Interest-Free and Low-Interest Loans

Rule: In computing income of a T from an office or employment, **6(9)** includes an amount in respect of a loan or debt that is deemed by **80.4(1)** to be a benefit received in a taxation year by an individual.
According to **80.4(1),** where a person receives a loan or otherwise incurs a debt <u>because of or as a consequence of a previous, the current or an intended office or employment of an individual, or because of the services performed or to be performed by a corporation carrying on a personal services business</u>, the individual is deemed to have received a benefit in a taxation year

- **80.4(1.1):** Loan or debt is deemed to have been received or incurred because of… **if it is reasonable to conclude that, but for** an individual's previous, current or intended office or employment, or the services performed or to be performed by the corporation, (a) the terms of the loan or debt would have been different; or (b) the loan would not have been received or the debt would not have been incurred.
    - Intended to reverse *Siwik* and *Hoefele*.

Computation:
The amount of the deemed benefit under **ITA 80.4(1)** is given by the following formula based on paragraphs **(a–d):**

$$\max\{(a + b) - (c + d), 0\}$$

where:

(a) the quantity a is the amount of interest that would be payable on the loan if computed at the **prescribed rate;**
    - **Prescribed rate** is defined in **Reg 4301**

(b) the quantity b is the actual amount of interest paid by the employer, or a related person;

(c) the quantity c is the amount of interest actually paid to the lender; and

(d) the quantity d is whatever part of b that the debtor (in our case, the employee) reimbursed to the person who paid it under paragraph (b).

In the case of a lump sum interest subsidy paid by the employer, the deemed benefit is inversely related to the size of the loan principal. This treatment of employer interest rate subsidies incentivizes employees to take on increased indebtedness.

80.4(3) states that **80.4(1) does not apply** where the rate of interest on the loan or debt is equal to or greater than commercial rates in effect at the time the loan was made or the debt was incurred, provided that the loan or debt was included in computing a T's income.

- *Archer v MNR* (1989): Latter exception could apply to a loan or debt subsequently included in recipient's income for taxation year as a payment of salary.
    - Exception might apply where an amount is included in a T's income under **s 6(15)** on forgiveness of loan or debt.

Home Relocation Loans (Special Case of Low-Interest Loans)

Rule: A T must include as income from employment any amount in respect of a loan that is deemed by **80.4(1)** to be a benefit (**6(9)**). Where a loan is a **home purchase loan** or a **home relocation loan**;

1. The T is partially insulated from upside changes in the prescribed rate of interest. In each 5-year period, w/ the first such beginning on the date the loan is taken out, the rate of interest determined under **80.4(1)(a)** may not go above the prescribed rate of interest at the beginning of the 5-year period: **80.4(4)** and **(6)**.
2. The T is eligible for a deduction under **110(1)(j)**. The computation of this deduction is explained in the section on computation, below.

Test: Home purchase loan is defined in **80.4(7)**. As defined in **248(1)**, a **home relocation loan** is a loan satisfying the following criteria:

- The loan was received by an individual T, or the T's spouse or CL partner;
- The T moved to a new residence in Canada from an old residence also in Canada;
- Before the move, the T ordinarily resided at the old residence and after the move, the T ordinarily resided at the new residence; and
- The reason the T moved is that he began employment at a new work location in Canada.

And:

- The new residence is at least 40km closer to the new work location than the old residence;

- The loan was used to acquire the new residence;
- The loan has the nexus to the T's employment described in **80.4(1)** and **80.4(1.1)** – it was received because of or as a consequence of a previous, the current, or an intended employment, in the sense that it is reasonable to conclude that, but for the previous, current, or intended employment, the loan would either (a) have had different terms; or (b) not have been received at all; and
    - *Canada v Hoefele:* **It is not the benefit that must arise 'because of', 'as a consequence of', or 'by virtue of' the employment; rather the loan or debt itself must be incurred 'because of' or 'as a consequence of' or 'by virtue of' employment. 80.4(1) requires a strong causal connection between loan/debt and employment, closer connection than that required by 6(1)(a).** (Possibly overruled by **80.4(1.1)**)
- The T designated the loan to be a **home relocation loan**, provided a maximum of one loan may be so designated, either in respect of a particular move, or at any particular time.

[Note that the definition for **home relocation loan** differs from that for **eligible relocation**]

Computation:
The **ITA 110(1)(j)** deduction in respect of a "**home relocation loan"** is the lesser of the following amounts:

i. where **ITA 80.4(1)** deems a benefit in respect of at least one loan that is not a "home relocation loan", the benefit that would have been deemed if **ITA 80.4(1)** was only applied to the "home relocation loan";
ii. the amount of interest for the year that would be computed under **ITA 80.4(1)(a) [and ITA 80.4(4) & (6)]** if the "home relocation loan" had a principal balance of $25,000 and, if the loan was issued more than five years ago, if it had been extinguished after five years; and
iii. the total benefit deemed under **ITA 80.4(1).**

In practise, most of the work is done by subparagraph **(ii).** For exam purposes, the computation in subparagraph **(ii)** will usually just entail multiplying the prescribed rate at the beginning of the initial five-year period by $25,000.

e.g. Assume that T borrows $500,000 from a financial institution on January 1, 2014, at a time when the prescribed rate is 1%, the interest rate on the loan is 2.5% per year, the loan qualifies as a home relocation loan, the T's employer pays an interest subsidy to the financial institution of $10,000 per year, and the T does not reimburse the employer for any of the interest subsidy that it pays to the financial institution. The amount of the benefit under subsection **80.4(1)** is $5,000 + $10,000 - $12,500 = $2,500. In this circumstance, the amount of the benefit under paragraph **110(1)(j)** is $25,000 X 0.01 = $250. As a result, the net inclusion for the T is reduced from $2,500 to $2,250.

Funnell v MNR (1991)	T had to move from Toronto to Edmonton and received interest-free loan to facilitate relocation.	**80.4(1)** and **6(9)** apply because benefit was conferred as a term of acceptance of K of employment.
Siwik v Canada (1996)	T received interest-free loan to assist in acquisition of new home when he was transferred from Montreal to Toronto.	Payment was non-taxable reimbursement under *Hoefele*. [Possibly overruled by **80.4(1.1)**]

Employee Stock Options

Warrants, employee stock options, and, generally, rights issued to employees to buy shares in an employer-corporation make up a particular class of taxable benefit which has its own inclusion section under Subdivision a (income from office or employment) of the Act, **ITA 7** [**7** overrules the general rule in **6(1)(a)**] plus special deduction treatment under **ITA 110(1)(d), (d.01)**, and **(d.1)**, which gives the benefit realized a sort of pseudo capital gains treatment.

Terminology: Generally an **option** in the employment context is given to an employee for free. If you pay to get an option then what you pay is the '**option price'**. Typically an option is not exercisable until the option '**vests**' i.e. until the option '**expires**'. Employees will often wait to exercise the option until just before it expires. The price when you exercise the option is the '**exercise/strike price'**. If at the time an option is issued, the option price is already lower than the FMV, then it is an **in the money** option.

- *Any difference between exercise price and FMV at time of exercise is an employment benefit. Any gain after that is taxed as capital gain.

Inclusions for Employee Stock Options

The inclusion for employee stock options comprises four major issues:

1. **Coverage:** do the rights or warrants issued fall under **ITA 7**, or ought they to be considered under **ITA 6(1)(a)?**
2. **Nexus:** is there a sufficient connection between the options and T's employment for a deemed benefit to arise?
3. **Timing:** at what point in time does the Act deem T to have received a benefit?
4. **Valuation:** what is the money value of the benefit deemed to be realized by T?

(1) Coverage: 7(3)(a) of the Act states: If a particular qualifying person has agreed to sell or issue securities of the particular person, or of a qualifying person w/ which it does not deal at arm's length, to an employee of the particular person or of a qualifying person w/ which it does not deal at arm's length, (a) except as provided by this section, the employee is deemed to have neither received nor enjoyed any benefit under or because of the agreement.

- In other words. Where <u>either</u> an employer-corporation A or any other corporation B which does not deal w/ A at arm's length, issues to an employee, T, of A the right to buy stock in <u>either</u> A or B, that right falls to be taxed under **s 7** or <u>not at all</u>. It does not matter which of A or B issues the right, or whether the right is to acquire stock in A or stock in B. However, subsection **(3)** must be read together w/ the nexus provision, **s 7(5)**.

Robertson v Canada (1990)	T was employed by another individual and received option right from employer to purchase shares of public corporation.	T realized employment benefits on both grant and exercise of options, but only latter could be quantified sufficiently to give rise to income inclusion under **6(1)(a).**
Henley v Canada (2007)	T received warrants to purchase shares of one of his employer's clients, as partial payment of fees owing in respect of T's work for client.	**6(1)(a)** applied to include an employment benefit in T's income in the year the warrants were granted, not in year they were exercised to acquire shares. Distinguished *Robertson* on basis that T there had only a conditional right to acquire shares under option subject to continuing in employer's service for some period of time.

(2) Nexus: There are two nexus issues to be aware of:

i. Was there a sufficient nexus to employment at the time T received the rights?
ii. What happens if T's employment ends before he exercises or disposes of the rights?

With respect to the first issue, the nexus provision, **s 7(5)**, states that **s 7** does not apply if the employee did not receive the rights "in respect of, in the course of, or by virtue of, the <u>employment.</u>" Because the entire section is inapplicable if there is an insufficient nexus, **7(3)(a)** would ∴ also not apply [so the benefit might fall to be taxed under **6(1)(a)**].

7(1) refers to the employee's employment, but does not refer to an officer's office, and **s 7(5)** refers to a nexus w/ the employment w/o any of the words employee, officer, or office. The word **employment** is defined in **248(1)** to mean "the position of an individual in the service of some other person" and ∴ would not appear to include directors, who hold an office and are not "in the service" of anyone. BUT see *Taylor*.

Taylor v MNR (1988) TCC
F: T, a geologist, became a director of two mining companies and subsequently was granted stock options from both companies. He argued that the exercise of his options could not be taxed because the office of director does not come within the term "employment" as defined in the Act.
A: Under **248(1),** a director is an employee. Conditions in **7(1)(a)** met. **7(1)** refers to an employee. **7(5)** refers to the employment**. 6(1)(a)** refers to an office or employment. The court reads together **7(1)(a)** and **7(5)** to get the result that this situation falls under **7(5).**
C: The option exercise is taxable under **ITA 7.** Options were granted in consideration of services T was to perform as a director and he received the options qua director, an employee of each of the corporations.
R: Taking into account the context and the intent of the Act, the word employment should not be restricted to the 248(1) definition but should be given an inclusive interpretation.

With respect to the second issue, **7(4)** states that if the T's employment ends before exercise or disposal of the options (or disposal of the underlying securities where **7(1.1)** applies), the T is deemed to remain an employee for the purposes of **s 7** until the applicable disposal or exercise event has taken place. Applied in *Aylward v Canada*.

Busby v Canada (1986)	T was granted a series of options to acquire shares in company for which she was acting as director; T had personal relationship w/ businessman in the company.	Benefits received by T from stock options were received by her as a person for considerations extraneous to such employment.
Scott v Canada (1994)	T became director of Night Hawk. T performed services through private company Delso for Night Hawk, pursuant to K between Night Hawk and company DZ. T was granted options to acquire shares in Night Hawk.	T had become an employee of Night Hawk independently of his position as director and officer of the corporation. Officer has an employment relationship w/ corporation.
Grohne v Canada (1989)	T, who was director, shareholder and president of company, received stock options.	Options had been received by virtue of T's relationship w/ company as a shareholder, not as an officer or employee.

Timing of Benefit
No benefit is deemed to be realized until the employee either exercises or disposes of rights. One of the following three timing rules will apply, depending on whether the rights are disposed of or exercised, and on whether a Canadian-controlled private corporation is involved:

1. If the **employee disposes of rights**, **ITA 7(1)(b)** deems him to have received the benefit in the year in which he disposed of the rights.
2. If the **employee exercises rights and the conditions of ITA 7(1.1) are not met** (see below), **ITA 7(1)(a)** deems him to have received the benefit in the year in which he exercised the rights.
   - *Ball v MNR* (1992) held that shares are not acquired until consideration is fully paid.
3. If the **employee exercises rights and the following conditions are met:**
   - the employer is a "Canadian-controlled private corporation" (CCPC);

- the employer issues the rights;
- the rights exercised are to acquire stock in the employer CCPC or another CCPC which does not deal at arm's length w/ the employer CCPC; and
- the employee deals at arm's length w/ all of the CCPCs involved

then **ITA 7(1.1)** deems him to have received the benefit in the year in which he disposes of the securities obtained as a result of exercising the rights. This deferral is mandatory if conditions in **7(1.1)** are met.

- These shares can also qualify for deduction under **110(1)(d)** if they satisfy the criteria. If they don't satisfy the criteria, they can get a different deduction under **110(1)(d.1).**

Note that the benefit deemed to be received under rules #2 and #3 relates to the acquisition of the underlying securities. **Any benefit from the ultimate sale of the underlying falls to be considered under the rules for capital gains.** The deferral in **ITA 7 (1.1)** does not change this fact – it simply means that a taxable benefit under **ITA 7** and a taxable gain may arise in the same year.

Quantum of Benefit

The quantum of the benefit from employee stock options is computed according to the following rules:

1. **If the employee disposes of the rights** then **ITA 7(1)(b)** deems the benefit to be the price received by the employee on the sale of the rights less the price, if any, paid by the employee to acquire the rights.

$$B = p_{sale} - p_{acquire}$$

This makes sense, since where the rights are disposed the price of the underlying securities should be irrelevant**. S 248(1)** defines a '**disposition**' of property.

- Courts have concluded on several occasions that **s 7(1)(b)** did not apply to amounts received as compensation for the cancellation of stock options generally resulting from the issuing company's amalgamation w/ another company – e.g. *Buccini v Canada* (2000)
- *An amendment in 2010 to **s 7(1.7)** effectively reverses the result in *Buccini* – **7(1)(b) applies to amounts received as compensation for cancellation of options**
  - **7(1.7)** says that if the rights expire because they're no longer exercisable (usually if the company merges) and you get compensation, then you are still deemed to get a benefit

2. **If the employee exercises the rights** then **ITA 7(1)(a)** deems the benefit to be the value of the securities acquired less the sum of the exercise price of the options and the price paid to acquire the options. The courts have typically interpreted "value" to mean "FMV", particularly when the underlying securities are exchange-traded.

$$B = FMV_{underlying} - (p_{qcquire} + p_{exercise})$$

- If the employee makes an additional gain when they sell the shares, this is subject to tax as a capital gain, not as a further employment benefit

Deductions for Employee Stock Options

Deemed benefits from employee stock options are given tax treatment similar to capital gains. The difference is that while w/ taxable capital gains the gain is halved at the inclusion stage**, w/ employee stock options the same approximate effect is achieved by permitting the employee to deduct half of the deemed benefit.** The following table summarizes.

	ITA 110(1)(d)	**ITA 110(1)(d.01) and ITA 110(2.1)**	**ITA 110(1)(d.1)**
Applies	Deemed benefits under	Deemed benefits under **ITA 7**	Deemed benefits to

to	**ITA 7** except those to which **ITA 7(1.1)** applies	where the employee donates the acquired securities to charity	which **ITA 7(1.1)** applies
Effect	Employee may deduct ½ of the deemed benefit.	Employee may deduct the other ½ of the deemed benefit (i.e. effectively reducing the deemed benefit to zero)	Employee may deduct ½ of the deemed benefit
Criteria	- Underlying securities must be non-convertible common shares - Rights must not be in the money when issued (after considering acquisition price of the rights) - Employee must be dealing at arm's length w/: the grantor of the rights; the employer; and any entity whose securities the rights may be exercised to acquire	- Employee is entitled to a deduction under **110(1)(d)** - Employee donates the securities (or under **ITA 110(2.1)**, the proceeds of selling them) to a qualifying charity: in the same year in which he acquired them; and no later than 30 days after acquiring them	- Underlying securities are shares of a "Canadian-controlled private corporation" - Employee does not dispose of or exchange the shares (not the rights!) for 2 years after acquiring them - Employee has not deducted an amount in respect of **ITA 110(1)(d)**

Exceptions, Exclusions and Deductions

8(1) states that Ts may in computing their income from an office or employment deduct specific amounts as indicated as are wholly applicable to that source or as may reasonably be regarded as applicable thereto. **8(2) limits the amounts that may be deducted** in computing a T's income from an office or employment **to the amounts specifically listed in s 8.**

- This is in contrast w/ rules for computing income from business or property which allows Ts to deduct a much broader range of expenses incurred to produce the income.
- Note requirement for certificate for some deductions in **8(10)**.
- **S 118(10)** provides a non-refundable Canada Employment Credit - ~$1000 – on assumption that all employees have some expenses for their work

LEGAL EXPENSES

Rule: Under **8(1)(b),** Ts may deduct amounts paid by T in year as or on account of legal expenses incurred by T to collect or establish a right to salary or wages owed to T by employer or former employer of T. These expenses are deductible regardless of whether the T prevails in his claim (*Werle v The Queen*).

The courts have held that damages payments, or other compensation for wrongful dismissal does not constitute "salary or wages" (see, e.g., *Werle v The Queen*). However, such payments come within the meaning of **retiring allowance** (see para **(b)** of the definition of **retiring allowance** under **248(1)**. **60(o)** and **60(o.1)** permit deductions for specific kinds of legal expenses that are not incurred in order to obtain income from these sources enumerated in **8(1)(b).** Under **60(o.1)**, the T may deduct legal expenses incurred in the year, or the preceding 7 years, to establish a right to a **retiring allowance**. Legal expenses incurred in order to collect or establish a right to damages following termination of T's office or employment are deductible under **60(o.1)(i)(B).**

- *Comier v MNR*: Legal expenses for unsuccessful challenge of conviction for tax evasion deductible under **60(o).**

Where a T receives an **award or reimbursement** in respect of legal expenses that are deductible under **8(1)(b),** amount of award/reimbursement must be included in computing T's income from an office or employment under **6(1)(j),** except to extent that it was otherwise so included or taken into account in computing deduction claimed under **8(1)(b).**

Limitations: Cannot deduct legal expenses incurred in order to obtain periodic benefits under a 'wage loss replacement plan', despite these benefits being included in computing T's income from office/employment under **6(1)(f).**

Cases:

- *Bongiovanni v Canada*: Legal expenses to obtain workers' compensation payments disallowed.
- *Blagdon v Canada*: Legal fees for representation at inquiry for incompetence disallowed.
- *Wilson v Canada*: Legal expenses to defend teacher charged w/ criminal offence disallowed.
- BUT *Atkinson v Canada*: Legal expenses to defend policeman against criminal charges connected w/ his employment allowed – enabled T to retain right to earn pension.
- *L'Ecuyer v Canada* and *Turner-Lienaux v Canada*: Legal expenses to establish right to future salary or wages disallowed. BUT may have been overturned by *Loo*.
    - **Loo v Canada*: **8(1)(b)** has 2 branches. The first branch permits a deduction for legal expenses incurred in an action to collect salary or wages owed. Second branch contemplates a situation in which matter in controversy is legal entitlement to salary claimed. **8(1)(b) can include future salary/wages.**

TRAVEL EXPENSES

Travel-related expenses make up another topic that mashes together inclusion- and deduction-related concepts, but which it makes the most sense to analyze holistically rather than splitting into pieces. The following three concepts are involved:

1. Exceptions from Inclusions: Exceptions from the general requirement, under **6(1)(b)**, to include allowances: **6(1)(b)(v), (vii)** and **(vii.1)**;
2. True deductions**: 8(1)(h)** and **(h.1**); and
3. Certain specific remedial exemptions: **6(6)** and **81(3.1**).

Travelling or Sojourning?

Travelling means to go back and forth within a short period of time. It is different from sojourning, which means to live temporarily in a place (*Blackman v MNR*).

General Rule: Exceptions from Inclusions of Allowances and Deductions of Expenses

Exceptions from Inclusions of Allowances

We looked at three travel-related allowances which a T may avoid including in his income from employment. These allowances are set out in **ITA 6(1)(b),** subparagraphs **(v), (vii),** and **(vii.1).**

Rule: Although an employee-T is generally required to include allowances for personal and living expenses under **6(1)(b)**, he is not required to include certain reasonable allowances for travel-related expenses. The allowances which may be excepted from inclusion are:

1. **6(1)(b)(v)** reasonable allowance for **travel expenses** received in respect of a period in which the employee-T was employed in connection w/ selling of property or negotiating of Ks…

2. **6(1)(b)(vii)** reasonable allowances for travel expenses in the performance of the employee T's duties of employment, except that this subparagraph does not apply to either of:

- allowances for the use of a motor vehicle, which are covered in subparagraph **(vii.1);** or
- allowances received in respect of a period when the employee was employed in selling property or negotiating contracts as described in subparagraph **(v);**

and this paragraph also does not apply **unless the employee travelled away from both** of:

(A) the municipality in which the employer's establishment at which the employee ordinarily reported for work was located; and

(B) the metropolitan area, if there is one, where that establishment was located; and

- [Note that **metropolitan area** is not defined in the Act)

3. **6(b)(vii.1)** reasonable allowances for using a motor vehicle for travelling in the performance of the employee T's duties of employment except that:

- this subparagraph does not apply to allowances received in respect of a period when the employee was employed in selling property or negotiating Ks as described in **(v)**; and
- if the allowance is not based solely on the distance travelled by the vehicle while the employee is using it in connection w/ office or employment, it is ipso facto unreasonable: **(ix)**.

Note: Apply *Healy* (see p 33) w/ respect to requirement to travel out of municipality and metropolitan area.

**Bouchard v MNR* (1980)	T lived in Quebec where he was employed 32 hours/week, received allowance for travel and living expenses under K w/ another employer where he worked PT. T argued that this fell under **6(1)(b)(vii).**	Expenses in respect of which payment was made were personal expenses for travel voluntarily incurred by T – not exempt. [BUT see **81(3.1)**]
Campbell v Canada (2003)	Ts hold offices w/ school board, worked out of their homes, and received allowance to travel from homes to board's admin building.	Exempt under **6(1)(b)(vii.1)** because Ts were going from one place of business to another place of business and ∴ travelling.
Canada v Salter (1985)	T received travel allowance as reimbursement to use own car to acquire land for job and visit construction sites.	T only spent 2% of time in land acquisitions, so only partial amount held to be non-taxable allowance under **6(1)(b)(v).**

Deductions of Expenses

As a general rule, these expenses include costs of transportation, accommodation, and meals that are consumed during the period of travel.

The main issues created by the travel expense deduction rules are:

1. If T has already claimed an exception from including an allowance under **6(1)(b)(v), (vii)** or **(vii.1**), is T entitled to a deduction as well? (See (3) below)
2. Did T's travel meet the nexus criterion of being in the course of his employment?

Rule: In computing his income for the year, an employee T may deduct non-motor vehicle travel expenses, under **ITA 8(1)(h),** or motor vehicle expenses, under **ITA 8(1)(h.1),** incurred by T in the course of his employment where the T's s employer provides the certificate, required by **ITA 8(10)** and in the form prescribed in the regulations, and the following conditions are met:

1. T was ordinarily required to carry on his employment duties away from the employer's place of business or in different places;

2. T was obliged under the K of employment to incur the particular type of travel expense deducted in the performance of his duties of employment; and
   - If there is an implicit understanding that you have to pay for expenses, then that satisfies the K requirement.
3. T did not already receive an allowance for the particular type of travel expense deducted and, by virtue of an exception available under **ITA 6(1)(b),** omit the allowance from his income for the year.
   - *Evans v Canada*: "**An allowance (if reasonable) is only a bar to any further claim w/ respect to the same travel for which it is paid**" – Court allowed T to deduct costs of travel between home and first and last schools she visited each day (not covered by allowance from employer).
     - Note that this limitation might not apply if the allowance does not come close to covering the actual cost.

Additional Qualifications/Requirements: Where T may claim a deduction under **8(1)(h) or (h.1), 8(1)(j)** allows T to deduct interest payments and capital cost allowances related to acquisition of a motor vehicle that is used to perform the duties of the T's office or employment or an aircraft that is required for the T's office or employment. **8(1)(f)** allows deduction of travel and other expenses incurred by Ts who are employed in the year in connection w/ selling of property or negotiating of Ks for T's employer. **8(1)(e) and (g)** permit railway and transport employees to deduct amounts disbursed for meals and lodging where they are required to travel in the course of their duties.

Travelling "in the course of" office or employment

Isn't clear where the law is right now. In *Luks,* the court used a very strict approach and held: in order that they may be deductible under this rule, they must be expenses which the holder of an office is necessarily obliged to incur – obliged by the very fact that he holds the office and has to perform its duties – and they must be incurred in the course of the performance of those duties.

After *Luks*, courts appear to be more generous to Ts on issue of whether travel expenses were incurred "in the course of" T's employment. Unclear whether *Evans*, which takes a very generous approach, can overrule *Luks*. According to *Merten*, *Chrapko* and *Evans*, *Luks* rationale can no longer be applied to preclude all deductibility where travelling itself is not the performance of a service for the employer.

NO (deduction disallowed)	YES (deduction allowed)
Luks v MNR*, (1958) Ex Ct: T was working for 3 different employers at different work sites. T was required to have an unwieldy amount of tools at the work site as a condition of his employment as an electrician ("a load that could not be conveniently be carried without a vehicle"). In order to reduce the risk of theft, T did not leave the tools at the site but carried them in his car everyday between his home and the work site. T was paid at hourly rate for time during which he was engaged on work, not including any time spent in travelling to or from work. T tried to deduct the automobile expenses under the predecessor of **ITA 8(1)(h.1). T argued that carrying tools to and from place where he was employed was part of duties of employment. C: Expenses were made in consequence of T's employment. Travelling was not done 'in course of' office or employment. Carrying the tools may have been	**Evans v Canada* (1998) TCC: T was school psychologist. T was required to travel to various schools in order to carry out her duties, sought to deduct car expenses incurred to travel in excess of an allowance paid by her employer that covered costs of travel between schools but not between her home and first and last schools that she visited each day. C: Expenses related to duties that T was required to carry on away from employer's admin office and in different offices – in part due to quantity of paperwork that she had to drive around and that she did not have a primary workplace where she

practical, but it was not part of T's duties of employment.	reported.

**Canada v Diemert*, (1976)	T lived in Regina, sought to deduct cost of travelling to Assinboia, where he reported to work and from where he made trips to other locations.	T's employment duties commenced in Assinboia, not Regina. Disallowed.
**Chrapko v Canada* (1988)	**8(1)(h) applies to expenses incurred in travelling to a place of work away from places at which T <u>usually</u> worked.** T could deduct expenses to travel to work location where he worked 25% of time, but not for expenses to travel to location where he worked 75% of time.	
**MNR v Merten* (1990)	T sought to deduct car expenses incurred to travel to different work sites in the Calgary area to which he frequently travelled directly from home before attending employer's permanent office and from which he often returned directly home at the end of the day.	Deduction allowed of all travel expenses claimed by T on grounds that *Chrapko* had recognized that a **T can deduct expenses for travelling from his home to a place of work as long as that place of work is other than the place at which he usually works.**
Hogg v Canada (2002)	T, judge in provincial court who was assigned to a base court and received a non-taxable vehicle allowance that was paid on a per km basis for travel in excess of 15 km when his duties required him to be away from his base court, sought to deduct car expenses incurred in driving from his home to the base court and back home again at end of day on basis that he was obliged to drive to courthouse by reason of security concerns.	Disallowed deduction on basis that T's security concerns were irrelevant w/ respect to whether or not T is entitled to a deduction under **8(1)(h.1).**

SPECIFIC REMEDIAL EXEMPTIONS

We looked at two specific remedial exemptions:

1. The exemption relating to board and lodging at, and travel to, a **special work site and a remote location** under **6(6)**; and
2. Allowances or reimbursements for expenses travelling long distances in respect of a PT job under **81(3.1)**

Special Work Site or Remote Location

Rule: 6(6)(a) exempts <u>value of</u>, <u>or reasonable allowance</u> in respect of, expenses that T has incurred for **board and lodging** during the period that the T is at the special work site or remote location from T's income from employment. **6(6)(b)** exempts benefits or allowances for **transportation** between a special work site and a T's principal place of residence or between a remote work location and any other location in Canada or in country in which T is employed from T's income from employment.

Test: According to **6(6)(a)(i)**, a **special work site** is a location at which T performed duties of a temporary nature [**6(6)(a)(ii)** refers to **remote location]**, but only when the following conditions are met:

- The T maintained a **self-contained domestic establishment**, at some other location, as his principal place of residence (where **self-contained domestic establishment** means a dwelling-house, apartment or other similar place of residence in which a person as a general rule sleeps and eats under **248(1)**);

- The T did not rent out his principal residence and kept it available for his occupancy throughout the whole period he was away at the **special work site**;
- The T could not, by reason of distance, reasonably have been expected to return daily from the **special work site**; and
- The period during which the T was required to be away from his principal residence was at least 36 hours.

Note that **6(6) applies to cases where there otherwise would be an inclusion under **6(1)(a)** or **6(1)(b),** but then excludes it – SO you have to undergo analysis under **6(1)(a)** or **(b)** first.

CRA's views on requirement that duties at work site be of temporary nature:

- Refers to **duration of duties** performed by individual employee, **not expected duration** of project as a whole
- Duties will be considered to be of a temporary nature **if it can reasonably be expected that they will not provide continuous employment beyond 2 yrs**. Determination of expected duration of employment must be made on basis of **facts known at its commencement**.

CRA further states that as a general rule, it will not expect someone to return to his principal place of residence if it is more than 80km from the **special work site** by the most direct normal route.

Guilbert v MNR (1991) held that a special work site had to be a **work site** (e.g. construction, forestry), and could not refer to just any place of work. This has now been overruled by *Jaffar*.

EXEMPT	NOT EXEMPT
Jaffar v R* (2002): T's employment K provided that he would work at Pennsylvania offices or, if directed, at office of clients. T was assigned to work in NY for over 1 year. Employer paid for apt in NY and expenses of travelling to Toronto on weekends to visit family. Amounts did not have to be included in income under **6(1)(b) as an allowance for personal or living expenses because they were exempt from tax under **6(6)(a). A special work site is an unusual place where an employee does his or her task; may be any place in the world, including a large metropolitan city.** **Rozumiak v Canada* (2005): T hired for 3-year term by VPA to open Chicago office. Special work site – exempt under **6(6)**. *Charun v MNR* (1983): 60 km between home and work – T worked 12 hrs/day, 7 days/week and commute would be difficult. Allowance exempt. **Consider the hours of work the employee is required to perform in carrying out his duties, the type of roadway he must travel each day, the time of day he must travel and the general physical and mental health of the T.**	*Harle v MNR* (1977): Ts sought to exclude 'subsistence allowances' paid to MLAs in AB who acquired a temporary residence in Edmonton for purpose of attending the legislative session. Ts duties were not of a sufficiently temporary nature to qualify. *Smith v Canada* (1998): 60 km commute not unreasonable. *Barrett v Canada* (1997): T held not to have principal place of residence because he split w/ wife during work period. ☹

Travel in Respect of Part-Time Employment

Rule: A T's income from employment shall not include any allowance or reimbursement paid by an arm's length employer for travel expenses incurred by the T in respect of his part-time employment w/ that employer if certain conditions are met: **ITA 81(3.1).** The expenses contemplated by **ITA**

81(3.1) are travel expenses other than those incurred by the employee in the course of his duties to the employer in question. The conditions which must be met are:

(a) the T had other employment or was carrying on a business throughout the period in which the expenses to which the allowance or reimbursement relates were incurred: **ITA 81(3.1)(a)(i);** and
(b) the T performed the duties of his PT employment at a location at least 80km from both of:
- his ordinary place of residence; and
- the place of his other employment or business: **ITA 81(3.1)(b)(i).**

81(3.1) was enacted to legislatively overturn the result of *Bouchard v MNR*.

MEALS

Rule: Under **8(4),** Ts who seek to deduct cost of meals as travelling expenses under **8(1)(h)** or under general deduction for salespersons in **8(1)(f)** must satisfy further requirement that: **meal was consumed during period while T was required by T's duties to be away, for a period of not less than 12 hours** from municipality where employer's establishment to which T **ordinarily reported for work** was located and away from metropolitan area, if there is one, where it was located.

- Note that deduction of meal expenses is also subject to limit in **67.1.**

Healy v Canada, (1979) FCA
F: T lived in Toronto and worked for Ontario Jockey Club. Head office was in Toronto. Employer from head office assigned schedules, disciplined and paid employees. T worked at 3 race tracks, 2 in Toronto and 1 in Fort Erie. T worked 2/3 time in Toronto, 1/3 at Fort Erie. While at Fort Erie T lived in a motel – received no allowance or reimbursement for expenses. T deducted costs of transportation, accommodation and meals, incurred while at Fort Erie. Claim for deduction for meal expenses was disallowed as not falling within exception in **8(4).**
L: Doesn't matter whether there is only one or several establishments in base municipality.
A: Municipality in which T usually worked was Toronto. Fort Erie was one of the different places at which he was required to work by virtue of nature of employment.
C: Deductible.
R: **Purpose of ITA 8(4) is first to find the municipality where the employee usually reports for work and second to find whether or not he was away from that municipality for more than twelve hours, so as to entitle him to the deduction.**

MOVING EXPENSES

Note that moving expenses are governed by **s 62, which is situated in Subdivision e of the Act because moving expenses may be deducted against income from <u>any</u> source.

Rule: According to **62(1),** Ts may in computing their income for a taxation year deduct 'amounts paid by the T as or on account of moving expenses incurred in respect of an **eligible relocation'** subject to a number of limitations in **paras (a) to (d).**

Moving expenses raise three major issues:

1. Do the expenses sought to be deducted qualify as **moving expenses?**
2. Is the relocation an **eligible relocation?**
3. Do any of the limitations listed in **ITA 62(1)** apply?

Storrow v Canada, (1978) FCTD
F: T moved from Ottawa to Vancouver, claimed: (1) Cost of new residence in excess of amount that he received on sale of former residence; (2) mortgage interest attributable to that amount; (3) land

registry fees paid on purchase of new residence; and (4) installation costs of dishwasher and new door locks. MNR disallowed. T's arguments were: Act uses the word 'includes' so the list is not exhaustive, everything that is caused by the move is a moving expense.
C: Disputed outlays were not moving expenses in the natural and ordinary meaning of that expression. 'Moving expenses' do not mean outlays or costs incurred in connection w/ acquisition of new residence.
R: 'Moving expenses' means the ordinary out-of-pocket expenses incurred by a T in the course of physically changing his residence.
D: Disallowance of land registry fees paid on purchase of new residence was legislatively overruled by enactment of **62(3)(f)** - land registry fees are now explicitly deductible.

Moving Expenses - 62(3)

62(3) defines '**moving expenses'** to include 'any expense incurred as or on account of':

Paragraph	Comment
(a) **travel costs** (including a reasonable amount expended for meals and lodging), in the course of moving the T and members of the T's household from the old residence to the new residence,	A dog can be a member of T's household and rabies shots and tranquilizers paid for as part of move can be travel costs: *Critchley v MNR*.
(b) the cost to the T of **transporting or storing household effects** in the course of moving from the old residence to the new residence,	Cost to move horse and horse trailer is not cost of transporting or storing household effects: *Yaeger v MNR*. Amount paid must have been paid when a T physically moves or changes her residence: *Hasan v Canada*.
(c) the cost to the T of **meals and lodging** near the old residence or the new residence for the T and members of the T's household for a period not exceeding 15 days,	See *Critchley* in (a) above. Note lack of reasonableness requirement.
(d) the cost to the T of **cancelling the lease** by virtue of which the T was the lessee of the old residence,	Has been interpreted strictly. Difference between amounts paid by T under original lease and amounts received by T under sublease were not deductible moving expenses: *Patry v MNR*.
(e) the T's **selling costs** in respect of the sale of the old residence,	Has usually been interpreted generously. Payment to replace asbestos in old residence as a condition of sale is deductible: *Trigg v Canada*. Payment to remove mold from old house not deductible – improvement: *Faibish v Canada.* See *Pollard* and *Collin* below.
(f) where the old residence is sold by the T or the T's spouse or common-law partner as a result of the move, the cost to the T of **legal services in respect of the purchase of the new residence and of any tax, fee or duty** (other than any goods and services tax or value-added tax) imposed on the transfer or registration of title to the new residence,	
(g) **interest, property taxes, insurance premiums and the cost of heating and utilities** in respect of the old residence, to the extent of the lesser of $5,000 and the total of such expenses of the T for the period	T only told family and friends that property would be for sale, and didn't want to sell until probationary period at new job had expired – not reasonable

(i) throughout which the old residence is neither ordinarily occupied by the T or by any other person who ordinarily resided w/ the T at the old residence immediately before the move nor rented by the T to any other person, and (ii) in which **reasonable efforts** are made to sell the old residence, and	efforts: *Lowe v Canada*. T's son continued to reside in old residence after he moved – not reasonable efforts: *Rosa v Canada*. T moved in April 2002; had two friends advertise that his old home was for sale between April and October; hired a real estate agent in October; and finally sold the place in December, 2002 – reasonable efforts – *Cusson v Canada*.
(h) the cost of **revising legal documents** to reflect the address of the T's new residence, of replacing drivers' licenses and non-commercial vehicle permits (excluding any cost for vehicle insurance) and of connecting or disconnecting utilities,	Cost of purchasing new cable antennae disallowed on basis that amount included equipment and installation charges, which are not provided for in paragraph since it refers to connection and disconnection costs: *Cusson v Canada*.

Postamble to **62(3)** stipulates that 'moving expenses' **does not include costs**, other than those referred to in **(f),** that are '**incurred by T in respect of acquisition of new residence'**. Unresolved interpretive issue of whether **62(3)** can be interpreted generously, or whether only those moving expenses *specifically* enumerated can be deducted. Note that **62(3)(a)** requires meals and lodging expenditures to be reasonable, and **62(3)(c)** does not. You may not deduct expenses for house hunting or job hunting: *Ball v Canada*.

**Vickers v Canada* (2011)	Legislative amendment replaced 'in the course of moving' w/ '**in respect of'** an eligible location.	Parliament did not just reshape the requirement that the expenses claimed under 62 be incurred in the course of moving, it removed the requirement entirely and replaced it w/ words of the **widest scope of any expression** intended to convey some connection between 2 related subject matters.
**Trainor v Canada* (1999)	T incurred meal and lodging expenses for 34 days before moving into new residence, for 23 days of which he was reimbursed by employer.	Allowed reimbursement of expenses for remaining 11 days. – **62(3)(c)**
Johnston v Canada (2003)		Interest on money borrowed to purchase a home in new work location is not within definition, even if loan is secured by a mortgage on home in former work location.
**Pollard v MNR* (1988)	T entered into agreement w/ mortgagee whereby he agreed to pay a higher rate of interest on new mortgage on new residence, resulting in additional interest over term of new mortgage.	Amount was a cost incurred in order to complete sale, and properly deductible under **62** as a selling cost under **62(3)(e).**
**Canada v Collin* (1990)	T paid a trust company in consideration for which trust company agreed to loan to purchaser of T's old residence at reduced rate of interest, which purchaser demanded in order to complete sale.	Payment characterized as deductible selling cost. Taxation rests on application of statute to facts as they were, not to facts as they might have been – argument that T might have reduced price of house is irrelevant. – **62(3)(e)**

Eligible Relocation - 248(1) – purpose of move, distance, residences

248(1) defines '**eligible relocation'.** In applying this definition in the context of the moving expense deduction in **62(1),** courts must consider: (1) the purpose of the relocation; (2) the residences at which the T ordinarily resided before and after relocation; and (3) the distance of the relocation.

(1) Purpose of Relocation

Rule: Relocation must 'occur to **enable**' the T to carry on a business, to be employed, or to be a FT student at a post-secondary education institution at the new work location in Canada.

- DD prefers focus on work enable
- A T may move before obtaining a new job or starting a new business and still deduct moving expenses under **ITA 62**: *Abrahamsen v Canada*.
- A T may start at the new work location, move many years later, and still deduct moving expenses under **ITA 62**: *Dierckens v Canada*.

An issue arises if the move enables the T to perform new duties at the old work location. Courts have considered whether the new duties cause a change in circumstances of T.

YES REQUIRE NEW LOCATION (taxable)	NO NEW LOCATION NEEDED (not taxable)
- *Howlett v Canada* (1998): T moved after accepting promotion that required him to spend more time at different work location. - *Broydell v Canada* (2005): T advised by employer to move closer to work after being late due to commuting problems. - **Grill v Canada* (2009): T, who had commuted to work for 10 years, sought to deduct moving expenses after separation w/ wife and move to new residence. - **Moreland v Canada* (2010): T assigned new employment duties at same location. - *Crampton v MNR* (1980): T worked at various job sites in Vancouver area, sought to deduct expenses incurred in moving from one suburb of Vancouver to another.	- **Gelinas v Canada* (2009): T switched from PT to FT work at hospital and moved closer. C: Deduction allowed. No reference in operative words to new location or new employment – T must move due to fulfilling employment requirements. Here, T's circumstances changed. - *Adamson v Canada* (2001): T moved after he obtained new position w/ employer which required him to work from home.

(2) Residences Before and After Relocation

Must determine where T 'ordinarily resides' before and after relocation. You cannot be ordinarily resident in 2 places at same time – what matters is where your ordinary mode of life is. 'Ordinarily resided' rather than 'residence' governs (*Rennie*).

- T allowed to deduct costs of selling former residence more than 2 years after acquiring new residence: *Jaggers v Canada*.

3 move-cases:

**Rennie v MNR*, (1989) TCC	**Pitchford v Canada* (1997)	**Ringham v Canada* (2000)
TAXED	NO TAX	NO TAX
Montreal -> Edmonton -> Victoria	Victoria -> Moose Jaw -> Saskatoon	Kanata -> Kanata -> Richmond Hill
T employed at McGill for one year, then moved to UofA in Edmonton in 1981 but unsure of K length, so did not sell Montreal house, and rented apartment in Edmonton. Then moved to UVic in 1983, and after K	T moved from Vic to Moose Jaw, and then Moose Jaw to Saskatoon. Sought to deduct expenses incurred in	T accepted offer to work in Hungary, sold home in Kanata and rented condo in Kanata, while

renewed, decided to make it permanent residence. On 1981 tax return, claimed moving expenses from Montreal to Edmonton to move stuff-allowed. On 1983 tax return, claimed moving expenses from Edmonton to Victoria to move stuff-allowed. On 1984 tax return, claimed old employer as McGill and new employer as UVic, but claimed former residence as Montreal residence (to include costs of selling home $$ and moving balance of effects). C: Deduction disallowed. Ordinary residence prior to move to Victoria could not be Montreal.	transporting furniture, most of which remained in storage until T moved to Saskatoon. C: On basis that T and family had no settled **routine of life** where they regularly, normally or customarily lived until they settled in Saskatoon, deductions allowed.	travelling weekly to employer in Thornhill where he stayed at hotel. When Hungary project was cancelled, T moved to near Thornhill and started working FT there. C: Only one move from Kanata to Thornhill – deduction allowed.

2-move cases:

**Calvano v Canada* (2003)	**Neville v MNR* (1979)
TAXED	NO TAX
Brampton -> Coquitlam	Peterborough -> Winnipeg
T moved from Brampton to rented house in Coquitlam, but delayed selling house in Brampton for 16 months after renting it to tenant. C: Deduction of selling costs for Brampton house disallowed because T ordinarily resided in Coquitlam.	T accepted temporary position in Winnipeg in 1973, sought to deduct moving expenses in 1975 when he resigned from prior FT post and moved to new home in Winnipeg. C: Deduction allowed – T's domestic arrangements during period prior to tendering resignation from FT post were temporary.

Temporary Work Cases:

**Cavalier v Canada* (2001)	*Persaud v Canada* (2007)	**Turnbull v Canada* (1998)	**MacDonald v Canada (*2007)
NO TAX	NO TAX	TAXED	TAXED
Delta -> Fort McMurray -> Delta	To and from AB		Cape Breton -> AB -> Cape Breton
T accepted teaching K that required move from BC to AB for 4 months. C: Allowed deduction of moving expenses to and from AB, even though wife remained in BC, mail was delivered to BC and did not change bank account.	Expenses incurred for T to travel to and from AB. C: Deduction allowed – T resided in AB for 4 months, opened bank account there and children lived there.	T maintained home in Newfoundland - worked in Edmonton; various locations in BC and Yellowknife. C: Disallowed deduction of moving expenses to and from BC on basis that T was at all time ordinarily resident in Newfoundland.	T worked in AB for 6 weeks. C: T was ordinarily resident in Cape Breton. Consider: driver's license, health insurance, partner stayed in NS.

Misc:

Klein v Canada (1997)	T owned 2 homes in Montreal, one was purchased to accommodate wife in wheelchair. Sought to deduct cost of selling both homes when he moved to Van.	Disallowed deductions for moving expenses related to accessible home.
Templeton v	T worked out of home, sought to deduct	Deductions allowed on basis

Canada (1997)	expenses incurred in moving from 2 residences to a rented house elsewhere.	that T needed to be closer to business contacts at new location.

(3) Distance of Relocation
New residence must be at least 40 km closer to new work location than old residence (**248(1),** definition of **eligible relocation**, para **(c)**). **Shortest normal route** is preferable test to straight-line (crow flies) method, for it is both realistic and precise (*Giannakopoulous v MNR*). This is intended to be an objective test combining:

- The notion of a normal route to the travelling public; w/
- The idea of the shortest route one might travel to work

Higgins v Canada (1995)	Deduction disallowed - 'shortest normal route' from old residence to new work location was by ferry a distance of 15-20 km, even though it may have been inconvenient.
**Nagy v Canada* (2007)	**Reason and common sense** should play a part in determination of distance - rejected a 40 road zigzag approach suggested by revenue authority.
**Lund v Canada* (2010)	Test is based on distance of the shortest normal route. **Test is not based on route which takes the least amount of time.**

Limitations - 62(1)

The T may not deduct, in a given taxation year, a greater amount in moving expenses than he earned as income from business or employment for the taxation year at the new work location: **62(1)(c).**

- BUT the T may carry forward undeducted moving expenses that were ineligible for deduction in the preceding taxation year and deduct them in the subsequent taxation year. **62(1)(b)** allows unlimited carry-forward.
- A necessary implication of **62(1)(c)** is that a T may not deduct moving expenses 'against' income from property. See e.g. *James* below.

The T may not deduct any moving expenses paid on his behalf in respect of employment under **62(1)(a)**. BUT he may deduct the value of allowances and reimbursements for moving expenses to the extent that these allowances and reimbursements are included in his income: **62(1)(d)**.

Hippola v The Queen, (2002) TCC
F: T commenced employment in Waterloo. While so employed, T rented in Waterloo while wife and children stayed in Navan. T then decided to move to Ottawa to start consulting business. While in process of setting up business, T was offered job and hired and moved back to Navan.
A: T ordinarily resided in Waterloo. Since T's intention of working towards setting up his business, he has not gained any income from that business, nor has the business got off the ground. T is not entitled to deduction of any amount since his income for year from his business was nil.
C: Deduction disallowed.

James v Canada (2001)	T moved from AB to BC, accepted offer to provide IT services under agreement that required him to incorporate company through which to provide services. T received no salary from his company, and instead withdrew funds in form of dividends against whim he sought to deduct moving expenses.	T could have deducted expenses had he withdrawn sufficient funds from company in form of salary rather than dividends.

OFFICE RENT

Rule: Under **8(1)(i)(ii),** Ts may in computing their income from an office or employment deduct amounts paid by the T in the year as **office rent** – the payment of which by officer or employee was required by K of employment. Under **8(1)(i)(iii)**, Ts may in computing their income from an office or employment deduct amounts paid by T for the **cost of supplies** that were consumed directly in the performance of the duties of the office or employment, and that T was required by K of employment to supply and pay for.

- Deduction for office rent likely not allowed where T owns property: *Felton, Thompson*, and other cases, but accepted in *Prewer*.
- According to IT-352R2, the deduction for cost of supplies may allow for deduction of some home office expenses such as fuel, electricity, light bulbs and cleaning supplies.

Limitation: **8(13)(a)** stipulates that, notwithstanding **8(1)(f) and 8(1)(i):** no amount is deductible … in respect of… a self-contained domestic establishment in which the individual resides, except to the extent that the work space is either
(i) the place where the individual principally performs the duties of the office or employment, or
(ii) used exclusively… for the purpose of earning income… and used on a regular and continuous basis for meeting customers…

- Where the conditions stipulated in **8(13)(a)(i) and (ii)** apply, **8(13)(b) and (c)** prohibit the deduction of these home office expenses to the extent that they exceed the individual's income for the year from the office or employment otherwise determined, allowing the T to claim these disallowed losses as deductible expenses from the office or employment in subsequent taxation years.

Prewer v MNR, (1989) TCC
F: T worked for Inis – for 15 years as admin assistant. Inis started experiencing difficulties, so T agreed to take on extra work in sales. T agreed to do sales work during office hours (office was very crowded) and admin work after hours at home. T converted use of 1 bedroom to office – deducted 1/3 cost of maintaining townhouse, not including mortgage interest or capital cost allowance. Employer signed tax form stating that she was required to maintain office in home. Minister disallowed deduction – T wasn't required to have a home office, office was provided by employer, no rent if T owns the home, costs weren't reasonable under **67.**
A: T's duties changed – became required to maintain office in home at her own expense. Requirement was implicit in acceptance of sales responsibilities. Would be an absurdity if you could deduct for renting of neighbour's office space, but not your own. Office was only 1/10 of townhouse and didn't use a lot of utilities.
C: Appeal allowed in part. Not more than 10% of residence expenses can be fairly attributed to 'home office'.
R: Reasonable expenses of using space in one's own home to meet a requirement for office space away from an employer's establishment are deductible under 8(1)(i)(ii).
D: *Felton* is probably better law than *Prewer.*

**Felton v MNR* (1989); Same approach in *Thompson v MNR*, (1989)	T maintained office in home as required by K of employment, deducted 1/6 of household expenses as office rent under **8(1)(i)(ii).**	**Office rent can only arise from a landlord and tenant relationship** – disallowed the deduction. Act does not permit T to deduct expenses incurred in home as office rent because under this K of employment he is required to have an office and be responsible for costs associated w/ office; such expenses were not payments of rent.
Haltrecht v Canada (2000)	T, part-time lecturer at York who was not allocated office, deducted 14% of	T had satisfied requirement under **8(13)(a)(i)** by working 20 hours a week at home.

	utilities and maintenance costs of his home, which Minister disallowed.	

CHILD-CARE EXPENSES

Note that childcare expenses are governed by **s 63, which is situated in Subdivision e of the Act because moving expenses may be deducted against income from any source.

Rule: According to **s 63**, Ts may, subject to a number of limitations, deduct in computing the T's income for the year such amount as the T claims not exceeding the total of all amounts each of which is an amount paid, as or on account of child care expenses incurred for services rendered in the year in respect of an eligible child of the T.

- **Eligible child** is defined in **63(3)**: Child of T or T's spouse or CL partner or a child dependent on T or T's spouse or CL partner for support whose income does not exceed the basic personal amount in **118(1)(c)**, provided that the child is at any time during the year under 16 years of age or mentally or physically disabled.
    - Also see extended definitions of **spouse** and **child** in **252** and the definition of **CL partner** in **248(1)**

Test: Child care expense is defined in **63(3)**. In order to satisfy the definition:

1. The expense must be for the purpose of providing **child care services**, including baby sitting services, day nursery services, or services provided as a boarding school or camp
2. The child-care services must be provided to **enable the T, or the supporting person** of the child for the year, who resided w/ the child at the time the expense was incurred to perform the duties of an office or employment, carry on a business or research in respect of which the T or supporting person received a grant, or attend a qualifying program at a secondary or post-secondary educational institution; and
3. The child-care services must be provided **by a person other than** the child's father or mother, a supporting person of the child, a person under the age of 18 who is related to the T, or a person in respect of whom a personal tax credit is deducted in computing the tax payable by the T or by a supporting person of the child.

Child-Care Services

The Act does not define **child care services**.

Levine v Canada, (1995) TCC
F: T was flight attendant. Worked 18 days on, 12/13 days off. But she was on-call on the days off. Husband was accountant. T and husband had 2 children – then T gave birth to twins. They had live-in nanny who generally didn't work weekends – but then nanny quit. T wanted to deduct finder's fee they paid to agency that found new nanny and a variety of expenses for recreational activities such as ballet and swimming incurred while T was on leave from work. Minister refused these deductions.
A: Finder's fee is deductible because it was incurred in part for purpose of providing child-care services in Canada. Recreational expenses are not deductible – incurred to develop physical, social and artistic abilities of the children.
C: Appeal allowed in part.
R: **Not all expenses incurred for care of children are deductible. The test is whether they are incurred for the purpose of watching over children to protect them, and ∴ to enable the parents to earn income from employment. Not eligible if expenses would be incurred whether or not parents were working. More likely not to be childcare services if only for limited periods of time. Consider what the primary purpose is of the service.**

**Acharya v Canada, (1996)*	Deductions allowed. Even if some education, musical or other, was involved – not sufficient in itself to hold that amounts cannot qualify as child care.	
**Bailey v Canada, (2005);* Similar result in *Jones v Canada, (2006*) [gymnastics]	T enrolled daughter in private education academy because she was barely too young to be enrolled in primary year of public school.	Deduction allowed. Expenses were paid not 'for' education, but for reasonably priced childcare services. Any education received was an incidental benefit. Look to <u>principal purpose</u> of expenditure.
**Lessard v Canada*, (2003)	Act does not require that parent's choice of child care services be justified by parent's work needs. Act does not require that questions be asked about whether a particular form of child care is chosen on basis of parent's work needs or child's needs.	

Purpose of Services
D'Amours v MNR, (1990) TCC F: While on maternity leave, T received benefits to which she was entitled under unemployment insurance scheme and employer made up difference – 95% of salary. T hired babysitter that overlapped 4 months w/ T's maternity leave – in part because T didn't want babysitter to find job elsewhere. L: Definition of earned income includes sums received by T from her employer during her maternity leave. A: Babysitter was employed for purpose of enabling T to perform her duties and not for strictly personal reasons. Costs that T had to continue to pay during her leave in order to ensure that babysitter was still available when T returned to work. May happen that parents are unable to dismiss a babysitter or interrupt day care services not merely for personal reasons but because of economic reality **– purpose here was to allow T to earn income in future.** C: Expenses were incurred for purpose of employment. Appeal allowed.

**McCluskie v Canada, (1994)* [Contrast w/ *D'Amours*]	T applied for migrant worker to come work as nanny and hired her when she arrived in Canada, 2 months before end of maternity leave.	Deduction disallowed for 2 months. Costs that a T incurs during leave while she/he is at home in order to ensure that the babysitter be available when T eventually returns to work may be described as a 'standby fee'. This is a personal convenience to the parent.
**McLelan v Canada, (1994)*	T, who was on maternity leave, sought to deduct payments made to nanny who was hired immediately when she became available for fear of losing her and not being able later to find a good nanny.	Deduction allowed. **Owing to market conditions** relative to securing a good nanny, especially in her residential area, she felt that it was the most prudent thing to do to hire the nanny in question as soon as the nanny was available.
**Sawicki v Canada, (1997)*	T, who suffered from depression but was able to work, sought to deduct as child-care expenses amounts paid to nephew to care for children on weekends and holidays. T argued that this childcare was necessary in order to enable her to work.	Personal expense, not childcare expense.
**Labreque c Canada,*	Parents of an autistic child sought to deduct cost of babysitting services on	Distinguished *Sawicki*. W/o childcare services on Saturdays, T would have to

(2007)	Saturdays when they did not work.	give up employment or go down to PT.

Child-Care Providers

Categories of ineligible providers seem to be designed to prevent income splitting within the family unit.

Clogg v Canada, (1997) TCC
F: Day care centre into which children of T were placed was operated by his wife, the children's mother, as a sole proprietorship. Minister disallowed deduction of child care expenses.
C: Child care expense may not be claimed.
R: **A sole proprietorship is carried on personally by the individual owning the proprietorship. It is not a separate and distinct entity such as a corporation.**

Limitations on Deductibility

S 63 contains 3 general limitations on the deductibility of child-care expenses:

1. Under **63(1)(e)(ii)** and the definition of '**annual child care expense amount'** in **63(3),** amount that may be deducted cannot exceed $10K per year for each disabled child, $7K for each child who is under 7 years of age at end of year and $4K for each other eligible child.
2. Under **63(1)(e)(i),** amount that may be deducted cannot exceed 2/3 of the T's 'earned income for the year' as defined in **63(3).**
3. By virtue of **63(2)** and **63(1)(c),** deduction must generally be claimed by the parent or other supporting person w/ the lower income.
    - **Supporting person** is defined in **63(3)**: in relation to an eligible child of a T as a person, other than the T, who is the child's parent, the T's spouse or CL partner, or an individual who claimed the child as a dependent for the purpose of calculating tax credits under **s 118,** provided that this person resided w/ the T at any time during the year and at any time within 60 days after the end of the year.
    - **63(2)(b)** allows for some cases when higher income earner can deduct certain amounts.

Reinstein v Canada, (1995) TCC
F: M and R are married. Issue is whether M is entitled to a deduction of child care expenses for 1992, and whether R is entitled to a deduction if M is not entitled.
C: No deductions allowed. R was the supporting person – has no earned income – so M is entitled to no deduction. R could deduct childcare from own income, limited to lesser of fraction of earned income (zero) and $4K/year for each child. ∴, R is entitled to no deduction.

In a number of cases, deductions for child-care expenses have been limited or disallowed altogether on basis that amount claimed exceeded 2/3 of T's earned income:

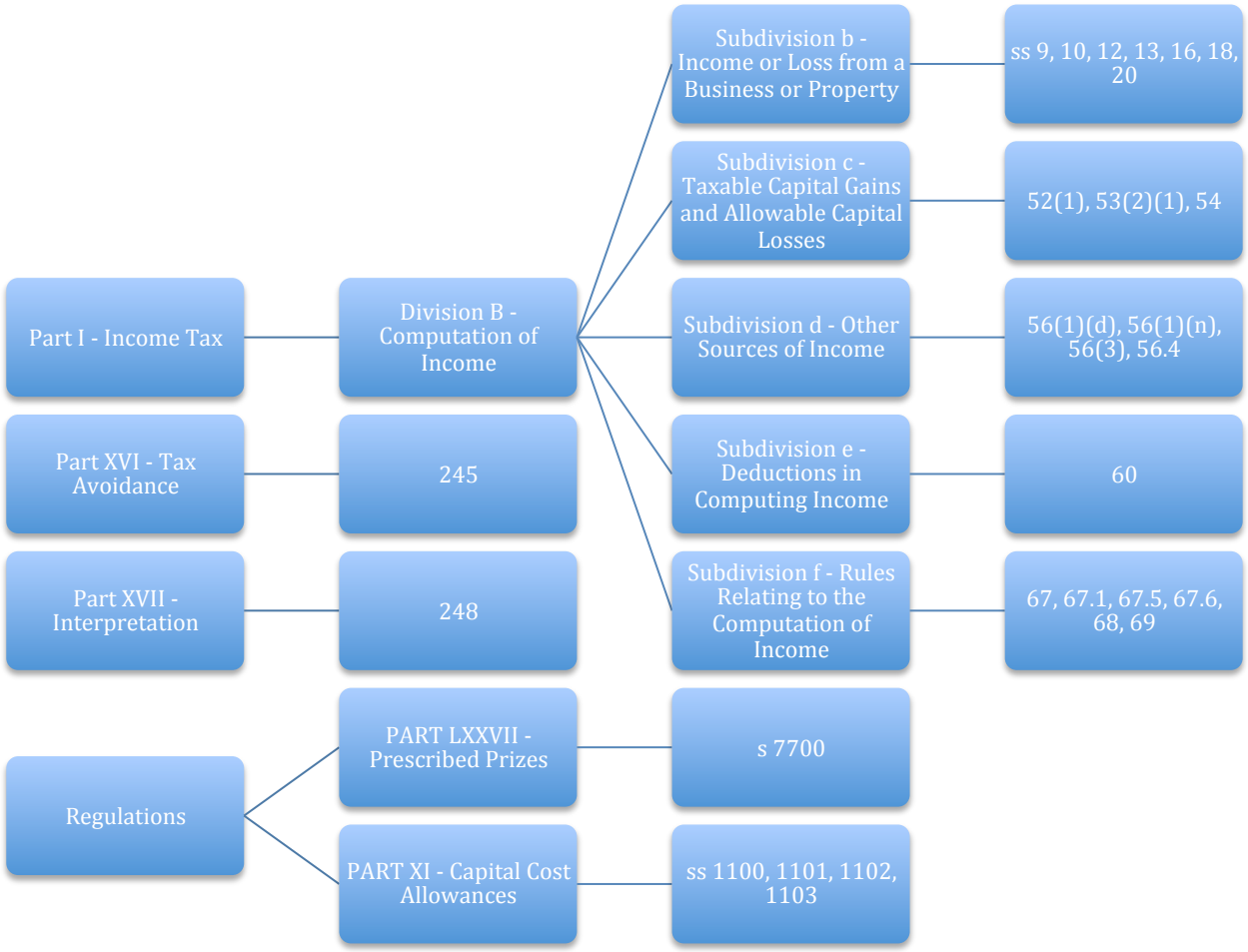
Lederhouse v Canada, (1993)	T sought to deduct child-care expenses during year in which income was mostly employment insurance and RRSP – argued that in order to remain employable, it was necessary to sustain childcare.	Deduction disallowed.
Matsi v Canada, (1994)	T started new business and had not yet made income. T sought to deduct child-care expenses from income comprised of RRSP funds.	Deduction disallowed.
McCoy v Canada,	T participated in job creation project for which she received	Deduction limited to 2/3 of employment income.

(1996)	unemployment insurance benefits.	
Metcalf v Canada, (1995)	T reported employment income of $50 K, while husband who was attempting to establish new business reported $10K income derived from redemption of RRSP to invest in business.	Deduction by T disallowed because husband has lower income.
Canada v Copeland, (1993)	T, whose wife was not employed and had no income, sought to deduct $1.5K in fees for daughter's attendance at Montessori.	To suggest that the work of a parent who stays at home for the sake of his or her children is any less onerous or important than that of one who chooses to join the workforce would be to belittle one of society's most sacred institutions. The choice, commendable as it may be, is, however, a voluntary one and it carries w/ it benefits and burdens…
Fiset v MNR, (1988)	Court accepted T's argument that no income did not count as the lower income in a couple. **In response, s 3 was amended to stipulate in 3(f) that where a T has no income, the T shall be deemed to have income for the year in an amount equal to zero.**	

DISABILITY SUPPORTS DEDUCTION

S 64 allows full deductibility of eligible expenses up to an amount of income earned as a result and recognizes a greater array of expenses than the previous 'attendant care expenses'.

INCOME OR LOSS FROM A BUSINESS OR PROPERTY AND OTHER INCOME



Characterization

3(a) of the ITA identifies each 'business' and each 'property', in addition to each office and employment, as sources of income from which Ts must include any income in computing their net income. **3(d)** permits Ts to deduct their losses from each business or property. The computation of a T's income or loss from a business or property is governed by subdivision b of Division B of Part I of the Act (**ss 9-37**). Where a T realizes a gain, it is to his advantage to argue that the gain is not contemplated in the Act OR that the gain originated from disposition of capital rather than business/property. Where a T suffers an economic loss, the converse is true.

Property is property of any kind whatever whether real or personal or corporeal or incorporeal.

- Meaning of property is pretty noncontroversial.

Business under **248(1)** includes a profession, calling, trade, manufacture or undertaking of any kind whatever and… an adventure of concern in the nature of trade but does not include an office or employment.

- For the purposes of the ITA, the concept of a **business** comprises both the ordinary meaning and the extended meaning set out in **248(1).**
- The distinction between income from a business and income from property generally depends on the degree of activity involved in producing the income.
- Meaning of business has been subject to some litigation. This is the main characterization question in the business and property context.

The main characterization issues boil down to:

1. Is a particular ongoing activity a business?
2. Is a one-off or temporary undertaking an ACNT so as to qualify as a business?

The REOP test is a tool that can be used to assist in answering the above two questions.

IS IT A BUSINESS?

Test: Courts often begin their inquiry w/ the definition of business given in *Smith v Anderson* (1880): Anything which occupies the time and attention and labour of a man for the purpose of profit is business.

- Subjective: Person's purpose is profit
- Objective: Person's efforts are organized – occupation of time, attention and labour

Commercial versus Personal: The REOP Test

Canadian courts have frequently supplemented the subjective profit-making purpose test for the existence of a business or property source w/ an objective REOP test to govern the deductibility of losses for a business or property.

The first question in determining whether there is a business or property source of income is whether T is carrying on the activity in a commercial manner. **Where the activity is clearly commercial, it necessarily involves the pursuit of profit and no further analysis is required.** BUT where the activity has a personal or hobby element, the SCC held in *Stewart* that the **commercial manner test** is only met when:

1. The T's predominant intention is to make a profit; and
2. The T carried out the activity in accordance w/ objective standards of businesslike behavior.
    - One objective **factor** that can help to determine whether T is following objective standards of businesslike behavior is whether the activity is being conducted w/ a **REOP**. As w/ all factors, REOP is not conclusive, but can assist in determining whether T is carrying on the activity in a commercial manner. (*Stewart*).
    - Other objective factors to consider (not exhaustive – from *Moldowan*): (1) the profit and loss experience in past years; (2) the T's training; (3) the T's intended course of action; and (4) the capability of the venture to show a profit.

Stewart v Canada, (2002) SCC
F: T, a TTC bureaucrat, bought 4 condos by leveraging to the hilt ($1,000 down for each unit). T bought the units to rent to arm's length parties and projected negative cash flow and income tax deduction of interest costs over a ten-year period. i.e. Projected that T would lose money over 10 years.
The rental experience ended up being somewhat worse than expected, so T took several actions to consolidate financially: he sold one of the condos to pay down debt on the others, and set up his own management company when the company he had been using before did a poor job of attracting tenants. At other times, however, T chose not to pay down debt when he clearly had the money w/ which to do so. After a few years of deducting interest expenses against income from business, T was reassessed by the Minister on the basis that he wasn't running a business because he had no REOP and had purchased the properties as a tax shelter.
L: The activity which T claims constitutes a source of income must be distinguished from particular deductions that the T associates w/ that source. An attempt by T to deduct what is essentially a personal expense does not influence the characterization of the source to which that deduction relates. **The profitability of the activity to which the expense relates does not affect the deductibility of the expense.**
A: When something is clearly commercial, it can't be struck down based on REOP.

C: T's activity was clearly commercial. The fact that there was no personal element was never questioned. ∴ it constitutes a source of income and the only remaining question is to classify it as business or property.
R: **Where the nature of T's venture contains elements which suggest that it could be considered a hobby or other personal pursuit, but the venture is undertaken in a sufficiently commercial manner, the venture will be considered a source of income.**
Two-step approach to source question:
(1) Is the activity of the T undertaken in pursuit of profit, or is it a personal endeavor? Is there evidence to support intention of profit?
(2) If it is not a personal endeavor, is the source of the income a business or property?
D: Condominiums in *Stewart* had all the hallmarks of a tax shelter, because they were acquired primarily w/ borrowed money and were projected to generate tax losses for a 10-yr period.

Walls v Canada (2002)	Ts invested in a limited partnership that had been structured as a tax shelter designed to generate tax losses that investors could use to offset income from other sources.	Rejected Minister's application of REOP test to disallow losses on basis that Partnership purchased and maintained an ongoing commercial operation.
Quebec (Deputy Minister of Revenue) v Lipson (1979)	T was 1/9 shareholders of company incorporated for purpose of operating apartment building. Company lost $50K in 6 months. As a result, shareholders formed a syndicate or joint venture that leased the building from the company under an arrangement that, in effect, shifted the losses from the company to the members of the syndicate. T admitted that sole purpose of transactions was to enable the members of syndicate to deduct the rental losses in computing their net income.	Disallowed T's share of syndicate's losses as a deduction in computing his income for purposes of provincial income tax. Purpose of transaction was not a genuine business purpose to make a profit, but a purely tax-motivated purpose.
Mason v MNR (1984)	T required by teaching position to live on premises. Incurred losses from renting out house during period that he was required to live at the school.	House had been maintained for T's own benefit and disallowed deduction of rental losses on basis that rental operation was not carried on w/ reasonable expectation of profit.
Morris v Canada (2003)	T claimed substantial losses relating to fishing guide activities. Had only had 2 clients over 6 yrs, but claimed all expenses for use of boat.	T's activities had a very substantial personal element. T was not engaged in an activity that could seriously be described as businesslike. *Stewart* applied.

- Feds have proposed statutory REOP, but it still has not taken effect.

It may be that where a T ordinarily carries on a business doing a very specific activity, one-off (or two-off) profits from a similar activity may escape characterization as business income.

**Cameron v MNR* (1971)	T, self-employed fisher engaged principally in fishing, joined w/ other fishers on 2 occasions to capture killer whales and sold them to aquariums.	T was a professional fisherman and not a whaler, and that the 2 occasions were fortuitous and not a business venture in the usual sense. Not taxable under ITA.

Gambling Cases

In gambling cases, the courts have distinguished between business and hobby based on the kind of organization that the gambler brings to his efforts (implicitly considering REOP) plus the gambler's subjective dominant purpose.

- In *Graham v Green (Inspector of Taxes*) (1925): the court distinguished between **organized effort involved in a bookmaker's taxable vocation** and **the betting, pure and simple of the gambler** for whom betting is a habit or addiction.

**Leblanc v Canada* (2006)	Ts were brothers who wagered heavily on sports lottery games. They figured out a system to win a ton of money. They hired helpers to buy lottery tickets and sued the ON Lottery Corporation to make them accept their lottery tickets in garbage bags.	Despite remarkable nature of brothers' financial success, fact that they had no occupation other than playing sports lotteries, and the long-term nature of their successes, court held that their winnings are not taxable (Ts brought in expert witness who said it was pure chance). BUT losses from gambling are not deductible either.
**MNR v Morden, (1961) Ex Ct*	From 1935 to 1957, T owned the Morden Hotel in Sarnia. 1942– 1948: T owns a racing stable and race horses and is an inveterate gambler particularly on horse racing. His gambling activities are "extensively organized and occup[y] much of his time". Operating the hotel in this period is not his only, or possibly even his main, business interest. 1948: T disposes of horses, loses all interest in horse racing, gambles less. BUT he still makes money gambling: once betting on the Grey Cup playoffs, plus various card games both for large and small stakes. T argues not taxable because winnings are a windfall.	Objective: There is a distinction between a bookmaker who organizes his efforts around "**aggregate odds**" and a player who simply expects to be more skillful than his opponents. Subjective: Profit-making purpose is not T's dominant purpose in gambling. After 1948, gambling was T's hobby, not his business. **To be taxable, gain must be derived from carrying on a 'business'. Each case must depend on its own particular facts.**

Treasure Hunting Cases

Gains from treasure hunting have been held to be taxable business income. BUT unlike the gambling cases, the flip-side of the taxing treasure hunting profit as business income is that losses from treasure hunting are deductible.

**MacEachern v MNR* (1977)	T carried out search for and recovery of treasure from a sunken ship.	In circumstances, the search had the characteristics of a well-organized business endeavor – taxable.
**Tobias v Canada* (1978)	T was involved in unsuccessful search for treasure.	Operation was of a commercial nature – costs of search allowed to be deducted as losses from a business.

IS IT AN ADVENTURE OR CONCERN IN THE NATURE OF TRADE?

Category of **'adventure or concern in the nature of trade' (ACNT)** has been a source of considerable litigation, constituting the main boundary between characterization as income or loss from a business on the one hand and a capital gain or loss on the other. Trade =/ ACNT (*Taylor*)

Test: The following factors are identified in *Taylor* as indicia of adventures or concerns in the nature of trade (depends on character and surrounding circumstances and no single criterion can be formulated):

Indicia of ACNT	**Factors which do not negative ACNT**
1. **Manner of dealing**: Does the transaction look like what people who are in the business of doing that activity do? E.g. Soliciting customers, holding period (typically traders buy and sell fast), REOP 2. **Subject matter:** Does the nature and quantity of the commodity stamp the transaction as a trading venture? (e.g. You're not going to use a huge quantity of TP or lead personally) [3. **Subjective intention to profit:** Does the T intend to sell at a profit? (*Regal Heights*: Even a secondary intention may suffice) – this isn't absolutely necessary for ACNT]	- **Singleness or isolation** of the transaction ("an" ACNT) - **Lack of organization** set up to put transaction into effect - **Lack of altering** subject matter of transaction to make it saleable - **Total difference in nature** between the transaction and T's other activities (e.g. here fact that T's purchase of lead relates to his employment is not totally crucial to identifying it as ACNT) - **Lack of subjective intention** to sell subject matter at a profit – it is what T actually did that must be considered

- **A secondary intention to profit, in the sense that T would not have engaged in the transaction but for the possibility of profit, may result in a transaction being characterized as an ACNT** (*Regal Heights*)

MNR v Taylor, (1956) Ex Ct
F: T is the president and general manager of Canada Metal Company (CMC), a wholly owned subsidiary of a US-based corporation called National Lead Company (NLC). CMC makes various products out of lead. NLC does not permit CMC to have more than a 30-day supply of raw materials on hand. CMC was having various difficulties w/ its Canadian lead supplier. Then, in 1949, lead prices fell precipitously, declining by almost 1/2 over three months. T asked NLC if CMC could take advantage of the drop by buying foreign lead for three months' future delivery. When NLC refused permission, T decided to do it himself. He personally bought 1,500 tons of lead requiring 22 train carloads to carry and sold it to CMC through brokers, netting a profit of $84K, on which the Minister assessed tax on the basis that T had engaged in an ACNT. T defends that he had no subjective intention to profit.
A: It was a bold adventure that was highly successful for CMC and himself. The nature and quantity of the subject matter (1,500 tons of lead) exclude any possibility that the transaction was of an investment (i.e. capital) nature. The commodity involved stamps the transaction as a trading transaction. Furthermore, T dealt w/ the lead as any dealer in imported lead would have done. T's lack of intention to profit, if true, is irrelevant.
C: T's purchase of lead was an ACNT.

Note on property: The Act divides property into 2 categories depending on the consequences: inventory **(248(1))** and capital property (**54).** If it's ACNT, then the property is inventory. Capital property can be divided into 2 categories: investment property and personal use property.

Stringham Farms Ltd v MNR (1977)	T, which operated a feed lot for cattle, owned land on which cattle were grazed, sold cattle for slaughter, and bought and sold future Ks in cattle, rapeseed, soybeans, and barley.	Characterized transactions in cattle futures as part of T's principal business and transactions in other futures Ks as ACNT. Purchase of commodity futures are by nature short-termed and highly speculative. T was not making a long-term investment but was seeking to make a profit on a purchase and quick sale of the commodities.
**Regal*	T acquired land in Calgary for the	The possibility of re-selling the land at a profit

Heights Ltd v MNR, (1960) SCC	purpose of developing a shopping centre, but ultimately subdivided and resold it at a profit when the emergence of a nearby competitor reduced the viability of the planned shopping centre.	was one of the motivating considerations behind T's decision to acquire the land in the first place. This secondary intention to resell the property made the resulting profit business income, not a capital gain.

Where T is a legal entity:

Anderson Logging Company v BC, (1924)	Presumption that activities consistent w/ stated objects of a corporation were necessarily carried out in the course of the corporation's business.
Sutton Lumber and Trading Co Ltd v MNR, (1953)	Question to be decided is what was in truth the business T did engage in.
Regal Heights v MNR, (196)	Interest and intentions of T corporation are identical to those of controlling shareholders or directing minds.

- In a more widely held company, the corporation's purposes are generally those of the natural persons by whom the company is managed and controlled, such as the directors.

Inclusions

According to **s 9(1),** a T's income from a business or property is the T's '**profit**' from that business or property. Profit is a net concept implying the deduction of reasonable expenses incurred for the purpose of gaining or producing the T's income from the business or property from the gross revenues obtained by the business or property.

The Act does specify certain mandatory inclusions, but for the purposes of this course the only ones that concern us are the interest income inclusion under **ITA 12(1)(c)** and the royalties inclusion under **ITA 12(1)(g).** The remainder of the inclusions in this section are based on the income-as-profit concept from **ITA 9(1).** On an exam, base any argument for the inclusion of a revenue item on **ITA 9(1)** unless the issue is whether or not it constitutes interest income or royalties.

Item	Page	Business Context	Notes
Gains from illegal activities	50	Taxable	
Damages and other compensation	50	May be income, capital, or a windfall depending on facts. Courts have applied surrogatum principle.	
Voluntary Payments	52	If for services rendered	
Prizes and Awards	53	Taxable	See also **56(1)(n)**
Non-Competition Payments	**Error! Bookmark not defined.**	Taxable	
Interest Income	56	Taxable	Issue is whether it <u>is</u> interest
Royalties	59	Taxable	Issue is whether it <u>is</u> royalties

INCOME FROM BUSINESS AND OTHER INCOME

Gains from Illegal Activities

Business income from illegal activities is taxable.

No 275 v MNR, (1955) TAB
R: The issue is not the means taken by T to earn the income, but whether or not the income is liable to taxation under the taxing statute. **Once the courts are satisfied that the income is liable to tax, it is immaterial whether it comes from a legal or an illegal business.**
D: Taxing an activity =/ participating in or condoning that activity.

Damages and Other Compensation

Damages awards, settlements, and other compensation received by a business can conceptually be categorized as having an income nature, a capital nature, or being merely a windfall.

- **Where a compensation payment stands in place of revenue that would have been included in income, the courts will apply the *surrogatum* principle and treat is as a taxable inclusion to income:** *Manley, Donald Hart Ltd, Prince Rupert Hotel, BC Fir*; and 30% of the payment in the *MV Donna Rae* case.
- **Where the payment replaces something that can be characterized as a capital asset, the courts will treat it as a non-taxable payment in the nature of a capital receipt:** *HA Roberts Ltd;* and 70% of payment in the *MV Donna Rae* case.
- **If the payment cannot be characterized as having an income nature or a capital nature, it is a windfall. Such a characterization has been given to punitive damages payments from a statutory body:** *Bellingham v Canada, Cartwright*.

A compensation payment may also be mixed income and capital: *MV Donna Rae Ltd*.

Test (*London & Thames)***:** The **surrogatum** principle applies where:

- Pursuant to a legal right, a trader receives
- Compensation for not receiving a sum of money
- Which, had it been received would have been treated as income from business

CRA Bulletin states that the following factors are important in making distinction between whether receipt of damages relates to loss of income-producing asset (capital receipt) or loss of income (business income):

1. If compensation is received for failure to receive a sum of money that would have been an income item if it had been received, the compensation will likely be an income receipt.
2. Where, e.g., structure of recipient's business is so fashioned as to absorb shock as one of normal incidents to be looked for and where it appears that the compensation received is no more than a surrogatum for future profits surrendered, compensation received is in use to be treated as a revenue receipt and not a capital receipt
3. When rights and advantages surrendered on cancellation are such as to destroy or materially cripple the whole structure of the recipient's profit-making apparatus, involving the serious dislocation of the normal commercial organization and resulting perhaps in cutting down of staff previously required, recipient of compensation may properly affirm that compensation represents price paid for loss or sterilization of a capital asset and is ∴ capital and not revenue receipt.

Prince Rupert Hotel (1957) v Canada (1995)	T received a lump sum in settlement of a legal action alleging negligence on the part of the T's solicitors in drafting a partnership agreement.	Business income. It replaced management fees to which the T would otherwise have been entitled.

**MV Donna Rae Ltd v MNR* (1980)	T received $60K from gov't of USSR in settlement of a claim for destruction of fishing gear and loss of income after a settlement of a claim.	Compensation was primarily for lost lobster traps and secondarily for lost profits – divided damages into two categories w/ different taxation.
**The BC Fir and Cedar Company Ltd v MNR* (1929)	T, which carried on a business as a manufacturer and dealer in lumber products, received insurance proceeds for lost profits and for fixed charges after plant was destroyed by fire.	Both payments are income from T's business. **Characterization as business income if compensation for lost profits.**
**HA Roberts Ltd v MNR* (1969)	T, which carried on a real estate business in course of which it managed mortgages for corporate clients received $ from clients when they discontinued long-term Ks w/ T.	Court characterized T's mortgage department as a separate business that ceased to exist, and Ks themselves as 'capital assets'. Accepted T's argument that payments were non-taxable capital receipts. Even it wasn't a separate business, the K was such a significant K that it itself was a capital asset (lower threshold for T to establish) – ∴ compensation for loss is capital receipt, not business income.
Bellingham v Canada (1995)	T received $ under *Expropriation Act*, which requires expropriating authority to pay additional compensation to persons whose land is expropriated under certain circumstances.	Payment was a non-taxable windfall – punitive damage award – not compensating for loss of land, but rather punishing the expropriating authority.
Cartwright & Sons Ltd v MNR (1961)	T sued Carswell for stealing list of lawyers – infringement of copyright – and was awarded damages.	Punitive damages award – don't put you back in the position that you were in, rather they are just a windfall.

- Re: *HA Roberts* – courts use of technique to hold that certain aspects of business are separate and have been discontinued **depends on how large the company is and how many Ks you have**.

Tort Compensation

Canada v Manley, (1985) FCA	Mr Levy engaged T to find a buyer for the controlling stake in a company owned by Mr Levy and his family. Turns out that Levy entered into K w/ T w/o authority to do so. The other shareholders refused to pay the finder's fee so T sued Mr Levy for breach of warranty of authority and was awarded damages equal to his expected profit - $587K. T is assessed for tax on $300K. T argues that it's a capital receipt – compensation for loss of source of income.	Damages award is a taxable inclusion of an income nature by operation of the surrogatum principle.
**Donald Hart Limited v MNR* (1959)	T was awarded damages in a tort action for infringement of its trademark and passing off. Only evidence referred to for basis of damages related to loss of profits.	Rejected T's argument that payment was a capital receipt in respect of a loss in the value of its trademark and its goodwill. Taxed as business income.

Voluntary Payments

Voluntary payments to businesses have repeatedly been held to be windfalls.

- BUT in *Campbell v MNR*, the payment was found to be 100% of an income nature [compensation for services].
- AND in *Mohawk Oil v MNR*, the FCA found the payment to be mixed income and capital.

The leading case on voluntary payments:

Federal Farms Ltd v MNR, (1959) Ex Ct
F: T runs a farm that was badly flooded by Hurricane Hazel. A group of "four well-known and public-spirited gentlemen" raised over $5M in donations as a relief fund for the community which was devastated by the hurricane. T received $40K from the relief fund which T spent rehabilitating the farm, repairing equipment, buying new supplies and seed, &c. Minister said that relief payment is a taxable inclusion in the nature of income – if crops hadn't been destroyed, they would have grown and made a profit – ∴ this is compensation for lost profits. T argues that it is a gift/windfall.
L: **No relation between measure that is used for purpose of calculating a particular result, and quality of figure that is arrived at by means of application of that test.**
A: T had no legal right to receive, nor any expectation of receiving, anything from the relief fund. No K. Payment did not result directly or indirectly from any business operation and is unlikely to ever occur again (no income nature). Relief Fund received nothing from T by way of contribution, insurance premiums, services, salvage or otherwise. Gift here is of an entirely personal nature, wholly unrelated to business activities of T. Fact that recipient is incorporated and that gift was a large one does not affect the true nature of the payment.
C: Non-taxable windfall in nature of voluntary personal gift.
R: Characterization as gift = non-taxable windfall.

German v MNR (1959)	T received $20 in 1958 pursuant to *The Oil and Gas Royalties Divided Act*.	Notwithstanding that provincial statute referred to payment as a 'dividend' - the amount was non-taxable on the basis that it was entirely gratuitous.
**Mohawk Oil Co v MNR* (1992)	T received $6M from Phillips in settlement of a claim for damages resulting from negligent construction of a waste oil reprocessing plant.	Payment had been received partly on account of income in recognition of lost profits, and partly on account of capital in recognition of the capital outlay involved in the construction of the plant.

Payments to shareholders may constitute a windfall (and not, e.g., income from property):

**Canada v Cranswick* (1982)	T, who held 640 shares in WCL, received $2K from WCL's majority shareholder, WEC, after WEC offered to pay 3$/share to minority shareholders or purchase their shares for $26/share.	Payment was a non-taxable windfall to which the T had no enforceable claim, no organized effort, no foreseeable element of recurrence, WEC was not customary source, T had provided no consideration. In the absence of a special statutory definition extending the concept of income from a particular source, income from a source will be that which is typically earned by it or which typically flows from it as the expected return. (DD: Should have been capital receipt)

Payments from one business to another may constitute a windfall:

**McMillan v MNR* (1982)	T, an insurance broker who operated his own agency through a corporation, received $5K a year for 3 years from another insurance broker, who had been asked by one of T's former clients to make these payments to T.	Gratuitous payments (DD disagrees – but TAB was confused because $ wasn't coming from T's clients directly).

Gratuitous payments from a government to a business can also be a windfall:

Frank Beban Loggin Ltd v Canada (1998)	T, which carried on business as a logging contractor and logging-road contractor, received $800K from province of BC after its operations came to end when gov't created a national park.	Non-taxable windfall because it was not received pursuant to any legal or statutory right.

Income from business:

**Campbell v MNR* (1958)	T, a professional swimmer, entered into K w/ Toronto Star under which T agreed to try to swim across Lake Ontario in exchange for $600, and a further $5K if she completed. T almost finished the swim, but was still paid the $5K.	Income from a business.

Prizes and Awards

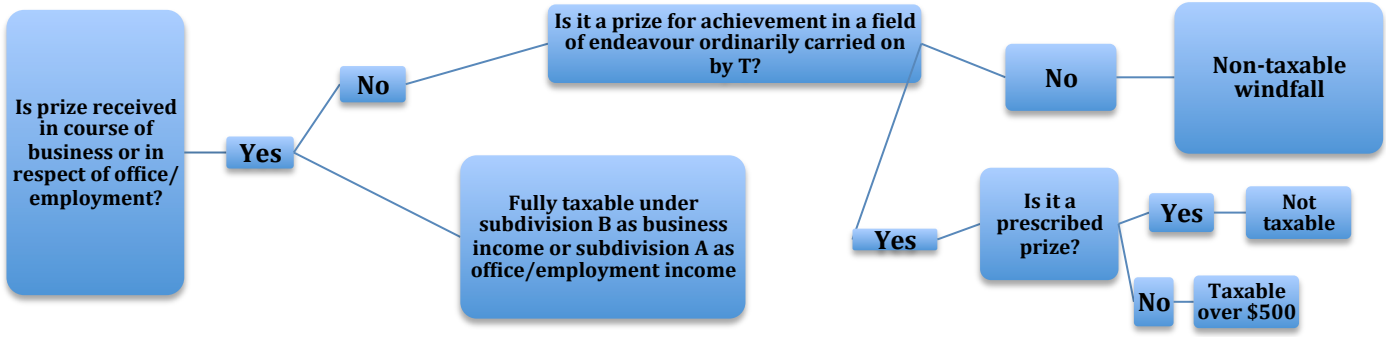
Prizes and awards aren't a business income issue per se. They can come up in the employment and business contexts or otherwise. They may be taxable as income from business, income from employment, or as income from another source assessed under **56(1)(n).**

Rule: Prizes received in respect of employment and in the course of business are expressly excluded from the scope of **56(1)(n).** They are taxable under the basic taxing provisions relating to their respective sources of income.

- A prize received in respect of employment is a **taxable** benefit under **6(1)(a)**.
- A prize received in the course of business is a **taxable** inclusion under **9(1)**.

For prizes not included as income from employment or business, there are two further questions to be answered.

- If the prize is not for achievement in a field of endeavour ordinarily carried on by the T, it is outside the scope of **56(1)(n)** and ∴ **not taxable** at all.
- For any other prize, it's taxability under **56(1)(n)** turns on whether it is a **prescribed prize** within the meaning of **Reg 7700.**
    - A **prescribed prize** is **not taxable**. Such a prize is:
        - Recognized by the general public; and
        - Awarded for meritorious achievement in the arts, science, or service to the public; but
        - Any portion that can reasonably be regarded as compensation for services rendered is excluded.
    - Any other prize is **taxable** under **56(1)(n)**, except that there is an exemption under **56(3)** for the first $500 or so of prize income.



The headings below deal w/ the issues needed to apply the analytical framework above:

- Was the alleged prize received in the course of business?
  - Alternatively, does it constitute income from a source? (*Rumack*)
- Is the payment a prize for achievement, or a scholarship, fellowship or bursary?
- Is the prize for achievement in a field of endeavour ordinarily carried on by T?
- Is it a **prescribed prize?**

In the course of business?

Even if it has some connection to business, a prize won by pure chance is not a taxable inclusion under 9(1) if it was not presented as remuneration for services rendered.

Abraham v MNR, (1960) TAB
F: T won money in a draw sponsored by M Loeb Ltd and the question is whether it is taxable as business income. T runs an IGA grocery in Ottawa and buys his stock exclusively from Loeb. Although Loeb is currently T's exclusive supplier, T's business is independent. It does not share profits w/ Loeb nor is it obligated to stay w/ Loeb for any length of time. T did not ask for tickets for the draw. They simply accompanied delivery of the merchandise and were completely free. All T did was sign the forms and returned them to Loeb. T won the draw by pure chance and, being given the choice between a car or cash, opted for the cash. T reassessed on basis that it is business income.
C: The money is not business income (nor would the car have been), having been won by pure chance and not as remuneration for services rendered.

A prize from a raffle which a T was entered in as a result of work performance (or the performance of his business) is not taxable simply by virtue of that fact.

**Poirier v MNR* (1968)	T was president of a Ford dealer that, having met a sales quota, participated in and won a lucky draw in which the prize was a holiday trip to the Caribbean.	Advantage given to T by Ford of Canada did not constitute an income because the origin of the advantage had none of the characteristics of a taxable income.

Prizes in competitions may be taxable as business income:

**Rother v MNR* (1955)	T, professional architect, received $2K as 1/6 participants in design competition.	Non-taxable receipt in the nature of a prize or gratuitous payment award received in the course of a competition.
**MNR v Watts* (1966)	T, architect, entered a design competition from which he received $4K as 1/5 entrants asked to submit further drawings and $15K as a prize for the best design.	Both payments are taxable income from a contractual relationship created between T and competition org by virtue of entering into competition by T and filings of drawings pursuant to it.

In *Rumack*, the controversy was not over whether the prize came from business or employment, but whether it was income from a source:

Rumack v MNR, (1992) FCA
F: T won a cash for life lottery. The prize was an annuity that paid $1,000 a month for life. The annuity was bought, not by T, but rather by the sponsor of the lottery, for $135K.
A: By its very nature, a stream of payments of $1,000 monthly for life has the character and quality of income – the payments are periodic, regular, certain, foreseeable, expected and enforceable. Source is the contractual obligation undertaken by the lottery sponsor at the time T bought the winning ticket. Portion of each $1,000 payment that is attributable to the annuity purchase prize is not taxable as a payment in the nature of return of capital (the capital itself being a non-taxable windfall), but the portion of the $1,000 attributable to interest is taxable income from a source.
C: Income element is taxable under **56(1)(d) and 60(a).**

Prize for Achievement (or scholarship, fellowship or bursary)?

The words of **56(1)(n)** refer to a "scholarship, fellowship or bursary, or a prize for achievement…"

- While evidently a bursary does not require achievement, the other members of the list do, and arguably it excludes lottery winnings.
- Achievement does not necessarily mean superiority in a contest w/ others.
- Effective for amounts received after May 23, 1985, **56(1)(n) was amended by excluding from the provision 'amounts received in the course of business, and amounts received in respect of, in the course of or by virtue of an office or employment'.** The purpose of this amendment was to reverse the result in *Savage.*

Canada v Savage, (1983) SCC
F: T's employer paid her $300 for successfully completing three classes. 61% of students in the classes taken by T passed and 39% failed. Only the successful candidates were eligible to receive the $100.
L: **A 'prize' for achievement is nothing more nor less than an award for something accomplished.**
56(1)(n) is not concerned w/ the identity of the payer or the relationship, if any, between donor and donee.
A: This is in field of endeavor ordinarily carried on by T.
C: $300 falls under 'prize' in **56(1)(n).**
R: The word "prize" in **ITA 56(1)(n)** is surrounded by other words which give it colour and content. **"Prize for achievement" does not necessarily connote an award for victory in a competition.**

Field of endeavour ordinarily carried on by T?

A field of endeavour ordinarily carried on by the T refers to a <u>defined, specific field of endeavour continuously engaged in by that person:</u>

Turcotte v Canada (1997)	T, a welfare recipient who had worked as a cinema manager but had been unemployed for 7 years, won $19,200 on a television game show in which he answered questions on Quebec cinema.	Payment was not taxable under **56(1)(n)** – culture is too broad of a field of endeavour.

Prescribed Prize?

The phrase "recognized by the general public" in **Reg 7700** is ambiguous. If a prize is well advertised in the community in which it is given out, it will qualify as recognized by the general public.

Foulds v Canada, (1997) TCC
F: T manages a cover band that normally plays gigs for small money in bars. In 1992, the band won two music prizes, the Music Spirit East Award and the Ultimate Deal Award. It is evident from the prize criteria (factors like musicianship, originality, X-factor were considered) that these were prizes for achievement. Prize money could only be used to finance an album of <u>original</u> music. Crown advanced two arguments to tax prizes: (1) The prizes should be included as income from business, taxable under ITA **9(1);** (2) The prizes are not a "prescribed prize" and ∴ taxable under **ITA 56(1)(n).**
A: The prizes are not taxable at all. (1) They don't look like income. They lack recurring character, were rewarded for excellence, not services rendered, and may only be used to pay for an album of original music, which the band has heretofore not been in the business of anyway. (2) The payments meet the definition of "prescribed prize" because they were awarded for meritorious

achievement and, having been well advertised in the press and on the radio in the areas where the prize was given out, they are recognized by the general public.
C: Not taxable – qualifies as prescribed prize.

**Labelle v Canada* (1994)	T, accounting prof, received a prize of $5K for winning the second int'l Accounting Case Writing Competition.	Awarded for meritorious achievement in the arts. Determining whether a prize is recognized by general public requires an element of evaluation or appreciation.

INCOME FROM PROPERTY

Interest

Often, **where interest is a candidate for inclusion**, it is as income from property and the main issues revolve around the distinction between receipts in the nature of income versus receipts in the nature of capital (i.e., the question is whether a given sum is interest at all). **Where interest is a candidate for deduction,** it is as an expense of doing business and the question is whether it is a reasonable expense incurred for the purpose of earning non-exempt income.

The two main issues for inclusions of interest income are:

1. Is an amount interest according to the **legal** test?
2. How is a sum in which a portion is attributable to interest income, and a portion to capital, to be treated? This is the subject of the SAAR in **16(1)(a).**

Legal Characterization of Interest

Rule: A T's income from business or property for a taxation year includes any amount received or receivable by the T in the year as, on account of, in lieu of payment of or in satisfaction of, interest: **ITA 12(1)(c).**

- **The phrase "as, on account of, in lieu of payment of or in satisfaction of" is a built-in surrogatum principle.**
    - In some cases, amounts have been taxable under **12(1)(c)** or its predecessors on basis that they were received **'in lieu of interest'**, e.g. *Hall v MNR* and *The Queen v Greenington Group Ltd*

Test:
Since the word "interest" is not defined in the Act, we must look to the jurisprudence for a definition. The following three elements of **legal "interest"** emerge from the cases:

1. compensation for the use or retention of a principal sum;
2. referable to the principal sum; and (e.g. interest is 5% of principal)
3. accruing day-to-day, meaning **capable of being computed** on a day-to-day basis (even if only paid at intervals).

The point of the inquiry is to decide whether an amount is income or capital.

Payments specifically described as 'interest' by the parties to an agreement may not be characterized as such for the purposes of the ITA:

Perini Estate v MNR, (1982) FCA
F: T sold his business to Columbia Records. The purchase price involved three components:
A. $660K due on closing—27 November 1968
B. Additional annual payments based on post-tax net profits, if any, in the three years after the deal, such payments not to exceed $1.2M in total.
C. An amount described in the K as "interest" assessed on the annual payments (B) and computed at an annual rate of 7% from the closing date to the date of the additional payment.

(B) and (C) are personal to T – he has to be alive to receive them.
T received the following payments under (C): 1969 $14K; 1970 $28K; 1971 $119K
T says that despite the K, these amounts are not legally interest because they could not have accrued day to day, there being no principal sum in existence on which they could accrue during the period between the closing date and the date the sum payable was determined according to the audited financial statements for the year – these are all part of purchase price, part of capital gain and ∴ not taxable.
A: There was in existence on the closing date an obligation to pay a price to be determined according to the formula set out in the agreement, but the precise amounts of the additional payments, if any, to be made were not determined as of that date. Once it was ascertained that the profits had been made and could be calculated and the vendor was still alive his obligation for the payments in each of the years became due, and the condition having been fulfilled it had a retroactive effect to the date of the K – Interest ran from that day on the payments due in accordance w/ the terms of the K. T was entitled to the amount the whole time, they were just waiting to calculate it.
C: Payments were interest.
R: Parties to a K can give contingent liability retroactive effect such that it can qualify as a principal sum to which interest can be referable. You can retroactively agree to something that makes interest accrue day-to-day because of retroactive effect.

- Cases also occur in which payments that are functionally equivalent to interest are not described as such by the parties to a K
- Some of the cases on characterization of interest pertain to **20(1)(c),** which allows Ts to deduct interest expenses that satisfy specific statutory criteria
- *Balaji* said that in order to be interest, the payment must be a percentage of the principle sum. *Sherway* says that this should be limited to facts where it is clear that payments in question was in addition to the obligation to pay interest on the loan. **Participatory interest is referable to principal sum because it is payable only so long as principal sum is outstanding.** *Sherway* said that appropriate interpretation to be given to daily accrual of interest is that each holder's entitlement to interest must be able to be ascertained on a daily basis.
- NOTE the distinction between interest payments referable to principal sum determined retroactively (*Perini Estate, Miller*) and payments comprising an element of compensation (*Huston, Bellingham*)

**Ahmad v Canada* (2002)	T received $388K as pre-judgment interest after a successful legal action in which he sued Ontario Hydro for inducement of breach of K.	No principal amount in reference to which interest could accrue until the judgment determined that he had been wronged, that he had suffered a loss from the wrong, and the amount of the loss.
**Coughlan v Canada* (2001)	T received damages and pre-judgment interest.	Payment was interest on liquidated amounts wrongfully withheld. Liquidated damages came into effect at time of breach of K.
**RG Huston et al v MNR*, (1962)	T received retroactive salary increase w/ "interest" payable from periods wo which salary related	Not interest because during period the **recipients were not entitled to a principal amount upon which interest could accrue.**
**Bellingham v Canada*, (1995)	T received amount pursuant to *Expropriation Act*, authorizing payment of "additional interest" on compensation award by Land Compensation Board.	Punitive damage award, not "interest"

Collins v Canada (2010)	If a T borrows money for the purpose of earning non-exempt income from a business or property and has, as in this case, a non-contingent legal obligation to pay interest on that debt, the T may deduct the interest.	
**MNR v Yonge-Eglinton Building Ltd* (1974)	T borrowed money to finance construction of building on terms whereby it agreed to pay quarterly interest computed at yearly rate of 9% and additional interest equal to 1% of its annual gross rental income for 25 years.	Rejected T's characterization of additional payments as 'interest' under **20(1)(c).**
**Sherway Centre Ltd v Canada* (1998)	T financed construction of a shopping centre in Toronto by issuing bonds paying fixed interest computed at annual rate of 9.75% and 'participatory interest' equal to 15% of T's 'operating surplus' in excess of $2.9M.	Jurisprudence interpreting the meaning of the definition of interest has not developed alongside of, or has not taken into account new and innovative financing schemes for new business ventures and allowed the deduction under **20(1)(c)** – **'participatory interest' is interest.**

Payments of Interest and Capital Combined (SAAR)

Rule: If, under a K or other arrangement, an amount can reasonably be regarded as being in part interest and in part of a capital nature, the amount that can reasonably be regarded as interest is **deemed to be interest**: ITA **16(1)(a).**

- Anti-avoidance provision: Determines tax consequences on basis of economic/commercial substance of K or other arrangement rather than its legal form.

Tests (from *Groulx*):
Objective:

- What is the prevailing rate of interest charged in similar transactions in ordinary business practice?
- Does the purported sale price of the thing sold exceed its FMV? (With the surplus presumed to be interest).
    - A widely accepted definition of the term 'FMV' is 'the highest price available in an open and unrestricted market between informed, prudent parties acting at arm's length and under no compulsion to act, expressed in terms of money or money's worth' – *Connor*

Subjective:

- Does the T have a subjective intent to capitalize interest? In *Groulx*, this is inferred from objective evidence:
    - T's level of sophistication and incentive to capitalize interest.
    - The course of negotiation between the parties.

A stream of future payments, purporting to be interest-free, from a sale of real estate, will likely be characterized as in part interest and in part capital:

Groulx v MNR, (1967) SCC
F: T owned and operated a farm for 20 years. In the last 6 years, various persons offering to buy the farm approached him. Eventually, Thorndale offered $350K for the farm and T counter-offered $450K. A period of intense negotiation ensued during which T gradually dropped his price: first to $400K, then to $395K, then to $395K w/ payments structured as follows: $85K down, w/ the balance of $310K over 7 years waiving interest, except that (1) a per annum rate of 6% would be levied on late payments; and (2) Thorndale had the right to pay early and so earn a discount calculated at a 5% annual rate. Minister proved that at the time the parties made the deal, the prevailing rate of interest on similar transactions was 5%. Minister also led expert evidence

establishing a prima facie case that $395K exceeded the FMV of the land sold, a case which T failed to rebut. T reassessed on basis that it was reasonable to regard some/all of deferred payments as interest.
JH: T was "no ordinary farmer". Parts of his income came in the form of a salary from a company of which he was president, but a considerable amount of it also came from investments. T was no stranger to real estate transactions. According to the judge of first instance, "a child could have seen" that interest on the outstanding balance at 5% would have doubled T's taxable income." He ∴ inferred that T was aware of the pecuniary advantage to avoiding "interest" – he was trying to avoid tax.
C: The part of the payments that would represent interest at 5% is taxable interest income under [the old equivalent of] **ITA 16(1)(a).** This portion can reasonably be regarded as interest because (1) the almost universal business practice is to charge interest at 5%; (2) this is supported by the Minister's evidence that the purported "price" exceeded the FMV; and (3) T's obvious interest in not doubling his taxable income.
D: Seems to suggest that at any time where there is deferred payment like this, some of it is interest – this has not been followed by the courts.

**Vanwest Logging Co Ltd v MNR* (1971)	T sold a tract of timber for 7.5M, of which 1.5M was payable on closing w/ remainder due over next 5 years in 5 equal annual instalments of 1.2M each. Did not provide for payment of interest except in case of overdue instalments. Minister characterized as interest a portion of the instalment payments.	In order to determine whether part of each instalment payment could reasonably be regarded as in part a payment of interest, it was necessary to **consider 4 criteria: (1) the terms of the agreement reached between the parties; (2) the course of the negotiations between them leading to it; (3) the relationship of the price paid to the apparent market value of the property at the time, and (4) the common practice w/ respect to payment of interest on the sale of timber limits.**
Lehigh Cement Ltd v Canada (2009)	Determining whether payments were in part of the character of interest and in part of capital is primarily a question of fact that must take into account the T's corporate mind.	
**Rodmon Construction Ltd v Canada* (1975)	Purchasers of a parcel of land assumed a non-interest-bearing mortgage payable by instalment to a non-resident.	**Prime factor to be considered is whether or not the FMV has been paid**: if the price paid is in excess of FMV, the excess is deemed interest; if the price reflects the FMV then there is no element of interest in the payment.

Royalties

Definition: Compensation for the use of property, usually copyrighted material or natures resources, expressed as a percentage of receipts from using the property or as an account per unit produced… a share of product or profit reserved by owner for permitting another to use the property.

Rule: Under **12(1)(g),** any amount received by the T in the year that was dependent on the use of or production from property whether or not that amount was an instalment of the sale price of the property, [except that an instalment of the sale price of agricultural land is not included by virtue of this paragraph]… will be included in T's income from a business or property.

Dependence on the Use of or Production from Property

MNR v Morrison, (1966) Ex Ct

F: T entered into K w/ purchaser to sell rock on his property. The K stated that the rock would be sold w/ a number of covenants and agreements, for consideration of $1 plus 1.5 cents per ton of 2,000 pounds of rock removed. A large quantity of rock was removed and weighed, but the gov't did not keep a record of how much rock it removed from T's property. Advance of $2,500 was paid to T in 1959, plus a further lump sum of $14,500 at the end of the work.
A: Amounts contemplated by K here were never received. The $ received did not relate to quantity of rock taken. $ was received by way of an accord and satisfaction of T's rights to be paid both the sums payable for rock under the K and the damage occasioned to his house. These were amounts paid in settlement of unascertained claims which T had against purchaser for rock removed and for damages to his house.
R: Amount must be (1) received by T in the year and (2) dependent upon use of or production from property to fall under 12(1)(g). Amounts must depend in some way upon extent of use of or production from property whether according to time or quantity of some other method of measurement.
C: Cannot be included in computation of T's income – does not fall under **12(1)(g)**.

Jurisprudence is somewhat conflicting on when 12(1)(g) applies:

MNR v Lamon (1963) and *Chen v MNR* (1984)	Gravel and timber removed from property held to fall under **12(1)(g)**	
Mouat v MNR (1958)	T sold all merchantable timber on parcel of land for an amount calculating according to Q of timber cut and payable in 4 instalments over 2.5 months.	**12(1)(g)** does not apply - legislator intended to tax not the natural produce of the soil, but the fruits of industry such as a crop, minerals, timber, which produce a periodical return as a result of yearly exploitation.
Hoffman v MNR (1965)	**12(1)(g)** denotes a continuing activity – one that goes on from year to year.	
Lackie v Canada (1978)	T received payments unrelated to volume of gravel removed.	**12(1)(g) and 6(1)(j)** apply on basis that amounts received depended on exclusive right to remove gravel for period of 5 years.

Amounts Received in the Year that Depend on Use or Production

Huffman v MNR, (1953) TAB
F: T sold 5 placer mining licenses for $25K. Purchase price was payable in installments of 25% of value of gold removed until full price was paid, plus interest of 2.5% per annum.
L: **3(1)(f)** was first provision relating to royalties – much narrower. Replaced by **6(j)** which was precursor to **12(1)(g)** – much broader. **6(j) [12(1)(g)]** is much wider than that of the former provision of **3(1)(f)** in that it provides that **any amount received in the year that was dependent upon the use of or production from property is to be included as income. Such amounts do not have to be rents, royalties, annuities, or other like periodical payments**
C: Falls under **12(1)(g).**
R: Where K provides for a royalty w/ a minimum stipulated amount, amounts received in year arguably depend on use of or production from property.

- In some cases, property is sold for a fixed price, w/ this amount payable by instalments based on the produce of profits of the property at various intervals (as in *Huffman*). The timing of payments depends on the use of or production from property, but the aggregate amount does not. BUT arguable that **12(1)(g)** should apply on basis that amount received by T in the year depends on use of or production from property.

- In other cases, property may be sold for a specified percentage of output or revenue, subject to an agreement that payments will not fall below a **minimum stipulated amount** over a specific period of time.

- Where the royalty is equal to or less than the minimum payment over a given period of time, the aggregate amount of the payments will not depend on the use of or production from property. Nonetheless, **while any 'top-up payment' required to reach the minimum amount will not depend on the use of or production from property** [IT-462, para 5(d)]**, amounts received as royalty payments in each previous year will depend on use of or production of property.**
    - In *Porta-Test Systems Ltd v Canada* (1980): Amount paid to satisfy minimum was not caught under **12(1)(g).**
    - *Brousseau v MNR* (1986): **12(1)(g)** applied only to payments in excess of the stipulated minimum.

- Property may also be sold for a fixed price, whether or not payable by instalment, w/ a proviso that this price will be **adjusted downward** if certain expectations regarding revenue or profitability are not met.

- *Pacific Pine Co Ltd v MNR* (1961): Agreement to reduce price if less than a specified amount of timber was logged from property was not enough to bring payments within scope of **6(1)(j) [12(1)(g)].** Fixed price was reasonable – so not subject to inclusion under **12(1)(g)** if there's a downward adjustment.
    - i.e. If there is a totally unrealistic fixed price that will be adjusted downward based on production if not reached, then **12(1)(g)** will likely apply because fixed price is basically meaningless.

Deductions

Recall that income from a business or property is the profit from that activity under **9(1).** The SCC has repeatedly affirmed that **s 9** implies that income is a net concept and that reasonable expenses may ∴ be deducted.

There are several sources of limitations on what a T may deduct from his income from business or property and these may broadly be classed as general rules versus specific rules. The general rules are based on the profit concept in **9(1)**; the income earning purpose requirement in **18(1)(a)**; and the overall reasonableness rule in **s 67**. The specific rules address issues such as the deductibility of interest expenses and various minutiae on which Parliament felt the need to override the courts or to act for political reasons (for example, expense account living and home office expenses).

GENERAL RULES

To be deductible under **9(1)**, an expense must be consistent w/ the ordinary principles of commercial trading or well accepted principles of business (*65302 BC*). In 1999, however, the SCC seems to have changed what this phrase means. Before then, the courts often followed the mixed objective/subjective approach to deductions taken in *Imperial Oil v MNR* (1947, Ex Ct). The objective question was whether the expense is incidental, in the sense of unavoidable, to the business. The subjective question, which is apparent on the face of **18(1)(a)**, was whether the expense is incurred for an income earning purpose. In 1999, the SCC swept away the objective part of the test in *65302 v MNR*.

Rule: Unless its deduction is prohibited by a more specific rule, an expense is deductible against income from business or property if it was incurred for the purpose of earning income from that business or property: **ITA 9(1), ITA 18(1)(a),** *65302 BC Ltd v MNR.*

- While this may seem to be a highly subjective test, an expense may only be deducted to the extent that it is reasonable in the circumstances: **ITA 67**. There is ∴ an objective component because the courts are not required simply to take the T at his word in circumstances in which no reasonable businessman would have incurred the expense.

Reasonableness

Rule: Under **67**, no expense may be deducted except to the extent that it was reasonable in the circumstances.

- Note that **s 67** is situated in Subdivision f of Part I, Division B, and ∴ **applies to all deductions**, including deductions taken against income from office or employment.

Cipollone v Canada, (1994) TCC
F: T carries on business as a "humourologist" providing humour therapy sessions &c. Over 7 years, T deducted expenses (many of which could conceivably be personal) quite out of any proportion to her revenues. She has so far failed to realize a profit. The Minister disallowed all of the deductions, offering as one basis that they were unreasonable.
C: The reason T's losses were so great is that she is claiming **unreasonable expenses – issue is not REOP**. It is obvious that they are unreasonable—one need **only look at them in relation to the revenues T was generating**—but the magnitude of the unreasonableness can't be determined on the available evidence. Matter remitted to the Minister to assess what portion of the deductions is reasonable. Good portion of expenses may turn out to be unreasonable.

Mohammad v Canada, [1997] FCA	Deduction of interest expenses on borrowed funds that T had used to purchase a residential property for rental purposes.	Deduction limited. **When evaluating the reasonableness of an expense, one is measuring its reasonableness in terms of its magnitude or quantum – there should always be a search for an objective component. There will be instances where the objective component will be difficult to isolate and, ∴, practical experience informed by commonsense will have to prevail.**
Petro-Canada v Canada, [2004] FCA	Reasonableness, like value, is a question of fact. May be true that paying FMV for something is prima facie reasonable. BUT doesn't necessarily follow that paying more than FMV is unreasonable.	
**Ammar v Canada*, [2006] TCC	T carried on immigration and consulting business for students in Egypt and the Middle East wishing to study in Canada, for purpose of which he rented an apartment in Cairo.	Court applied **s 67** to limit deductible amount – a hotel room or comparable apartment could have cost less than half of what was claimed by T.
Olympia Floor & Wall Tile (Que) Ltd v MNR, [1970] Ex Ct	T sought to deduct charitable expenses as a business expense.	**Necessary expenses must also be reasonable expenses.** The fact that a businessman makes a BF decision to make disbursements for business reasons raises a presumption that it was 'reasonable' to make such disbursements unless facts are proved that establish that it was not 'reasonable'.
Humphrey v Canada, [2006] TCC	T sought to deduct amounts that she paid back to her former employer from whom she had embezzled.	Since T had declared bankruptcy and consequently did not actually pay any tax on the embezzled funds, court relied on **s 67** to disallow the deduction on basis that it would be unreasonable for her to be able to deduct the repayments of amounts on which she has never paid tax.

SPECIFIC RULES

Expense Account Living

Personal and Living Expenses

Rule: A T may not deduct personal or living expenses against income from business or property under **18(1)(h).**

Clothing bought by an individual which she wears or *could wear* in everyday life is a personal or living expense which may not be deducted due to 18(1)(h):

No 360 v MNR, (1956) TAB
F: T is an actress and TV personality. She stars in CBC period and modern plays, sometimes in movies, and regularly appears in "TV engagements", including on a TV show in which she gives "advice on beauty and elegance to an extremely exacting female audience" who, T says, write nasty letters if they catch her wearing the same dress twice. In the CBC plays, the broadcaster furnishes costumes for period pieces but the actors must buy their own clothing for the contemporary plays. Moreover, many of T's Ks and engagements derive from her reputation for elegance and style, which she must ∴ keep up by spending considerable amounts on clothing in general. T admitted that **she wears, or could wear, the clothing and accessories she buys for TV engagements on other occasions**.
C: T's spending on clothing and accessories represents non-deductible personal and living expenses.

Giroux v MNR, (1957) TAB	T, stage and TV artist, sought to deduct $ incurred to purchase clothes and accessories that T considered necessary for playing her roles, and further amount for cost of cleaning these items.	**Court distinguished between work clothes that could be worn in everyday situations and those that could not.** Allowed deduction for clothes but not for cleaning.

Golf Course or Facility, Yacht, Camp, Lodge

Rule: Under **18(1)(l)(i)**, a T may not deduct an expense incurred for the use or maintenance of any of the following: a golf course or facility; a yacht; or a camp or lodge *unless* the T incurred the expense in the ordinary course of the business of providing the property for hire or reward.

- CCA disallowed under **Reg 1102(1)(f)**
- Use need not be exclusive, and incidental expenses are also non-deductible (*Sie-Mac*)

The terms used in **18(1)(l)(i)** are not defined in the Act, but the courts have weighed in on them:

On the meaning of "camp" or "lodge":

**Fehrenbach v MNR*, (1994) TCC	T, a partner in a law firm, sought to deduct expenses incurred to maintain a condo which he used primarily for personal use but at which he also entertained clients and prospective clients.	Deduction disallowed. It is not barred by **ITA 18(1)(l)(i) because it would be stretching the words "condo" or "lodge" to the breaking point to include them.** However, it is disallowed under both **ITA 18(1)(h)** and separately under **ITA 67.**
Hewlett-Packard (Canada) Co v Canada, (2005) TCC	Corporation attempted to deduct expenses from an internal program that rewarded successful employees w/ weekend stays at hotels.	Deductions allowed. **The common meaning of 'lodge' does not include large resort hotels of the type that are at issue here.**

The meaning of the words used in the provision should account for the purpose of the provision and the use to which the T puts the property:

**John Barnard Photographers Ltd v MNR, (1979) TRB*	T sought to deduct the cost of maintaining a boat that it used to conduct the research and photography necessary to product a fishing almanac which it hoped to sell to tourists.	Deduction allowed. **18(1)(l)(i)** is aimed at recreational facilities including using a yacht for pleasure and **does not deny deductions in respect of any motor boat** regardless of the use it is put to.
No 308 v MNR, (1955) TAB	T, manufacturer and distributor of wire coils, sought to deduct expenses incurred in operating and maintaining a lodge at which it entertained customers.	Deduction disallowed on basis that relationship between entertainment expenses and T's sales was too remote. Codified in **18(1)(l)(i).**

Or maybe not:

**MNR v CIP Inc*, (1988) FCTD	$ paid to rent converted tugboat for purpose of business entertainment.	Deduction allowed. Vessel is a tugboat generally used as personal residence, and only occasionally for recreational purposes.

The prohibition in 18(1)(l)(i) includes incidental expenses:

Groupe Y Bourassa & Associes Inc v Canada, [1995] TCC	T, insurance broker, sought to deduct expenditures for golf tournaments conducted to promote T's business among its clients.	Deductions disallowed. Green fees were related to direct use of a golf course/facility, while cost of meals and beverages consumed there and prizes purchased from shop were incidental expenses, but still prohibited by **18(1)(l)(i).**
**Sie-Mac Pipeline Contractors Ltd v Canada (MNR), (1992) FCA*	T sought to deduct $12K which it spent to send 7 customers, 5 employees and 2 employees of related company on 3-day trip to fishing lodge in order to show its appreciation to its customers and inform them of new equipment and techniques.	Not deductible even though it may have been incurred for purpose of producing income, because it falls within language of **18(1)(l)(i)**. **18(1)(l)(i) is not restricted to a T who is the owner of a property described. Effect of 18(1)(l)(i) is to prohibit deduction of both direct and indirect or incidental expenses relating to the use of a property referred to in that subparagraph.**

Membership in Club Providing Dining, Recreational, or Sporting Facilities

Rule: Under **18(1)(l)(ii)**, a T may not deduct an expense incurred as membership fees in any club whose main purpose is to provide: dining, recreational, or sporting facilities to its members.

- Applied in *Damon Developments Ltd v Canada (MNR)*, [1988] TCC to disallow deduction of membership fees paid by T to SK Roughrider Football Club in order for its senior management personnel to obtain access to the club and host guests for promotional purposes.

The specific decision in *Royal Trust* was reversed by the introduction of **18(1)(l)(ii)** in 1972 (but it depends on the main purpose of the club). BUT the court's analysis in *Royal Trust* of the word 'profit' and of the relationship between this concept and the general limitation in former **12(1)(a)** is still relevant:

The Royal Trust Company v MNR, (1957) Ex Ct

F: T has concluded that the best way of attracting trust company business is through the personal contacts of its officers and senior managers. Accordingly, T has a very detailed policy requiring all officers to become members of social clubs in their communities and attend them regularly, and designating the clubs to which particular officers should belong. Policy resulted in business – T considered it to be good business practice. Other trust companies have similar policies. T pays the admission fees and membership dues for its officers and seeks to deduct them in computing its income from business.
L: In a case under the ITA the first matter to be determined in deciding whether an outlay or expense is outside the prohibition of **12(1)(a**) of the Act is whether it was made or incurred by T in accordance w/ the ordinary principles of commercial trading or well accepted principles of business practice. If it was not, that is the end of the matter. But if it was, then the outlay or expense is properly deductible unless it falls outside the expressed exception of **12(1)(a)** and ∴ within its prohibition. **Fact that there is no resulting income does not prevent deductibility of the amount of the outlay/expense.** It's the purpose that counts, not the results.
C: Deductions allowed (although later legislatively disallowed by **ITA 18(1)(l)(ii)).** The use of social clubs by T's officers is particularly suited to the kind of personal business done by a trust company and generated profitable business beyond that which mere advertising could produce. Accountant approved of deduction. Moreover, T's competitors followed similar policies and considered it good business practise to do so. Purpose was earning income. **It is consistent w/ good business practise for a trust company like T to make the payments in question and the expenses are hence deductible.**

Parties

There is no rule in the Act which specifically relates to parties. The courts have generated mixed results by applying a combination of the **9(1)** (consistency w/ the principles of commercial trading or accepted business practise) and **18(1)(a)** (income producing purpose) tests to parties. **Cost to entertain business guests at personal-parties is generally non-deductible unless specifically identified as business guests.**

NO DEDUCTION (or benefit assessed on individual)	DEDUCTION ALLOWED
Roebuck v MNR* (1961) TAB: T and brother invited a number of clients and prospective clients to bat mitzvah held for T's daughter in order to establish goodwill w/ clients. Deduction disallowed – not ordinary/well-accepted. **Fingold v MNR*, [1992] TCC: T was assessed under **15(1) on basis that he had received a shareholder's benefit from company, which had paid part of cost of receptions held after bar mitzvah of T's son and after wedding of T's stepdaughter. Corporation paid only a proportionate share of the expenses based on percentage of business guests invited, but court dismissed T on basis of no evidence that business guests were aware that they were guests of the corporation rather than T. **Adaskin v MNR*, (1953) TAB: T, producer of radio shows, sought to deduct $500 to host 2 parties for cast members held after performance was finished and actors had been paid. Deduction disallowed on basis that expenses had not been incurred for purpose of gaining or producing income. Show already happened, so not a cost of earning income.	***Grunbaum v Canada*, [1994] TCC: T was president and primary shareholder of company that sought to deduct $12K expended on a wedding reception for T's daughter. Expenses were proportionate to number of business guests, invitations were sent through company, and all correspondence w/ business guests was handled by company. Wedding expenses were deductible expense to company and not a taxable benefit to T.

Meals and Entertainment

Rule: The Act does not eliminate entirely the possibility of deducting food, beverages, and entertainment expenses, but it does reduce them via a deeming rule. Assuming they are not limited by any other rule (e.g. moving expense deduction in **62,** child-care expense deduction in **63,** medical expenses tax credit in **118.2)** and are properly deductible under *Royal Trust*-type principles, **67.1** deems amounts paid in respect of:

- The human consumption of food or beverages; or
- The enjoyment of entertainment

To be the ½ of the lesser of the actual amount paid, or if the amount paid was unreasonable, then an amount that would be reasonable in the circumstances.
67.1(2) lists a number of exceptions to the percentage limitation in **67.1(1).**

Stapley v Canada, (2006) FCA
F: T is a real estate agent. In the expectation that they would refer more business to him, T bought gift certificates for food, beverages, and tickets to concerts and sporting events for clients who had bought or sold homes through his business. T did not use these vouchers himself, nor had he any control over how—or whether—his clients used them. It is a fact that these expenses were marketing expenses for T's business. He sought to deduct them.
C: Deductions limited to 50% of cost. The plain wording of the subsection suggests that there is no requirement of T use in **67.1(1).** The words 'in respect of' in **67.1(1)** are of the widest possible scope. Deductions here are caught by plain wording of **67.1(1).** In its current form, **67.1 interferes w/ Ts' business decisions and how they allocate their marketing budgets.**

Pink Elephant Inc v Canada, (2011) TCC	T carried on a business of providing public educational courses in IT, which were held in hotels and included breakfast and lunch as part of the total cost for the course.	Catering expenses incurred by T for meals and beverages provided w/ courses were subject to exemption in **67.1(2)(a).**
**Scott v Canada*, (1998) FCA	T, courier who delivered packages by foot and public transit, sought to deduct the cost of additional food and water that he consumed as part of his daily routine.	Court analogized food and water to gasoline used by couriers who drive cars and allowed deduction.

Home Office Expenses

Rule: There are 2 rules relating to home offices in **18(12)**, and they both relate only to an individual T's income from business. The first rule, in **18(12)(a)**, limits deductibility by narrowly defining what a home office is:

a) An individual T may only deduct expenses for any part of a **self contained domestic establishment** in which he resides to the extent that that part (the **work space**) is:
   i. His principal place of business; or
   ii. Used
      - Exclusively for the purpose of earning income from business; and
      - On a regular and continuous basis for meeting clients, customers or patients of the individual in respect of the business.

The second rule, in **ITA 18(12)(b-c),** limits deductibility by prohibiting the T from using home office expenses to generate a loss.

b) the amount of a deduction permitted under **(a)** may not exceed the individual's income from business computed w/o reference to that amount;
c) where paragraph **(b)** limits a deduction, the T may carry it forward to a future year.

Locke v MNR, *Logan v MNR*, and *Mallouh v MNR* were all cases on office expenses before the existence of **18(12)**. *Locke* [lawyer] and *Mallouh* [doctor] disallowed the deduction, holding that the expenses were personal expenses. *Loga*n [doctor] allowed the deduction based on the ratio of the area of the home office to the area of the entire house.

- **Factors to consider:** was the room definitely separate from the living quarters of family; was an appreciable amount of business transacted in the said room or was it just used for convenience; was house partially municipally assessed for business purposes; was there a sign on his house announcing to general public that a law office was being maintained therein; if he already has an office where he regularly practices his profession, was his home office, in fact, a second branch office (*Locke*)

**Ellis v Canada*, (1994) TCC	T operated business producing and selling pottery and stained glass out of studio/store built over garage at her residence and connected to rest of house through 2 interior passages.	Applied **18(12)(b)** to disallow deduction of losses. Studio was an area which formed part of T's residence. In order to apply, **18(12)** does not require smell of home-baked bread wafting into work space.
**Dufour v Canada*, (1998)	Notary business carried on in office constructed in T's garage.	Part of T's self-contained domestic establishment – physically attached to, shared utility connections w/, and was accessible from interior of T's home.
**Maitland v Canada*, (2000) TCC	Ts operated B&B business in a residence purchased for this purpose, residing on top floor and part of 2nd floor and using remainder in business.	Residence was clearly their home and fell within definition of 'self-contained domestic establishment'. Deduction disallowed.
**Sudbrack v Canada*, (2000) TCC	T incurred losses in operation of country inn.	Deduction allowed. Even though T and his family resided in same building in which business was carried on – separate living quarters of family, which are essentially a separate apartment within inn, constitute the self-contained domestic establishment.
**Broderick v Canada*, (2001) TCC	T lived in basement apartment and operated B&B in rest of house.	*Sudbrack* distinguished on basis that business was largely seasonal, making residence fully available to T and family for 7 months of year.
**Lott v Canada*, (1997) TCC	Ts sought to deduct losses from daycare business operated out of home.	**Expression 'any part' in 18(12) clearly includes the whole**. Rejected argument that **18(12)(b)** should apply to disallow losses generated only by costs associated w/ residence itself but not land subjacent and adjacent to residence.
**Vanka v Canada*, (2001) TCC	T, family physician w/ office dt, sought to deduct expenses related to home office.	Allowed deduction on basis that office was used on regular and continuous basis for meeting patients. **'Meeting patients' can include phone calls w/ patients.**

Travel Expenses

Rule: Business-related travel expenses may be deducted under the general principles of **ITA 9(1), 18(1)(a)** and **67**. Under **ITA 18(1)(h),** personal or living expenses that would otherwise be disallowed are deductible if they are travel expenses incurred by T while away from home in course of carrying on T's business.

The two main issues we covered are:

1. What is T's base of operations?
2. Is T carrying on one business at 2 locations, or 2 different businesses?

And a third issue may be:

3. Is T travelling, or sojourning?

What is T's base of operations?

When the issue is T's expenses of commuting between his home and some location where he carries on business, the cases turn on factual question of the location of the base of operations of T's business. If the court finds as a fact the base of operations of T's business is his home, then travel between T's home
and another work location isn't a "personal or living expense" at all, does not even come within **ITA 18(1)(h),** and is deductible under the general principles relating to income from business.

Cumming v MNR, (1967) Ex Ct
F: T is an anaesthetist whose home is ½ mile from the hospital in which T performs operations on patients. Hospital has no place at all where T can carry out "the administrative functions of his practise"—namely, maintaining business records, preparing billings, reviewing medical journals and the like. T only has a locker at the hospital. T's routine is ∴ to return home from the hospital at 4:00pm each day to work on his records in a home office he maintains for that purpose. He then goes back to the hospital at 6:30pm to visit patients and get the schedule for his next operation. T seeks to deduct the expenses of using his car to travel to and from the hospital.
C: Deductions permitted. The **base of operations** of T's business is his home. ∴, commuting between his home and the hospital is not a "personal or living expense" at all. T's choice of location for home was dictated either wholly or at least partially by desirability for reasons relating to his practice of his living conveniently near to place where his services were required as opposed to personal preference.
There may be cases where a further element of personal preference for a more distant location has an appreciable effect on amount of expense involved in travelling between 2 points.
D: Followed in *Prowse*.

If T maintains a separate office outside of his home, he will have difficulty convincing a court to find that his home is his base of operations:

**Henry v MNR*, (1971) SCC	Anesthetist claimed traveling expenses – T also maintained a separate office where records were kept and accounts made up.	Disallowed.

Under the base of operations concept, a T can deduct commuting expenses against income from business even when

- Only a small part of T's business activities occurs at the base of operations; and
- Most of the commuting expenses result from T's choice to situate the base of operations far from the other sites where he carries on the business.

**Forestell v MNR*, [1991] TCC	T, independent contractor engaged solely by ROM, commuted to Toronto on weekly basis where he rented a small apartment that he claimed to use as office.	Base of operations was home. Expenses incurred for travelling to and from Toronto and meals while travelling were properly deductible.
**Canada v Cork*, (1990) FCA	T, mechanical-design draftsperson who maintained office in one room of rented home, sought to deduct expenses incurred in travelling to construction sites at which he performed services.	Deduction allowed. T used home as base of operations. Travel was from and to his home *qua* place of work in circumstances here.
Brown v	T lived in SSM and worked as independent	Disallowed. Not reasonably

Canada, [1998] TCC	contractor in Toronto, staying at variety of apartment hotels in Toronto.	attributable to business carried on in Toronto.
Friedland v MNR, [1989] FCTD	T, economics prof at York who performed outside consulting work, sought to deduct travelling expenses associated w/ use of Rolls Royce and BMW.	Deduction allowed.

Is T carrying on one or two businesses?

The deductibility of commuting and travel expenses when T travels from point A to point B assumes that T is operating the same business at both A and B.

**Randall v MNR*, [1967] SCC	T, resident of Vancouver engaged in business of managing horse-racing activities, entered into agreement to manage business affairs and transactions of Portland group.	Portland operation was only one base of a single business carried on in various geographical locations. Deductions allowed.
**Waserman v MNR*, (1969) TAB	T, who operated furrier shop in Pembroke but resided 100 miles away in Ottawa, sought to deduct expenses incurred travelling between these 2 cities as well as expenses for meals and lodging while in Pembroke.	Allowed. T was carrying on business in both cities as well as while travelling.

Misc

**A-1 Steel and Iron Foundry Ltd v MNR*, (1963) TAB	T sought to deduct $3K in respect of expenses of a trip to Europe taken by its president and controlling shareholder, who was accompanied by wife.	Allowed only 35% of half of total expenses. **Where travel involves both business and pleasure, a portion of the expense may be non-deductible.**
Shaver v Canada, [2004] FCA	T attempted to deduct travel expenses associated w/ attending monthly Amway business seminars through NA.	Not deductible because they were not incurred for purpose of gaining or producing income. Payment 'on account of capital' since they contributed to training which would result in a lasting advantage to T – so limited by **18(1)(b)** and **20(10).**

Child-Care Expenses

Symes held that childcare expenses may not be deducted under income from business because **s 63** operates as a complete code.

Symes v Canada, (1993) SCC
F: T was a lawyer and mother of three children. Employed a nanny and sought to deduct in computing her professional income from her legal practice – NOT under **s 63**. Deduction was prohibited on basis of characterizing these payments as personal or living expenses.
L: Majority: **9(1)** generally operates to prohibit the deduction of expenses which lack an income earning purpose, or which are personal expenses. Real issue may be whether a deduction is prohibited by well accepted principles of business practice *for the reason* that it is not incurred for the purpose of earning income, or *for the reason* that it is a personal or living expense – any treatment of the issue will necessarily blur **9(1)** w/ **18(1)(a)** and **(h). Look for objective manifestations of purpose of expenditures – purpose is ultimately a question of fact to be decided w/ due regard for all of the circumstances:** (1) Is the deduction ordinarily allowed as a business expense by accountants; (2) Is it normally incurred by others involved in T's business; (3)

Would it have been incurred if T was not engaged in pursuit of business income; (4) Is this a personal consumption choice; (5) 'But for' test for the need which the expense meets, rather than the expense itself. Traditionally, **T is expected to be available to the business** as a quid pro quo for business income earned. **S 63 is intended to be a complete legislative response to the childcare expense issue.**
Minority: **The meaning of 'business expense' must account for the experiences of all participants in the field.** Child care may be held to be a business expense deductible pursuant to **9(1)** and **18(1)(a)** and **(h),** all other criteria being respected – **s 63** should not bar this.
A: Majority: The need which is met by childcare expenses on the facts of this case exists regardless of T's business activity. Minority: The reality of T's business life necessarily includes childcare.
C: Child care cannot be deductible under principles of income tax law applicable to business deductions.

Interest Expense

In the area of interest expense **deduction**, the major issue is whether it is used for the purpose of earning income from business or property.

Rule: The rule on interest expense deductibility is codified in **ITA 20(1)(c)(i).** As set out in *Shell Canada Ltd v Canada* (SCC), the rule is that an amount is deductible if it meets the following four conditions:

1. the amount is paid or payable in the year in which the deduction is sought;
2. the amount is paid under a legal obligation to pay interest on borrowed money;
3. the borrowed money is used **for the purpose of earning non-exempt income from business or property**; and
4. the amount is reasonable in the circumstances (the provision contains its own built-in reasonableness language).

It is the third element of the test that is most often controversial.

20.3 was enacted in response to *Shell Canada*. It limits the deduction of interest expenses on weak currency debt to an amount that would have been payable if T had incurred the debt directly in the final currency that is used for purpose of gaining/producing income.

**Shell Canada Ltd v Canada*, [1999] SCC	T, which required US $100M for its general corporate purposes, entered into elaborate series of transactions whereby it borrowed funds in NZ$ that was expected to depreciate against the USD, exchanged these funds for USD, and entered into a forward exchange agreement to purchase the NZD as needed to make interest and principal payments on the loan. As a result, T incurred much higher interest expenses during term of loan than it would have incurred if it had borrowed USD, and corresponding foreign exchange gains on payments of interest and principal. T deducted CDN equivalent of NZ$ interest expenses and reported foreign exchange gains as capital gains.	Borrowed funds were used by T for purpose of earning non-exempt income from its business, notwithstanding purpose for which NZ$ were borrowed, and interest rate negotiated w/ NZ lender was reasonable.

Direct Use Test

The test for purpose under **20(1)(c)(i)** is based on the direct use to which the borrowed funds are put. The courts must look to the current and direct use of the money to see if it is an eligible use.

- **Note that the emphasis on economic substance to determine the purpose for which the borrowed funds are used (*Bronfman Trust, Mark Resources, Robitaille*) has been rejected in

more recent SCC decisions (*Shell Canada, Singleton, Ludco*), and not challenged under GAAR (*Lipson*).

Bronfman Trust v Canada, (1987) SCC
F: Sam Bronfman set up a trust for his daughter Phyllis and her children in 1942. The trust is fixed as to income (Phyllis entitled to 50% of income) and discretionary as to capital (trustees may distribute in their sole discretion). As the trust's investment policy is focused on capital appreciation, there is very little income. Poor Phyllis is only getting payments of $150K/annum. ∴ in 1969 and 1970 the trustees decided to pay large amounts to Phyllis out of capital. The trustees concluded that liquidating assets to pay Phyllis would have been "commercially inadvisable" AND most of the investments at the time were not readily realizable so they instead borrowed the money to pay Phyllis and sought to deduct the interest payments for the purpose of computing the income from the trust. When the Minister protested, the trust advanced the following two arguments in court:
1. The interest expense was incurred for an <u>indirect</u> income-earning purpose, because by borrowing the money to pay Phyllis the trust avoided dissipating income-earning assets.
2. The trust would have obtained the deduction if it had sold assets to pay Phyllis and then borrowed money to replace them, so it should ∴ be permitted the deduction. (Hypothetical argument)
L: **Eligibility for the deduction is contingent on the use of borrowed money for the purpose of earning income. What is relevant is the T's purpose in using the borrowed money in a particular manner. The borrowed funds must still be in the hands of the T, as traced through the proceeds of disposition of the preceding ineligible use, if the T is to claim the deduction on the basis of a current eligible use. Direct ineligible use of borrowed money cannot be overlooked whenever an indirect eligible use of funds can be found. Use must be direct. Even in rare exceptions <u>where indirect use qualifies</u>, you would have to establish that the BF purpose was to use the borrowed funds to earn income.**
A: Re argument #2, hypothetical alternatives are not relevant. The loans merely postponed need for eventual reduction in trust's capital assets. Real purpose here was to pay out money to Phyllis. BF use was not demonstrated here.
C: Deduction disallowed. (1) The courts should ignore the indirect use of the money and consider only the current and direct use of the loan. (2) As to the second argument, the question is what T did, not what it could have done.
R: **Direct use test** (as modified by *Ludco* and *Singleton*). **

- The statement in *Bronfman* that if the trust really had sold assets and then borrowed to repurchase them, its deduction of interest expense could be disallowed as a "sham", is overruled by *Singleton*
- **The statement in *Bronfman* that the income-earning purpose must be BF is overruled in *Ludco*.**
- ****BUT *Bronfman* remains good law for the <u>direct</u> use test and for the proposition that it is the <u>current</u> use of the money that is important.**

The <u>direct</u> use inquiry should not search for the <u>economic reality</u> behind a situation:

Singleton v Canada, (2001) SCC
F: T, a partner at Singleton Urquhart in Vancouver, entered into a series of transactions on a single day, 27 October 1988. Although the exact order of the transactions is not clear, T withdrew some $300K from his capital account at the firm to use to buy a house, and borrowed $300K from a bank to repay to his capital account at the firm. He deducted the interest on the bank loan against his income from his law practice. T argued that the purpose of the borrowed funds was to re-capitalize his account at the firm.
C: Deduction allowed. The purpose of T's loan was to refinance his capital account. **The court must (1) view the transactions independently; and (2) focus on the <u>direct use</u> of the loan. It should not search for the "economic realities" behind the situation.**

D: Overrules *Robitaille*. In that case, a partner at a law firm did precisely what T did in *Singleton*. The TCC held for the Minister and disallowed the deduction essentially on the basis that the true purposes of the loan was to buy a house.

The bizarre result is that T can effectively deduct interest on a residential financing loan through the intermediary of his business.

Note that under the direct use test, a T cannot use the loan for a **non-eligible purpose**, use his own money for an **eligible purpose**, and then deduct the interest on the loan as if it had been used for the eligible purpose.

MNR v Attaie, [1990] FCA	When T left Iran for Canada around the time of the revolution, he had some $200,000 squirreled away there, which he didn't have immediate access to. In order to buy a house in Don Mills, ON, ∴, T borrowed money from the bank. Expecting to get at the Iranian $ quite soon, T ensured that his Canadian mortgage was repayable early without penalty (even though the bank charged higher interest for this right). The final rate was 10¾ percent. But by the time T got the Iranian money, interest rates had risen dramatically. Instead of repaying the mortgage, T bought term deposits at 14–16% in order to earn the spread over the mortgage interest. He then sought to deduct the mortgage interest against his income from this little investing adventure.	Deduction disallowed. The direct and actual use of the mortgage loan was to obtain a personal residence.

The <u>direct</u> use of the borrowed money must be to earn income in the sense of <u>revenue</u>, not necessarily in the sense of net income.

Ludco Enterprises Ltd v Canada, (2001) SCC
F: This case involves two companies located in an offshore tax haven. The companies' declared purpose is to pay little in the way of dividends in order to accumulate untaxed investment returns. In turn, these accumulated assets increase the companies' share prices so that shareholders can sell the shares at a capital gain. The Ts (Ludco Enterprises) in this case borrowed money in order to buy shares in the above off-shore companies (Panamanian Companies). That money is then used by the off-shore companies on secure investments. They incurred interest expenses of $6M, which they deducted, on these loans; but earned only $600K in dividends in the same time period. At the end of the period, Ts sold the shares in the Panamanian Companies for a capital gain of $9.24M – half of which is taxable. From tax perspective, they've generated a loss of ~780K, but really they have incurred a ~3.8M gain.
C: Deduction allowed for the full $6M.
R: **The term "income" in ITA 20(1)(c)(i) does not refer to net income but to income subject to tax – to gross profit. Purpose requirement in 20(1)(c)(i) need not be BF, but can be ancillary. ∴ if a T has an ancillary purpose to earn income subject to tax, the interest expense is deductible.** So long as you get at least some revenue from the shares, the interest expenses are deductible.
D: If court had read **9(1)** and **20(1)(c)** together – income in **20(1)(c)** refers to profit. Court is allowing a tax shelter by completely ignoring the Act. Effectively reverses *Mark Resources*, which held that interest incurred in financing a scheme by affiliated companies to import taxable losses into Canada is not deductible.
Result of ratio here is that **an ancillary purpose to earn income is sufficient to satisfy the statutory test, even if primary purpose is to obtain a capital gain or avoid tax.**

Despite the direct use test, in at least one case T has obtained a favourable result by application of an <u>indirect</u> use:

Canadian	After borrowing the money at interest, SubCo (T)	Deduction allowed.

Helicopters Ltd v Canada, [2001] FCA	turned around and loaned it to ParentCo interest-free. The purpose of the loan was to enable ParentCo to buy up CompetitorCo and then earn income from business by (1) charging management fees to CompetitorCo; and (2) amalgamating the operations of SubCo and CompetitorCo. SubCo sought to deduct the interest it paid on the original loan.	Even though the loan was not directly used to earn income, it was used for an eligible indirect use.

Replacement of One Loan by Another

If a T borrows new money to repay money previously borrowed, the new money is deemed to be used for the same purpose as the previous indebtedness was used under **20(3)**.

**Grenier v MNR*, [1992] FCTD	T borrowed $66K on security of his home, which was used to earn income from an automobile garage in Hull. (Should be deductible) When he subsequently moved to a new residence, he used the proceeds from the sale of the old residence to repay the original $66K loan, borrowed a further $151K to purchase the new residence, and sought to deduct the interest on the full amount of this new loan on the basis that it had replaced the original $66K loan. Direct use of borrowed funds is to buy a house. BUT more broadly, $66K is still earning income at automobile garage – kind of just swapping out security.	T allowed to deduct interest payable on $66K of new loan. **20(3)** maybe applies here (although it doesn't really…). There's nothing offensive here, if T had done things in the right order he would have gotten the deduction no problem. **Indirect use argument from *Bronfman Trust* accepted here.**

Student Loans

Student loan interest is not deductible against income from employment: *Leslie v Canada*.
BUT interest on a student loan is deductible if, instead of using the loan to pay for education, T uses the money to earn income from business:

Sinha v MNR, [1981] TRB	T who had borrowed $4.5K in 1977 in form of a Canada student loan, did not use funds for educational or living expenses but invested cash in interest-bearing securities. When Canada student loan began to bear interest in 1978, T deducted these payments.	Deduction allowed. T used funds to earn income, regardless of original purpose for which they were borrowed.

Misc

Canwest Broadcasting Limited v Canada, (1995) TCC	Court must look at the commercial, practical and economic reality of the T's transactions, and **not permit form to override substance.**	
Zwaig v MNR, [1974] TRB	T sold securities to a brokerage firm on the understanding that he would repurchase them, used the proceeds to purchase a life insurance policy, and borrowed money in order to repurchase the securities.	Deduction disallowed**. One must look at the whole picture of the transaction to discover its substance** and by the same token to find out if the borrowed money was used to earn income.
Sherle v Canada, [2009] TCC	T sought to deduct interest paid on a loan secured against a mortgage on a dwelling she had converted from her	Funds in question were not borrowed for an income-producing purpose – deduction disallowed.

	principal residence into a rental property.	
722540 Ontario v Canada, [2003] FCA	T engaged in a complicated series of pre-ordained and circular transactions designed to obtain interest deductions by borrowing money and loaning it to a company w/ accumulated losses and no ongoing business.	Disallowed deduction under former **245(1)** on basis that the transactions would artificially reduce T's income.
**Tennant v MNR*, [1996] SCC	T borrowed $1M in 1981 w/ which he purchased 1M common shares of RW at $1/share. In 1985, T disposed of shares to holding company TWL at a declared FMV of $1K, in exchange for 1K class B common shares of TWL. When T continued to deduct interest on full $1M borrowed in 1981, CRA reassessed, allowing T a deduction for interest on the $1K value of the shares declared in 1985.	Full amount of borrowed funds could be traced to T's interest in the 1K TWL shares – T's appeal allowed. In order to deduct interest payments, **T must establish a link between the current eligible use property, the proceeds of disposition of the original eligible use property, and the money that was borrowed to acquire the original eligible use property.** Original RW shares, the first source of income, were exchanged for the TWL shares, a replacement source. First source continued in a new form, as both RW and TWL shares are directly and fully traceable to loan, as all proceeds of disposition were reinvested in the second source.
Hills v MNR, [1970] TAB	T sought to deduct interest payments on a bank loan obtained to acquire a home 25% of the living space of which was used for rental purposes.	T allowed to deduct only 25% of interest expense.
Emerson v Canada, [1985] FCA	T borrowed $100K in 1980 to purchase shares of 3 small business corps, which were sold at loss of $35K in 1981, at which time T borrowed a further $63K to discharge the amount of the initial loan still outstanding.	T failed to establish the existence of a source of income to which the interest expense continued to relate.
Gifford v Canada, [2004] SCC	If funds are borrowed in order to add to financial capital of a T, then interest payments thereon will be payments on account of capital, regardless of whether payments would otherwise be appropriately characterized as capital expenditures.	

Lipson v Canada, (2009) SCC
F: T conducted a series of transactions whose purpose was to minimize income tax. T concedes that his transactions were avoidance transactions within meaning of **245(3).** In April 1994, T and wife entered into agreement of purchase and sale for family residence. Purchase price was $750K. In August 1994, wife borrowed $562.5K from BMO to finance purchase at FMV of 20 and 5/6 shares in Lipson, a family corporation [wife would be able to get deduction for interest on the loan, because it was used to buy property]. T had agreed to repay loan in its entirety the following day. Wife paid borrowed money directly to husband, who transferred shares to her. T bought house for $562.5K. T and wife obtained a mortgage from BMO for $562.5K, which was advanced on closing date of September 1, 1994. Same day, T and wife used mortgage loan funds to repay share loan in entirety. Wife also got dividends from shares in the family company. T does not elect out of **73(1)** rollover –

so attribution rules do apply. T is higher income spouse, so they would prefer to attribute losses rather than gains to him.
T relied on 4 provisions of ITA to claim a deduction of mortgage loan interest on his 1994, 1995 and 1996 tax returns.
(1) **73(1):** Transfer of shares from T to wife was deemed to have occurred at adjusted cost base, such that neither sustained a loss nor realized a gain on the sale.
(2) **74.1:** Although wife owned shares acquired from T, divided income and losses were attributed to T.
(3) **20(3):** Allows a deduction for interest on money borrowed to repay previously borrowed money if interest on original loan is deductible. [For wife taking out mortgage – i.e. borrowing funds – to repay loan to BMO]
(4) **20(1)(c):** Permits deduction of interest on money borrowed for purpose of earning income from a business or property. [For interest paid on wife's loan to buy shares.]
L: GAAR: For the purposes of **245(4),** abusive tax avoidance occurs where the impugned transaction frustrates the object, spirit or purpose of one or more of the provisions relied on by the T. To determine if one or more transactions in a series is abusive, **individual transactions must be viewed in the context of the series.** Motivation, purpose and economic substance are relevant under **245(4)** only if they establish that the transaction frustrates the purpose of the relevant provision. **Focus of analysis should be on overall result of series**, not overall purpose.
Interest deductibility: Purpose of **20(1)(c)(i)** is to create an incentive to accumulate capital w/ potential to produce income by allowing deduction for interest on a loan. **20(3)** was enacted for greater certainty in order to make it clear that interest is deductible under **20(1)(c)** does not cease to be deductible because original loan was refinanced.
A: Misuse or abuse of **20(1)(c)** or **20(3)** not established. Under **20(1)(c)**, Mrs L used loan to buy shares which is income producing purpose and allowed.
C: MNR has established abusive tax avoidance. GAAR applies to one of the transactions within the series and can accordingly be used to deny one of the tax benefits sought by T. Appeals dismissed. Disallow interest deduction in computing income or loss attributed to T and attributing that deduction back to wife.

Timing Issues

The final task in computing a T's income from a business or property is to determine the taxation year in which specific amounts must be included and may be deducted. Business income is typically computed on an **accrual basis**, according to which revenues are included in computing a T's income in the taxation **year in which they are earned**, even if they have not been received, and expenses are deducted in the taxation **year in which they are incurred**, even if they have not been paid – i.e. amounts are included when they are **receivable.**

- While interest and rental income are also generally included on an accrual basis, other amounts are included in computing a T's income from a business or property only when they are received. Other rules defer the taxation year in which specific kinds of expenditures may be deducted (e.g. farming, fishing), while yet others permit Ts to deduct specific amounts in respect of amounts that were previously included in computing their income from a business or property.

As a general rule, Ts would prefer to have inclusions recognized later and deductions recognized earlier. This may be flipped in some specific circumstances, e.g. when there are a bunch of losses that are about to expire.

Inclusions: The statutory starting point for determining the taxation year in which amounts must be included in computing a T's income from a business or employment is **ITA s 9.**
In addition to these basic rules, **s 12** contains a number of additional rules:

- **12(1)(a)** refers to amounts received

- **12(1)(b)** codifies the idea that **amounts receivable should be included** – basically accrual-based accounting
- **12(1)(c)** refers to timing for interest income inclusions
  - **12(3)** and **12(4.1)** require interest income to be included in computing income on an annual basis, even if interest isn't payable until sometime in the future.
  - **12(4)** sets out the timing rules for interest from investment contracts.
  - **12(11)** defines 'anniversary day'.
- **12(j)** and **(k)** – dividends on accrual basis
- **12(1)(g)** – royalties – amounts received = cash-based

Deductions: The taxation year in which amounts may be deducted in computing a T's income from a business or property is determined both by the general concepts of 'profit' and 'loss in **ss 9(1) and (2**) of the Act and by other rules that apply either generally to all expenditures or more narrowly to specific kinds of expenditures. Deductions for amounts payable under **18(1)(a) – amounts are payable when T is legally obliged to make a payment.**

GENERAL PRINCIPLES

The general principle bundle involves 3 major concepts:

1. The **matching principle**, which is really a sort of general philosophy or approach taken by the courts;
2. **Running expenses,** which are a CL exception to the matching principle which permit certain future expenses to be currently deducted; and
3. The prohibition against deducting certain **prepaid expenses** that is contained in **18(9)**.

Matching Principle

A business' annual income tax return is just a snapshot of the revenues and expenses of a business that is fluidly changing in time. The courts often say that they want this snapshot to reflect a **"true picture"** of the state of the business. While the courts will pay heed to GAAP &c, they refuse to defer to accountants, and may resist permitting the present deduction of expenses which actually relate to anticipated future revenues.**The courts prefer that expenses be deducted against (i.e. matched with) the revenues to which they relate.** They prefer to avoid the deduction of particularly large expenses that will "distort" a T's "income" for the year. Nothing in the Act specifically requires such amortization—the doctrine originates w/ the judges.

West Kootenay Power & Light Co v MNR, (1991) FCA

F: T is investor-owned corporation engaged in business of generating and distributing hydro-electric power. Its residential customers were on a 2-month billing cycle, and meter readings were made on a bi-monthly basis. At relevant fiscal year-ends, 1983 and 1984, T had delivered some electricity for which, as of those year-ends, the customers had not yet been billed. Regulation did not permit T to issue bills for electricity supplied to December 31 until completion of billing cycle ending after that date. Starting in 1979, T recorded income based on estimates of revenue anticipated to be received (accrual method), both for financial statements of its operation and for tax purposes. In 1983, while maintaining accrual basis for calculating income for annual financial statements, T changed from an accrual to a 'billed' basis for its income tax return, eliminating from its income the estimate of revenue unbilled at year-end, and reported revenues only as billed. Unbilled revenue was added to T's income by MNR. MNR argued for conformity between financial accounting and tax accounting and consistency in accounting practices.

L: **Undesirable to establish an absolute requirement that there must always be conformity between financial statements and tax returns. Whichever method presents the 'truer picture' of a T's revenue, which more fairly and accurately portrays income, and which 'matches' revenue and expenditure, if one method does, is the one that must be followed.**

Receivable = **recipient must have a clearly legal, though not necessarily immediate, right to receive it.**
A: Accrual method of accounting adopted in 1979 for both financial and tax purposes presented a truer picture of T's revenue because it more accurately and fairly **matched revenue and expenditure** – this, despite the fact that the estimate of revenue for the 'stub-end' of the year could be only an approximation of the actual revenue. Amount here is sufficiently ascertainable to be included as an amount receivable. T was absolutely entitled to payment for any electricity delivered, and in an amount reasonably estimated – actually receivable because T has legal rights to the amounts.
C: Appeal dismissed – unbilled revenues should be included in computing T's revenue.
R: **Computation of profit for a taxation year under 9(1) is based on true picture principle (for which matching of revenues and expenses is a guideline, but not a rule of law.**
Inclusion for amounts receivable under 12(1)(b) – amounts receivable (amounts to which T is legally entitled, provided they are sufficiently ascertainable).

Canderel Ltd v Canada, (1998) SCC
F: T's business is developing and managing commercial properties. In order to attract tenants, T spend some $1.2M in the 1986 taxation year on tenant inducement payments (TIPs). For accounting purposes, T amortized each TIP over the life of the lease to which it related (3–10 years, depending on the case). But for tax purposes, T deducted the whole of each TIP in 1986.
L: GAAP are non legal-tools and as such are external to the legal determination of profit, whereas the provisions of the Act and other established rules of law form its very foundation. These principles will, more often than not, constitute the very basis of the determination of profit. BUT these principles must necessarily take a subordinate position relative to the legal rules which govern. While GAAP may more often than not parallel the well-accepted business principles recognized by the law, there may be occasions on which they will differ, and on such occasions the latter must prevail. **Matching principle is merely an interpretive aid, not an established rule of law.**
C: The TIPs are running expenses because they cannot be causally linked to any specific item of revenue. Rather, they yield four primary benefits to T: (1) prevention of a "hole" in income caused by vacancy; (2) satisfying the requirements of T's financing arrangements w/ its bankers; (3) maintaining T's competitive position and reputation; and (4) generating revenues through rentals and management and development fees.
D: Note that other cases might be distinguished from *Canderel* if they do not provide **general advantages to T in the current period** beyond the resulting rental income.

Ikea Ltd v Canada, [1998] SCC	T, which received a $2650K inducement payment during its 1986 taxation year in order to enter into a long-term lease agreement, sought to defer recognition of the payment by amortizing it over the term of the lease.	Payment was fully taxable in T's 1986 taxation year. **Matching principle is not an overriding rule of law.**
Publishers Guild of Canada Ltd v MNR, [1956] Ex Ct	T, which sold books and magazines through door-to-door canvassers, computed its annual income on an instalment basis, according to which amounts receivable from door-to-door subscriptions were not brought into income until actually received, while expenses incurred in order to earn subscription income were not deducted until this income was received.	Accounting method employed by T accepted on basis that instalment system of accounting as adopted by T is an acceptable system, is appropriate to the T's business and more accurately reflects its income position than any other system of accounting would do. **Prime consideration, where there is a dispute about a system of accounting is, in the first place, whether it is appropriate to the business to which it**

		is applied and tells the truth about the T's income position and, if that condition is satisfied, whether there is any prohibition in the governing income tax law against its use.
Boosey & Hawkes (Canada) Ltd v MNR, [1984] TCC	T, which was in the music publishing business, received royalties in its 1979 taxation year, which the Minister included in computing the T's income for its 1978 taxation year on the basis that these amounts were receivable at the end of that year.	T had consistently adopted a cash method of reporting its income since at least 1958 and Minister failed to establish that this method did not accurately reflect the income of the T in the taxation year at issue.

Running Expenses

Rule: Expenses that **cannot be easily matched w/ specific revenues** may be deducted in the year in which they are incurred, even if the amount of the deduction may be particularly large and distort the T's income for that particular year.

Oxford Shopping Centres Ltd v Canada, (1980) FCA
F: T paid city slightly less than $500K in respect of construction by city of a road interchange affecting the access and use of P's parking area. Agreement stated that the payment was in lieu of local improvement rates and taxes that might be payable by reason of the works and improvements undertaken by the city. T amortized the cost over 15 years for accounting purposes, but for tax purposes they took the entire deduction in 1 year. Minister argued that amount of deduction should be amortized over a period of years.
L: For IT purposes, while the **matching principle** will apply to expenses related to particular items of income, and in particular w/ respect to the computation of profit from the acquisition of sale of inventory, it **does not apply to the running expense of the business as a whole even though the deduction of a particularly heavy item of running expense in the year in which it is paid will distort the income for that particular year.**
C: Whole amount is deductible in year of payment. Appeal allowed. Expected duration of benefits to popularity of shopping centre is imponderable.
D: In response to this case, ITA was amended to introduce **18(9)** [prepaid expenses]**.**

Payments to induce tenants to enter into leases are running expenses because they produce benefits in current period as well as future periods:

**Canderel Ltd*, SCC	See p. 77. The TIPs are running expenses because they cannot be causally linked to any specific item of revenue. Would be arbitrary to spread it out over life of the lease.

Advertising costs are a classic running expense:

MNR v Tower Investment	T built 24 apartment buildings in Montreal and spent large sums over three years on an intensive advertising campaign to attract tenants for the 660 new apartments ($92K, $59K, $2K). For income tax purposes, T spread the deduction over the three years in a different order so as to defer some of the deduction ($7K, $64K, and $82K). This approach reflected GAAP and more accurately reflected T's income picture.	Allowable.

Misc:

Vallambrosa Rubber	T, which was in first year of new business involving cultivation and sale of rubber, deducted full costs of overseeing and maintaining its rubber	Nothing ever could be deducted as an expense unless that expense was purely and solely referable to a profit which was reaped in the year.

	plants, even though only 1/7 of the return from the plant was realized in the first year.	
Naval Colliery	T incurred expenses to recondition its equipment after a national stoppage in the coal-mining industry.	That sort of expenditure is expenditure incurred on the running of the business as a whole in each year, and the income is the income of the business as a whole for the year, w/o trying to trace items of expenditure as earning particular items of profits.
Cummings v Canada (1981)	T constructed a 15-story office building, incurred expenses to indemnify a key tenant for penalties and rental costs resulting from the decision to vacate other office space.	Running expense.

Prepaid Expenses

Rule: 18(9) requires Ts to defer the deduction of various prepaid expenses, (a) prohibiting their deduction in the taxation year in which they are made or incurred, and (b) allowing these amounts to be deducted instead in the subsequent year to which they can reasonably be considered to relate.

- **18(9)(a)(i)** prepaid for services to be rendered after the end of the year
- **18(9)(a)(ii)** prepaid for interest, taxes, rent or royalties in respect of a period that is after the end of the year
- **18(9)(a)(iii)** prepaid insurance in respect of a period after the end of the year
    - in respect of period after end of year

Urbandale Realty Corp v MNR (2000)	**18(9)** did not require amortization of a regional dev't charge levied by the Regional Municipality of Ottawa-Carleton on the grounds that the one-time tax did not relate to a period as indicated in **18(9)(a)(ii)** and was not imposed in respect of a period after the end of the year.
Toronto College Park Ltd v Canada (1996) [Compare w/ *Canderel*]	Rejected T's argument that absence of tenant inducement payments from **18(9)** implicitly authorizes their immediate deduction on basis that the kinds of expenses subject to **18(9)** are mostly expenditures that, unlike tenant inducement payments, cannot be easily matched to a specific source of income in subsequent taxation years.
Canderel Ltd v Canada (1998)	T not required to amortize amounts paid to induce tenants to enter into long-term leases on the grounds, inter alia, that **18(9)** does not include TIPs in the list of amounts that must be amortized.

INTEREST INCOME

Subject to several particular timing rules – in particular **12(1)(c)**. **12(1)(c)** states that interest income should be taxed when received or receivable.

BUT, for most debt obligations, interest income is now subject to tax on a **pure accrual basis** under ss **12(3)** and **12(4)** (i.e. annual inclusion even if not received or receivable in the year).

- **12(3)** states that: in computing the income for a taxation year of a corporation, partnership, unit trust or any trust of which a corporation or a partnership is a beneficiary, there shall be included any interest on a debt obligation…[other than certain excluded forms of debt] that accrues to it to the end of the year, or becomes receivable or is received by it before the end

of the year, to the extent that the interest was not included in computing its income for a preceding taxation year. `

- **12(4)** states that: where in a taxation year a T (other than a T to whom subsection (3) applies) holds an interest in an investment K on any anniversary day of the K, there shall be included in computing the T's income for the year the interest that accrued to the T to the end of that day w/ respect to the investment K, to the extent that the interest was not otherwise included in computing the T's income for taxation year or any preceding taxation year.
    - **12(11)** defines **anniversary day** as: (1) the day that is one year after the day immediately preceding the date of issue of the K, (b) the day that occurs at every successive one year interval from the day determined under para (a), and (c) the day on which the K was disposed of.

Freeway Properties Inc v Canada, [1985] FCTD	T, a corporation engaged in the business of land dev't, sold a parcel of land in 1979, for which it took back a $300K mortgage repayable in full in December 31, 1984, w/ interest owing during the term of the mortgage.	According to **12(1)(c),** interest for taxation purposes can and must be taken into account as income in only 2 ways: when the T is entitled to account for income on a cash basis, interest is to be considered in computing income during the year of receipt; when the T is accounting for income under the accrual method, interest must be taken into account when it is receivable.
Elm Ridge Country Club Inc v MNR, [1995] TCC	T received an interest payment of $43K in 1983, $41K of which it sought to include in computing its income for its 1982 taxation year on the grounds that this amount accrued during 1982.	T reported other interest income on cash basis and had not reported the accrued interest in computing its income for its 1982 taxation year. Cash basis.

TRANSFERS OF DEBT OBLIGATIONS

Vendor: Where a T sells a debt obligation on which interest has accrued w/o receipt, the price at which the obligation is sold is likely to include an amount equal to the value of the accrued but unpaid interest to which the purchaser will be entitled.

- **12(3)** and **(4)** provide that the accrued interest up to the time of the sale must be included in computing the vendor's income for the taxation year.
- Under **52(1)**, accrued but unpaid interest that is included in computing the vendor's income under **12(3)** or **(4)** may be added to the cost of the debt obligation, thereby reducing the amount of any gain on its disposition.
- Where the debt obligation is disposed of for consideration equal to its FMV at the time of the disposition, **20(21)** permits a deduction in the year of disposition in respect of accrued interest otherwise included in the vendor's income to the extent that it cannot reasonably be considered to have been received or to have become receivable.

Purchaser: For a T who acquires a debt obligation on which unpaid interest has accrued, the full amount of this interest must be included under **12(1)(c)** in the year that it is received or receivable.

- Absent any other rule, this would mean that the accrued but unpaid interest would be taxable to both vendor and purchaser.
- *To address this, **20(14)** allocates accrued interest between vendor and purchaser on transfer of a debt obligation by requiring inclusion to transferor and permitting deduction to transferee, w/ adjustments to ACB of debt obligation under **52(1)** and **53(2)(1).**
    - **53(2)(l)** reduces the cost base of the debt obligation by any amount that is deductible under **20(14)**.

Canada v Antosko, (1994) SCC
F: The New Brunswick Industrial Finance Board ("Transferor") financed Atlantic Forest Products Ltd. ("Atlantic") through a combination of controlling equity, debt and guarantees of loans on which it became the subrogated creditor. Atlantic experienced financial difficulty – had a debt of $5M. The Transferor (and its successor in interest, the Province of New Brunswick) transferred its equity interest (shares) in Atlantic to Antosko and another ("Purchasers") for nominal consideration ($ 1.00) and an undertaking essentially to "work out" Atlantic's financial problems. After two years, provided the Purchasers had operated Atlantic for two years, the Transferor agreed to transfer its interest in Atlantic's debt together w/ accrued interest to the Purchasers for nominal consideration ($10). Part of the original agreement was the postponement of the payment of the accrued interest until after the debts transfer two years hence. The debt was transferred at the end of the two-year period; accrued interest was paid to the Purchasers who included the interest under paragraph **12(1)(c) of ITA** and claimed an equal deduction under paragraph **20(14)(b).** T1 (Antosko) received 38K in 1977, and T1 and T2 received 283K in 1980. The tax authorities disallowed the **20(14)(b)** deduction to the Purchasers on the basis either that **20(14)** was inapplicable or, if it was, that the deduction was unavailable because the Transferor was not taxable on the interest accrued prior to the Transfer.
I: When debt is transferred from non-taxable gov't body to investors trying to rehabilitate a failing company, does such a transaction come within the scope of 20(14)?
L: **In order to come within 20(14)**: (1) There must be an assignment or a transfer of a debt obligation; (2) The transferee must become entitled, as a result of the transfer, to interest accruing before the date of the transfer but not payable until after that date. Motives of the parties, and setting in which transfer took place, are not determinative of application of **20(14)**. **It is not the role of the Court to determine whether the transaction in question is one which renders the T deserving of a deduction. The amount, if any, of the interest determined for the purpose of 20(14) is unaffected by either the prospects of its payment or non-payment or the nature or value of any consideration given by the transferee.** No words in **20(14)** or the Act as a whole make **(b)** conditional on application of **(a).**
A: Substance of transaction meets requirements of **20(14)**. Not a sham. The interest which accrued during the 2-year period during which the debt was suspended was payable after the transfer and ∴ meets the terms of **20(14)**. Agreement to suspend repayment of accruing interest that would otherwise have been payable was legally enforceable. SO accrued interest was not payable before the transfer.
C: Appeals allowed. Referred back to Minister for reassessment. Ts get the interest tax-free!
D: Might be decided differently if GAAR had been in place.

INVENTORY COSTS

Where a T acquires or produces property for the purpose of sale in the course of a business, the property is generally characterized as **inventory** in the T's business. **248(1)** of the Act defines **inventory** as 'a description of property the cost or value of which is relevant in computing a T's income from a business for a taxation year' (either because cost or value is deducted in computing the T's gross profit as in *Neonex* or because cost or value of homogenous inventory is added back in computing T's gross profit for the year). **Costs to acquire or produce inventory are generally deductible only in the year in which the inventory is sold or otherwise disposed of.**

- **10(5)(a):** property (other than capital property) of a T that is advertising or packaging material, parts or supplies or work in progress of a business that is a profession is, for greater certainty, inventory of the T.

Neonex International Ltd v Canada, (1978) FCA
F: T is engaged in production and subsequent sale or rental of electrical signs – all custom-built. At year-end, there is always a certain number of signs partially completed and in the course of construction. Until 1970 the T treated the uncompleted signs for both accounting and tax purposes as 'work in progress' inventory – would deduct expenses, then add back value that had been put

into uncompleted signs (so not deduct cost associated w/ uncompleted signs – then deduct costs when signs are sold). Continued to do so for accounting purposes thereafter but for 1970-1972 taxation years the costs incurred to the end of the tax years in respect of partially completed signs were deducted, for the purpose of computing income for tax purposes, on the basis that they represented period expenses not required to be carried for income tax purposes as the cost of work in progress inventory. T argues that he shouldn't be required to match. MNR disallowed deductions.
L: **Matching principle requires that at the end of an accounting period an effort be made to identify those costs which have been incurred during the period but which have not yet been expended in the revenue earning process so that they may be recorded as assets and carried forward to the accounting period in which the revenue they aid in producing is recorded**.
C: Appeal dismissed. Truer picture of income comes from deferring costs of making those signs until revenue for those particular signs is received.
R: **Inventory costs not deductible until inventory sold.**

Having characterized a particular item of property as inventory, next step is to **determine the specific expenses that must be allocated to the cost of this inventory**. Where particular items of inventory are unique or easily distinguishable, as in *Neonex*, inventory accounting can be achieved directly by deferring the deduction of inventory costs until the taxation year in which the property is sold or otherwise disposed of.

- **Where a T's inventory is numerous and relatively homogenous**, this result is generally achieved indirectly by deducting all expenses incurred in the year and *adding back* the cost of inventory that remains unsold at the end of the year -> GP = Proceeds –Co –C1 +C2
- **Where inventory is numerous and heterogeneous and acquired or produced at different costs**, it is often impractical or impossible to track the cost of each individual item in order to determine the aggregate cost of inventory that remains at the end of each year. As a result, accounting practice has generally relied on different assumptions about the order in which inventory is disposed of e.g. FIFO, LIFO, average cost method to value cost of unsold inventory.

LCM (lower of cost or market) method: Under **10(1)**, where inventory decreases in value (in relation to cost) in a taxation year prior to its disposition, inventory accounting has traditionally recognized these accrued losses by valuing this property at the lower of its cost and FMV at the end of the year.

- **10(1.01):** However, **this does not apply for business that is ACNT** (added in response to *Friesen*).

10(21) legislatively confirmed *Cyprus Anvil*.

**MNR v Anaconda American Brass Ltd*, [1955] PC	T carried on a business of manufacturing metal sheets, rods, and tubes, in the course of which it purchased substantial quantities of copper. In 1947, at a time when metal prices were increasing after the removal of wartime price controls, the T adopted a LIFO method of accounting for the cost of products sold during the year and thereby reduce its income for the year.	PC upheld Minister's reassessment, which computed cost of unsold copper on a FIFO basis, on grounds that this method more nearly than the LIFO method measured the actual stock so far as it can be ascertained. **Rejects LIFO unless it reflects the actual physical flow of inventory.**
Friedberg v Canada, [1993] SCC	T traded in gold futures K, buying and selling Ks both to buy gold at future dates and to sell gold at future dates, in the course of which he realized substantial business losses by selling Ks that had decreased in value at the end of	Losses were properly deductible in each of the taxation years in which they were claimed on the grounds that they were actually incurred in these years while the gains were actually realized in the following taxation years.

	each taxation year and delaying the sale of Ks that had increased in value until the following taxation year.	
**Friesen v Canada*, [1995] SCC	T, who purchased a parcel of land for the purpose of resettling it at a profit, relied on LCM rule to deduct as losses in computing his income for his 1983 and 1984 taxation years decreases in the value of the property during each of these years.	Land was 'inventory' within meaning of ITA because it was relevant in computing the T's income for the taxation year in which it would be sold or otherwise disposed of. T could trigger accrued losses on the land by valuing the property at its FMV at the end of the 1983 and 1984 taxation years.
MNR v Cyprus Anvil Mining Corp, [1989] FCA	T, which opened a new mine that was exempt from income tax for a 3-year period, changed its method of accounting for inventory from the LCM method to the FMV method during the years when it was tax-exempt, after which it returned to the LCM.	**10(1)(a)** neither contains a prohibition against changing the method of inventory valuation from time to time, nor (b) permits the method selected to be changed at will, nor (c) provides a departure from the GAAP of valuing inventory only at cost or the lower of cost or market. BUT the changes distorted T's income – should be computed on LCM method.

PROPERTY EXPENSES

The expense of repairing or improving existing property can be classified in the same manner. Where such expenses are capital expenses, they may relate either to depreciable or non-depreciable capital assets. If they relate to **depreciable property**, these expenses are added to the capital cost of that property.

The main issue we looked at is whether an outlay is:

- a currently deductible expense; or
- a capital expense

We also looked at how CCA works in general.

- The issues include how property should be classified when acquired (whether it is **depreciable property**) and what tax rules are triggered on disposition of **depreciable property**.
- The CCA rules feed into the principle issue in the chapter on taxable capital gains and allowable capital losses – whether and to what extent the Minister may challenge the parties' allocation of the purchase price between assets when one party sells a bundle of capital assets to another party.

Capital Expenses versus Currently Deductible Expenses

The cases often use the term income expense to describe the cost of acquiring property that is not capital property, or of repairs that are not capital improvements. However, DD prefers the term currently deductible expense.

Rule: In computing a T's income from a business or property, **18(1)(b)** of the Act **prohibits any deduction** in respect of an outlay, loss or replacement of capital, a payment on account of capital or an allowance in respect of depreciation, obsolescence or depletion except as expressly permitted by this Part.

- Depreciation is covered under **20(1)(a)**

- **20 (1)(a)** authorizes the deduction of such part of the capital cost to the T of property, or such amount in respect of the capital cost to the T of property, if any, as is allowed by regulation. **Reg 1100(1)** creates a series of CCAs and **Schedule II** sets forth the classes of property to which these rates of allowances may be applied.

- Terminal loss under **20(1)(a)** gives you a deduction for obsolescence of certain kinds of equipment – **20(16)**
- Separate rules (which we won't cover) deal w/ deductions for depletion

Test: The Act does not define the words **outlay or capital, replacement of capital**, or **payment on account of capital**. The SCC considered various tests for a capital expense in *Canada v John-Manville Corp*.

Capital Expense	Currently Deductible Expense
Expended on establishing structure within which profits are earned or in process of earning income (*BP Australia, Sun Newspapers, Hallstrom's*)	Part of the money-earning process
Expended to acquire the means of production	To use to means of production?
Expended: - Not only once and for all, - But also w/ a view to bringing into existence an asset for the enduring benefit of a trade (*British Insulated and Helsby Cables v Atherton)*	

Canada v Johns-Manville Corp, (1985) SCC
F: T operated an open-pit asbestos mine in QC, in the course of which it was necessary to purchase land on a regular basis in order to extend the perimeter of the mine to maintain a gradual slope and prevent landslides. Land itself contained no ore – so not depreciation. No rule in Act allowed deduction of capital expense as CCA for this purpose. T deducted the cost of land acquired during the year as an ordinary business expense – about 3% of annual revenue of mine. Minister disallowed deductions on basis that the cost of the land was a capital expenditure.
L: **Consider: purpose of expenditures, when viewed from practical and business outlook (business operation versus acquiring capital asset/setting up business); if $ were incurred year in and year out versus once and for all; if they were an easily discernible, more or less constant, element and part of the daily and annual cost of production; whether it was acquired for intrinsic value; transitional benefit or enduring value; how often the $ have been incurred; whether $ produces an asset; relative cost**. *3-step test from *Sun Newspapers*: character of advantage sought; whether practice was recurring and manner in which object of expenditures was applied; means adopted by T to gain advantage. **Hallstroms Pty Ltd*: classification of such expenditures depends on what the expenditure is calculated to effect from a practical and business point of view rather than upon the juristic classification of legal rights.
A: Here the T, at end of mining operations, is owner of large hole. Removal of the ore here was obviously the continuous and recurrent struggle in which the T was principally engaged, and the expenditure here was, as revealed by its uniform history over the years and by its role in the process of the recovery of ore, part of the essential profit-seeking operation of the T. No depletion allowance. These expenditures were clearly made for BF purposes – clearly are not disqualified by **12(1)(a)** nor by any other section of the ITA dealing w/ expenditures in the course of operating a business.
C: Expenditures (business expense), not capital. Appeal allowed.

A payment to acquire the right to stop running a money-losing business can be a capital expense:

British	Fed up w/ running a money-losing	Capital expense, not currently

Columbia Electric Railway Co v MNR, [1958] SCC	railway, T paid five municipalities to obtain their approval for a plan to replace the rail service w/ bus service. It sought to deduct the $220K total expense in the year in which it paid the municipalities.	deductible. Either (1) the termination of an unprofitable railway is an enduring benefit to T's business; or (2) even if it isn't an enduring benefit, it increased the value of T's transportation franchises, which are capital assets.

The character of spending on appliances and furnishings for apartments depends on the useful life of the items bought.
Apartment building:

**MNR v Haddon Hall Realty Inc, [1961] SCC*	T owns and operates rental properties. It seeks to currently deduct amounts spend on replacing stoves, refrigerators and window blinds that had become worn out, obsolete, or unsatisfactory to its tenants.	Capital expense, not currently deductible. These are expenses to replace capital assets that have become worn out or obsolete and are very different from ordinary annual expenditures on repairs. T made the payments once and for all w/ a view to bringing into existence an asset or advantage for the enduring benefit T's business.

Hotel:

Damon Developments Ltd v MNR, [1988] TCC	T owns and operates a hotel in Regina. T seeks to currently deduct the expense of buying draperies, televisions, and washer and dryer appliances to replace outmoded hotel equipment.	Currently deductible. *Haddon Hall* does not apply to the facts. The items bought have a shorter useful life in a hotel than when used by tenants in an apartment building. They occur regularly at relatively short intervals.

In some cases, courts have refused to characterize an outlay or expense as a capital expenditure on the basis that the expenditure was incurred in the process of gaining or producing business income:

Bowater Power Co v MNR, [1971]	T, which generated and sold electrical power, sought to deduct $ for engineering studies undertaken to assess opportunities for increasing the generation of hydroelectrical power.	Incurred while the business of the T was operating and were part of cost of business.
Wacky Wheatley's TV & Stereo Ltd v MNR, [1987]	Travelling expenses incurred by various officers of T in order to assess opportunities for business expansion.	Deductible current expenses on basis that expenses were anterior to any business decision to enter the Australian market and resulted from the current operations of the T.
Inskip v MNR, [1986]	T, a cattle rancher who held a licence enabling him to obtain water for irrigation purposes from a damned lake on Crown land, was required to pay to Crown for purpose of reconstructing the dam.	Expenditure was made by T in course and for purpose of his regular day-to-day business operations.
Pantorama Industries Inc v Canada, [2005]	Pantorama, T corporation, sold casual clothing through more than 200 leased premises located in shopping malls. T retained a firm to find new locations for its stores and negotiate new leases. T paid firm a fixed periodic fee plus a variable fee based on floor area and duration of leases it entered into.	T could treat variable fees as current expenditures. Consider role the leases play in T's business – variable fees were not paid to firm to secure an asset, but simply to allow it to carry on business as it had done previously.

Repairs or Improvements of Tangible Property

Usually "repairs" are currently deductible and "improvements" of capital property are not, but it does depend on the circumstances and on the fickleness of the court involved.

CAPITAL EXPENSE	CURRENTLY DEDUCTIBLE EXPENSE
Canada Steamship Lines Limited v MNR*, [1966] Ex Ct: The cost of replacing a boiler in a ship is a capital expense, mainly because earlier precedent says that **a boiler is a distinct capital asset and not an integral part of the ship. Boiler is an asset in and of itself, which happens to be in a ship.	**Canada Steamship Lines Limited v MNR*, [1966] Ex Ct: The cost of repairing a ship's cargo hold (has to be about every 10 years) is a currently deductible expense. Repairs do not become capital expenses merely because required repairs are extensive or because their cost is substantial.
**Thompson Construction v MNR*, [1957] Ex Ct: The cost of replacing the engine in a power shovel is a capital expense because: the price of the new engine is very high in relation to the value of the power shovel as a whole; and old engine still has substantial commercial value. As a general rule repairs necessitated by wear and tear of equipment used in the business are allowed as deductions. **MNR v Vancouver Tugboat Co*, [1957] Ex Ct: Expense to replace engine in tugboat is capital expense to cover the accumulations of past wear and tear and to prevent the necessity for so many repairs and so much loss of time in the future. Court was influenced by size of expenditure in relation to repair costs.	
**Canadian Reynolds Metals Co v Canada*, [1996] FCA: Replacing carbon cathode lining in pots used to produce aluminum. Capital expense. Capital assets of an enduring nature whose useful life is 4-5 years. *Donohue Normick Inc v Canada*, [1995] FCA: 0.5M in "alternate" parts in 1985, and another $½M in 1986 which were commercially necessary so that T can keep operating a $30M paper machine are capital expenses because: they cost a lot ($1M over two years); are expected to last 10 years; and aren't "spare parts"—the old parts aren't being thrown out but will be used alternating w/ the new ones.	**Canaport Ltd v Canada*, [1993] TCC: Inserting fibreglass liner into crude pipeline to prevent leakage and extend life expectancy. Analogous to repairing a cargo hold in *Canada Steamship Lines* -> currently deductible.
Bowland v Canada, [1999] FCA: T owned a rental property that was damaged by fire, sought to deduct expenditures incurred to restore the building to a condition less than its original state. Provided for permanent advantages as T will not have to incur them ever year. One-time occurrence. Gave rise to an enduring benefit. Effect brought rental property back into existence. House was virtually rebuilt and resulted in new capital asset.	

Buildings

CAPITAL EXPENSE	CURRENTLY DEDUCTIBLE EXPENSE
**Shabro Investments Ltd v MNR*,	**Gold Bar Developments Ltd v MNR*, [1987] FCTD: On an

[1979] FCA: T owned a two-story rental building built on top of an old landfill. At some point, the landfill compacted, causing substantial damage. Floor-related outlays are capital costs. BUT costs of repairing drains, plumbing, and wiring that was damaged due to subsidence are currently deductible. Court drew the distinction between repairing damage to the fabric of the building (currently deductible) and improving the building by replacing a substantial part w/ something essentially different in kind (capital expense).	apartment building worth about $8M, T spent $240K replacing an exterior brick wall that inspection revealed had become unsound w/ metal cladding – significant improvement. The problems w/ the wall were caused by negligent workmanship by a contractor. Moreover, the risk from falling bricks was "unacceptable to the public" and might have caused the city to close the building had T not done the repairs. ∴ T had no choice but to do the repairs. It was **dealing w/ a crisis.** The expense is currently deductible. **From T's point of view, he had no choice but to do the repair work**. Purpose was to deal w/ fact that bricks were falling off building. This was simply a repair to the fabric of the building and **T was within his rights to adopt modern technology, not just put things back exactly as they were before.** Finally, the cost represents only 3% of the value of the building.

Misc:

Montreal Light, Heat & Power Consolidated v MNR, [1942] SCC	T issued $15M in news bonds in order to discharge olds bonds on which higher rate of interest was payable. Sought to deduct refinancing costs, which proposed to amortize over life of new bonds	Deduction disallowed – not ordinary annual expenditures.
No 237 v MNR, (1955) TAB	T incurred legal expenses making representations to fed gov't leading to a reduction in customs duties on imported materials used in T's manufacturing business.	Capital expenditures on grounds that advantage paid for need not be of positive character and may involve getting rid of an item of fixed capital that is of an onerous character; it is fundamental to the whole theory of our legal system that the state of the law today must be taken as a permanent and abiding thing.
Mandrel Industries Inc v MNR, [1965] Ex Ct	T, subsidiary of which had granted an exclusive right to distribute its products in Canada for 5 years, paid $150K to terminate the distributorship.	Capital expense – made to reacquire the right to sell its own products and to launch its own selling org.
Supertest Petroleum Corporation Ltd v MNR, (1964) TAB	T incurred expenses to improve the premises of various dealers who, in consideration for these improvements, entered into 'tying' agreements pursuant to which they agreed to sell only T's products for periods averaging 10 years.	Capital expenditures made w/ view to bringing into existence an asset or advantage for the enduring benefit of the trade.
HJ Levin v MNR, [1971] Ex Ct	T, dentist, sought to deduct tuition fees and travel expenses incurred to attend a course in prosthodontics.	Expenditures were not of a recurrent nature and were made w/ a view to bringing into existence an advantage – capital.
Johnston Testers Ltd v MNR, [1965] Ex Ct	T, which had entered into agreement to pay royalties for the use of certain patents, paid $146K to obtain a release from this obligation.	Court allowed deduction on basis that the payment was made to get rid of an annual charge against revenue in the future.

**Algoma Central Railway v MNR*, [1967] Ex Ct	T, which operated a railway, commissioned a 5-year geological survey of the properties through which its railway ran, in the hope that this would lead to resource dev't and increased traffic on its lines.	Anticipated benefit of increased traffic was too remote and speculative to constitute an advantage of an enduring benefit – not unlike advertising expenditures, ∴ deductible as expenses.
Canada Starch Co Ltd v MNR, [1968] Ex Ct	T, which produced and distributed cooking oils etc., paid owner of a registered trademark in consideration for which the latter withdrew its opposition to the T's registration of a similar trademark.	Payment did not bring into existence an asset or advantage for enduring benefit of T's business. Mere registration is an empty right if it is not based on a trademark that has business or commercial reality as an incidental consequence of the current operations of the business.
Oxford Shopping Centres Ltd v Canada, [1980] FCA	T paid city in consideration for which city agreed to construct a road intercharge affecting access to the T's parking lot.	Advantage obtained by the T was no more permanent in nature than that expected to be realized from the survey in *Algoma*. Should be regarded as having been laid out as a means of maintaining, and perhaps enhancing, the popularity of the shopping centre. Can be regarded as a revenue expense notwithstanding the once and for all nature of the payment on the more or less long term character of the advantage. Money was not paid for changes in or additions to T's premises or the buildings thereon or in connection w/ the structure of T' s business.
**Central Amusement Co v MNR*, (1992)	T spent $ to replace circuit boards in video and arcade games, creating new games that satisfied market for a few months.	Expenditure was required on a recurring and regular basis and temporary advantage in nature. Expenditures.
Bennett & White Construction Ltd v MNR, [1948] SCC	T company deducted commissions paid to 3 of its directors in consideration for their agreement to guarantee the company's indebtedness to a bank.	Distinguished between expenditures made in providing capital for an enterprise and those for the carrying on of the trade from which its earnings are derived. Deduction disallowed.
Cormack v MNR (1965) TAB	T, medical practitioner who devoted much of his time to education projects, sought to deduct the cost of a trip to observe schools in other countries.	Capital expense – T did not spend money in earning of income, was for purpose of increasing his knowledge of a special subject, or adding to what virtually was a capital asset.
Canadian Glassine Co v MNR, [1976] FCA	T, which manufactured lightweight specialty papers, entered into agreement to construct at its own expense 2 underground pipelines to convey slush pulp and steam from its plant to that of the T and to supply slush pulp and steam to the T's plant for stipulated periods.	Disallowed deduction on basis that the cost was a capital expense incurred for the establishment of the profit-making structure of the T's trade.
DM Firestone v Canada, [1987] FCA	T set out to create his own venture capital business by acquiring financially distressed manufacturing businesses and making them profitable.	Capital expenses incurred in the course of putting together a new business structure.

	Sought to deduct $ incurred to investigate potential businesses for acquisition.	
Bancroft v Canada (MNR), [1989] TCC	T, chartered accountant who acquired land w/ intention of opening a tourist resort, sought to deduct $ before he abandoned the project due to insufficient financing.	Disallowed deduction – he was in the process of creating a business structure.
Marklib Investments II-A Ltd v Canada, [1999] TCC	T, which owned 2 apartment complexes, was required to spend 3.5M in order to comply w/ work orders issued by municipality.	Court allowed T to deduct on grounds that the repairs merely restored the building to its original condition and were undertaken to comply w/ municipal work orders. **It's the purpose, rather than the result of an expenditure that determines whether it is characterized as a capital outlay or a current expense.**

CAPITAL COST ALLOWANCE

For tax purposes, deductions in respect of depreciation are explicitly prohibited under **18(1)(b)** – BUT **20(1)(a)** allows a T to deduct such part of the capital cost to the T of property, or such amount in respect of the capital cost to the T of property, if any, as is allowed by regulation. If capital property is **depreciable property** as defined in **13(21)** and **Reg 1102**, then T cannot deduct the whole cost of acquiring it *at once* but must depreciate it gradually under the CCA rules. The CCA rules use the "declining balance" method of depreciation, which means that every year the "undepreciated" balance remaining in the purchase price is multiplied by a fixed scalar, reducing it further.

- Under the '**straightline method'** of depreciation, the cost of the property is deducted in equal annual increments over the course of its useful life until the unrecovered or **undepreciated cost (or 'book value'**) reaches zero (generally the approach used by accountants).
- Under the '**declining-balance method'**, a percentage of the unrecovered or undepreciated cost is deducted each year, causing this book value to approach but never reach zero (more frequently used for CCAs).
- The use of the words 'there may be deducted' in the preamble to **20(1)** suggests that the deduction of CCAs under **20(1)(a) is** optional.

Instead of tracking the undepreciated amount on an item-by-item basis, the Act and the Regs creates *classes* of property. For every class of property, each T has a notional "pool" of UCC, which is defined in **13(21)** by a rather complicated formula, which we can distill down to:

$$\mathbf{A - E - F + B}$$

This notional account is perpetual for the life of a business and is subject to continual adjustment.

- **A** is the total of the capital cost of all depreciable properties of the class acquired by T before the time. This addition to the UCC of a class increases the amount that may be deducted.
    - Courts have held that there is **no difference between the capital cost of a particular depreciable property and its cost as commonly understood.**
    - The capital cost of certain kinds of depreciable property is subject to specific rules in **s 13**

- **When is property "acquired"?** In *MNR v Wardean Drilling Ltd*, court stated that proper test as to when property is acquired must relate to title to the property in question or to normal incidents of title, either actual or constructive, such as possession, use and risk.
- Capital cost includes the purchase price of the assets plus capital expenses for upgrading or improving them.

- **E** is defined as the "total depreciation allowed to T for property of the class before that time" which is further defined in subsection **13(21)** as amounts deducted under **20(1)(a)** (capital cost allowance) and **20(16)** (terminal loss). A terminal loss may be deducted only where there is a positive balance to the UCC and there is no property left in the class.
- **F** is the total amounts deducted from UCC before time in question as a result of dispositions of property of the class (for each disposition the lesser of the proceeds and cost of the asset is deducted from UCC of the class).
- **B** is the amount of any recapture added to T's income in previous years in respect of the class.

When the T acquires a new capital asset of a given class, the price of that asset is added to **A**, resulting in an increased UCC "balance". Similarly, when the T expends money on capital improvements to existing **depreciable property** of the class, those expenditures are added into **A**, increasing the overall UCC "balance".

Every year, the T is authorized under **20(1)(a)** to deduct depreciation for the class as a whole. This is done (more or less) by multiplying the class UCC by the amount of depreciation permitted for the class under **Reg 1100** and **Schedule II** of the regs. **Reg 1100(1)** says that for each class of property, you can deduct a specified percentage of the UCC. In theory, these rates are designed to approximate the rate of depreciation actually experienced by each kind of depreciable property. For most classes of depreciable property, CCA is computing according to a specified rate of the UCC of property of the class at the end of the T's taxation year. For these classes of depreciable property, CCA is determined on a declining-balance basis determined according to rate applicable to the class. The amount deducted, the **capital cost allowance**, is added to **E.** This reduces the UCC "balance" (because **E** is subtracted) but notice that it can never reduce UCC below zero because the amount of depreciation added to **E** will always be less than the old UCC "balance".

- **Special rules for rental property: Reg 1100(11)** prevents Ts from using CCA deductions to create or increase rental losses in order to shelter income from other sources. For purposes of this limitation, **Reg 1100(14)** defines a rental property. Virtually identical provisions, preventing Ts from using CCA deductions to create or increase losses from the rental of a 'leasing property', are contained in **Reg 1100(15). Reg 1100(17)** defines a leasing property.

When the T disposes of *any* capital asset of a given class, the proceeds of disposition are included in **F**, but only up to the initial capital cost of the asset. This is because **if the T sells the asset for more than the capital cost, the difference is a capital gain and is taxable under the rules for capital gains**, rather than within the depreciation scheme (which is premised on the idea of *falling* value for assets). Since adding to **F** reduces the UCC "balance", any disposition can cause UCC to go negative.

A negative UCC "balance" indicates that the value of the assets in the class declined *less* than the amount of depreciation estimated by the tax return. As a result, the T was able to take more deductions than he actually suffered in depreciation. The gov't wants these deductions "back", so **13(1)** requires T to include the entire amount by which the UCC balance is negative in his taxable income. This is called **recaptured depreciation.** The amount of this inclusion is added into term **B** in the UCC computation in order to zero out the UCC "balance" after the T includes the recaptured depreciation.

When the T disposes of the last remaining asset in the class (having added the proceeds of that last asset, up to its capital cost, into **F**), a positive UCC "balance" indicates that the T has suffered more depreciation over the life of the assets of that class than he was permitted to deduct under the tax system. This difference is known as a **terminal loss**, which the T is permitted to deduct under **20(16)** *but only where there is no more depreciable property remaining in the class.* The amount of the terminal loss is added into term **E,** bringing the UCC balance back to zero.

The main issues specifically related to CCA are:

1. Is the capital property eligible for CCA at all, or is it non-depreciable capital property?
2. On disposition of the property:
    - May the T deduct a terminal loss?
    - Is the T obligated to pay recaptured depreciation?
    - Is the T obligated to pay tax on a taxable capital gain?

Issue: Depreciable capital property?

Rule: Only the subset of capital property that is **depreciable property** under **13(21)** and the **Regs** [Part XI and Schedule II] qualifies for depreciation deductions. **Reg 1102** contains a number of rules which exclude particular property from the definition of **depreciable property**. In particular, the following property is not **depreciable property:**

- **1102(1)(a)** prevents the deduction as CCA of amounts that are already deductible in computing a T's income
- **1102(1)(b)** prohibits a deduction for CCA in respect of property acquired or manufactured by the T for the purpose of sale (inventory)
- ****1102(1)(c)** is consistent w/ the policy underlying **18(1)(a),** which prohibits any deduction in respect of an outlay/expense except to the extent that it was made or incurred for purpose of gaining or producing income [**income producing purpose test**], and **18(1)(h),** which prohibits deduction of personal living expenses
- **1102(1)(f)** is consistent w/ policy underlying **18(1)(l)(i),** which prohibits any deduction in respect of an outlay or expense for the use or maintenance of various recreational facilities
- ****1102(2**) excludes all land from the categories of depreciable property in respect of which CCA may be claimed

Schedule II includes most kinds of tangible property, and some kinds of intangible property. Intangible property that is not described in schedule II of the Regs is defined as **eligible capital property**, a percentage of which may be deducted on a declining-balance basis under **20(1)(b**). In CL provinces, courts have consistently held that e.g. lease arrangements constitute an acquisition of property by the lessee, so that the lessee and not the lessor may deduct CCA – e.g. *MNR v Wardean Drilling Ltd* [1969] Ex Ct.

When a T acquires a bundle of capital assets, the income-producing purpose test from **Reg 1102(1)(c)** must be applied separately to the property in each class. ∴, where T buys land w/ the intention of demolishing the buildings, he may not be able to deduct CCA.

Ben's Limited v MNR, (1955) Ex Ct
F: T runs a bakery in Halifax. In January 1952, T bought three adjacent residential properties for $42K w/ a plan to replace the frame houses on those lands w/ an extension of the main bakery building. T successfully petitioned to get zoning changed from residential to commercial/business. T allocated the acquisition cost almost exclusively to the buildings: $39K to buildings and only $3K to the land. In June, T sold the buildings for $1,200 and they were removed from the land. In its return for the 1952 taxation year, T claimed the maximum possible CCA for the buildings. Disallowed on the ground that the entire amount had been expended for the purpose of acquiring the site on which the plant addition had been erected and that no portion of the payment was expended for the purpose of acquiring depreciable assets.

A: **Question is not whether T's outlay as a whole was for purpose of gaining or producing income, but rather "Was the property referred to in Class 6 as a building of frame acquired by T for purpose of gaining or producing income?' Argument has to go to the particular item of depreciable property that you are trying to deduct CCA on.** Frame buildings located on lands purchased were not acquired for purpose of gaining or producing income and sole purpose in making outlays was that of acquiring the land as a site for the extension of the factory. Mere fact that T made some rental income from buildings does not affect the real purpose of acquisition. **Reg 1102(1)(c)** bars the frame houses, under the circs, from being property which was subject to CCA.
C: CCA disallowed.
D: BUT *Ludco*, which came later, held that **primary purpose does not have to be earning income – could be secondary purpose.** To avoid the result in this case, T must use the capital asset acquired in some kind of direct income-producing scheme (e.g. rental) for a long enough period of time that it can argue that the initial scheme, and not the ultimate use, is the purpose for which the asset was acquired.

Glassman v MNR, (1966) Ex Ct	T purchased several parcels of real estate in Vancouver, demolished the old houses situated on the property, and built high-rise apartments.	Applied *Ben's Limited.* Disallowed deductions in respect of CCA on old houses on basis that T's basis or primary motive was to acquire property to build a high-rise apartment.
Adanac Apparel Ltd v MNR, [1969] Ex Ct	T, which carried on a retail apparel business, sought to deduct CCA in respect of a building situated on property adjacent to T's shop, which T acquired w/ intention of opening a 'bargain barn' in the building.	Although T demolished building and sold the property – CCA deduction allowed on basis that T had acquired the building for purpose of gaining or producing income from expansion of its business.
Moldaver v MNR, [1992] TCC	T acquired a building zoned exclusively for use as dental offices, sought unsuccessfully to obtain tenants, applied to rezone property, and subsequently demolished building and constructed an apartment building for residential use.	T had acquired the building for the purpose of gaining or producing rental income – T allowed to deduct terminal loss on demolition.
Gascho Farms Ltd v Canada, [1996] TCC	T, which received a residential property as partial consideration for sale of family farm, claimed a terminal loss on sale of residence after a period during which it rented the residence at a loss.	T acquired property for purpose of completing sale of the farm – deduction disallowed.
Bolus-Revelas-Bolus Ltd v MNR, [1971] Ex Ct	T, which owned land in Niagara Falls and 50% of shares of a company that had acquired land for an amusement area, acquired 2 amusement rides, which remained in storage throughout the year.	Deduction of CCA disallowed. Although T had acquired rides for purpose of gaining or producing income generally from its business, it had not acquired the rides for purpose of gaining or producing income from specific business of operating these 2 rides.
Roywood Investment Ltd v MNR, [1981] FCA	T purchased land and buildings for $589K, of which it allocated $471K to buildings and claimed CCA.	Property was subject to head lease lasting almost a thousand years according to which rent could be based on value of land alone w/o buildings or improvements – deduction of CCA disallowed.

Reg 1102(1)(c) uses the word "income" like **20(1)(c)(i)**, not "profit" like **9(1). It is only necessary that T uses the assets to produce revenue and not profit:**

Hickman Motors Ltd v Canada, (1997) SCC
F: There are three companies involved: ParentCo (T) and two subsidiaries, SubCo1 and SubCo2. As part of a scheme to wind up SubCo1, ParentCo acquired title to certain leasing equipment from SubCo1 and held it for only 5 days before selling it to SubCo2. During the 5-day period, the leasing equipment yielded rental revenues of $20,550 to ParentCo. In the tax year in which these events occurred, ParentCo deducted CCA of $2,029,942 on the leasing equipment.
C: Deductions allowed in full. The fact that the assets produced revenue establishes that they continued to be used for the purpose of producing income. **Reg 1102(1)(c) does not require that depreciable property be held for any particular period of time**. The assets were business assets associated w/ production of income. Fact that directors of T may have intended to obtain a tax saving by acquiring the asset is irrelevant.

Issue: Terminal Loss on Disposition

When a particular item of depreciable property is sold or otherwise disposed of, the proceeds from the disposition may be equal to, less than, or greater than the undepreciated cost in respect of the asset. Because **individual assets are generally aggregated into classes** for the purpose of computing CCA, the disposition of most kinds of depreciable property does not necessarily result in a terminal loss or recaptured depreciation.

Where these proceeds are less than this undepreciated cost, it follows that the rate at which the asset was depreciated was insufficient to account for the actual depreciation in its value. As a result, the person disposing of the asset will suffer a loss on the disposition.

Rule: Where a T disposes of **all** depreciable property of a class for proceeds less than the UCC of the class prior to the disposition, such that the T owns no property of a class that retains a positive balance in the UCC account at the end of the taxation year, **20(16)** prohibits the deduction of any CCA and requires the deduction of a terminal loss equal to the amount of the remaining UCC.

- The amount of this terminal loss is included in the definition of 'total depreciation' in **13(21)** and subtracted in computing the UCC to a T of depreciable property of a prescribed class by virtue of the description of E in definition of UCC in **13(21),** thereby reducing UCC account to nil.

Issue: Recaptured Depreciation on Disposition

Where the proceeds are greater than the undepreciated cost of the asset, the rate at which the asset was depreciated must have been excessive. In this situation, the person disposing of the property will realize a gain on the disposition, equivalent to the excessive depreciation recognized in previous accounting periods.

Rule: Any negative balance in the UCC of a class of property at the end of a taxation year must be included in income for that year as **recapture** under **13(1)**.

- Under the description of B in the definition of UCC in **13(21),** this recaptured amount is added in computing the UCC of the class after that time, increasing the UCC account to nil.

Issue: Taxable Capital Gain on Disposition

Rule: As a result of description of F in **13(21),** where a T disposes of a depreciable property of a particular class in a taxation year, T must subtract the lesser of its proceeds of disposition and its capital cost in computing UCC of the class. Where the proceeds of disposition exceed the original capital cost of the property, the excess is subject to tax as a taxable capital gain.

- **248(1)** defines words '**disposition of property'** to include 'any transaction or event entitling a T to proceeds of disposition' and **13(21)** defines 'proceeds of disposition'

- SCC in *Canada v Compagnie Immobiliere BCN Ltee* held that 'disposition of property' should be given broadest possible meaning.

Where a T receives compensation - for property unlawfully taken, for property destroyed and any amount payable under a policy of insurance in respect of loss or destruction of property, or for property taken under statutory authority or sold to a person by whom notice of an intention to take it under statutory authority was given – that is used to acquire a 'replacement property' within a specified period of time, **13(4)** reduces the amount of the proceeds that must be subtracted in computing the UCC of the class by the lesser of the proceeds otherwise determined and the amount used to acquire the replacement property, thereby eliminating any tax consequences that would otherwise result from such a disposition.

- **13(4.1)** stipulates that a property is a replacement for a former property where **(a)** it is reasonable to conclude that the property was acquired by T to replace the former property and **(a.1)** it was acquired by T and used by T or a person related to T for a use that is the same as or similar to the use to which T or a person related to T put the former property.

MNR v Browning Harvey Ltd, [1990] FCTD	T, a manufacturer and distributor of soft drinks, sought to deduct terminal losses on refrigerators costing 1.5K that were sold under supply agreement to shopkeepers for $2, half of which was payable at the time of the agreement and the other at the end of the 7 year agreement.	T did not dispose of refrigerators at time of agreement. Shopkeepers had limited possession and limited use.
Borstad Welding Supplies, (1972) FCTD	T sold all of its working assets to another company under an agreement providing that certain gas cylinders would be sold over the course of 5 years, w/ 1/5 purchased each year and the remainder leased for a monthly rent.	T did not dispose of depreciable property until dates stipulated in agreement.
Hewlett Packard (Canada) Ltd v Canada, [2004] FCA	T provided new cars to its employees for work-related purposes. In order to maximize CCA deductions, T acquired the new Ford vehicles before its financial year-end and disposed of the previous year's cars to Ford shortly after its financial year-end. T claimed entitled to 2 years of CCA w/ respect to vehicles, despite having had them for just over 1 year (but during 3 separate fiscal years).	Minister reassessed and refused deduction for CCA for previous year's cars on basis that there had been a change of use of the vehicles before the end of the year such that they should be deemed to have been disposed of before the end of the fiscal year. FCA reversed – Parliament ensured that the time of disposition of property corresponds w/ time of its acquisition.

Special Rules

ITA requires or permits specific kinds of depreciable properties to be categorized as separate classes for purpose of computing CCA, recapture, and terminal loss.

- *According to **Reg 1101(1ac),** a separate class is generally prescribed for each **rental property** w/ a capital cost of 50K or more [so it is likely that disposition of these types of property will result in recapture or terminal loss].
- Where a T acquires depreciable properties for the purpose of gaining or producing income from **different business, Reg 1101(1)** prescribes a separate class for properties acquired for purpose of gaining or producing income from each business**.**
- **Regs 1101(5p) and 1101(5q)** allow Ts who have acquired **rapidly depreciating electronic equipment** as specified to select to treat each such depreciable property as a separate class, making the T eligible for a terminal loss on its disposition.

- Where the property is held for 5 years, **Reg 1103(2g)** requires the property to be transferred back to the class in which it would have been included but for the election.

The ability to claim CCA on newly acquired property is subject to specific limits in **13(26)** and **Reg 1100(2)**.

- **Reg 1100(2)** imposes a special limit known as the **'half-year rule'** on the CCA that may be claimed in respect of depreciable property acquired during a particular taxation year: Where amounts added to UCC exceeds the aggregate amounts deducted from UCC as a result of dispositions of depreciable property of the same class during the taxation year, CCA that a T may deduct in respect of property of that class is based on UCC of the class otherwise determined less half of the net addition to the UCC during the year.

Allocation on Disposition of Property or Provision of Services (SAAR)

Ss 68 and 69 are **anti-avoidance rules** that specify the amount at which certain transfers of property are deemed to have occurred for tax purposes. **68** applies where an amount received or receivable from a person can reasonably be regarded as being in part the consideration for the disposition of a particular property of a T or as being in part consideration for the provision of particular services by a T. **69** applies to various kinds of non-arm's-length transfers.

As a general rule, **vendors,** who are likely to have claimed CCA on depreciable property in previous taxation years, will prefer to allocate as much of the proceeds as possible to non-depreciable capital property and depreciable property on which little or no CCA has been claimed. **Purchasers** will generally prefer to allocate as much of the proceeds as possible to inventory or services provided, since these are fully deductible in computing the purchaser's income, or to depreciable property, especially depreciable property w/ a high rate of CCA, in order to benefit from high CCAs and/or terminal losses on the subsequent disposition of this property.

Rule: In order to limit opportunities for abuse in these circumstances**, s 68** sets out that:

a) the part of the amount that can reasonably be regarded as being the consideration for the disposition **shall be deemed to be** proceeds of disposition of the particular property **irrespective of the form or legal effect** of the K or agreement, and the person to whom the property was disposed of shall be deemed to have acquired it for an amount equal to that part; and
b) the part of the amount that can reasonably be regarded as being the consideration for the provision of particular services shall be deemed to be an amount received or receivable by the T in respect of those services irrespective of the form or legal effect of the K or agreement, and that part shall be deemed to be an amount paid or payable to the T by the person to whom the services were rendered in respect of those services.

Test: Patently or clearly unreasonable – if amount agreed upon is significantly out of sync w/ FMV, then courts will apply s 68. (*Petersen*)

Golden v Canada, (1983) SCC
F: T and 3 other partners own the BelAir apartments in Edmonton. T is the seller and Skalbania is the buyer. The deal shaped up like this:

Date	Action	Alloc'd Land	Alloc'd Other	Total Price
March 7	Skalbania unsolicited offer	$2.6M	Buildings—$2.4M Trucks, equipment, roads, &c—$0.6M	$5.60M
⋮	Negotiations			
March 14	Final deal	$5.1M	Equipment, buildings, roads, sidewalks—$0.75M	$5.85M

Buyer and seller dealt at arm's length. They negotiated over the final allocation. There was no sham or subterfuge. Skalbania was a knowledgeable purchaser. Minister said that allocation was unreasonable – allocation in initial offer was more reasonable. Accepting the evidence of an

appraiser who said the FMV of the land alone was only $2.3M, TJ upheld the Minister' reassessment, resulting in substantial recaptured depreciation on the buildings. In his reasons, however, TJ specifically found as a fact that $5.1M was not an unreasonable price for Skalbania to pay for the land alone.
L: Where, as in this case, the transaction is at arm's length and is not a mere sham or subterfuge, **the apportionment made by the parties in the applicable agreement is certainly an important circumstance and one which is entitled to considerable weight**. **The inquiry is not one as to reasonable value but as to proceeds of disposition. It is open to an owner to dispose of his property as he sees fit and for that purpose it is open to him, when he sees it to be to his advantage, to realize on the full potential of an asset of one kind even if as a result the greatest potential of a related asset cannot be realized in the transaction.**
In his concurring judgment, Thurlow held that the respective FMVs of the land and **depreciable property** are relevant factors to consider, but they aren't determinative.
C: TJ erred in deciding that the determination under 68 is to be approached from the POV of the vendor only.
R: You have to assess reasonable consideration from perspective of purchaser and vendor. As well as all relevant circumstances surrounding the transaction.

13(21.1) prevents Ts from claiming a terminal loss on the disposition of a building where subjacent or contiguous land is disposed of at a gain in the same year.

An amount can reasonably be regarded as consideration for disposition of particular property if a *reasonable* businessman, w/ business considerations in mind, would have allocated that amount to the property:

**Transalta Corp v Canada*, [2012] FCA	T sold its regulated electricity transmission business for a negotiated price 1.31x the net regulated book value of its tangible assets. The parties allocated the majority of the 31% premium over book to goodwill. The Minister was indignant: no goodwill exists in a regulated industry.	Parties' allocation upheld. The efficient management of T's business, and the potential for new business opportunities from T's transmission network could be viewed as goodwill.

The courts may defer to the negotiated allocation even if the T (vendor) subsequently tries to invoke s 68 to change it:

H Bauer Investments v MNR, [1987] FCTD	As part of T's sale of an apartment building, parties agreed to a building-heavy allocation of assets in an amending agreement settled after they executed the agreement of purchase and sale. It turns out that T didn't like this result for tax purposes, so it commissioned an appraiser's report that valued the building lower than the parties' allocation, and used this value for computing recaptured depreciation (i.e. T is trying to invoke **ITA 68** to its benefit).	T is stuck w/ the original allocation. While the courts aren't obligated to defer to the parties' allocation, in this case the parties' agreement had all of the *Golden* factors whereas T is urging the court to disregard the viewpoint of the buyer and consider only that of the seller.

When there is a significant departure from established FMV, the court may find the parties' allocation to be unreasonable:

**Petersen v MNR*, [1988] TCC	T sold a money-losing daycare centre whose license had been cancelled for $158K, $45K of which the parties allocated to goodwill (28% of the price). The centre's losses had been	Allocation overruled and the Minister's proposed allocation substituted. Although there was no sham or subterfuge and the parties bargained at arm's length, the allocation is clearly unreasonable in the circumstances. There is no foundation for apportioning 28% of the price to

	continuous for the past five years.	goodwill, if indeed there is any goodwill at all. No evidence of negotiations here.

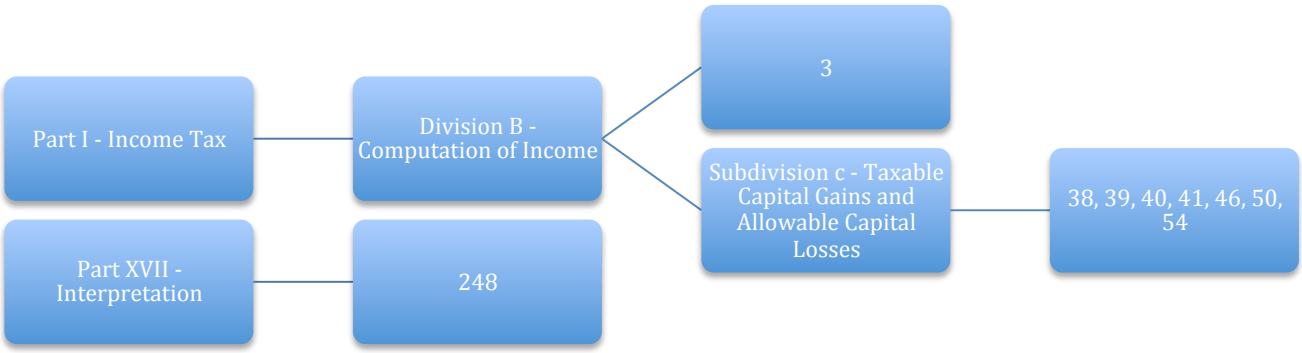
Where one or more of the *Golden* factors are missing, the courts may override the parties' allocation. For instance, the absence of bargaining --

Leonard v Canada, [1990] TCC	Ts seek to claim deductions based on the appraised value of the assets it sold rather than the allocation of the parties (again, T is invoking **ITA 68**). The distinguishing fact in this case is that there was no serious negotiation between the parties over allocation. Ts dealt at arm's length, agreed on prices to be allocated to various items, but no serious negotiations. Ts were informed of the apportionment of the purchase price by the buyers at the last minute, even though they should have received this information several weeks earlier.	Ts deductions upheld. The apportionment on which Ts based their tax return is reasonable. Allocation by parties was unreasonable. **Evidence of negotiations leading to an apportionment of value is an important factor in determining the weight to be given to the parties' allocation.**

In many cases, land and buildings are sold or expropriated and the buildings are subsequently demolished:

MNR v Steen Realty Ltd, [1964] Ex Ct	T sold land and buildings to a purchaser who immediately demolished the buildings in order to construct a 12-storey office building.	It is not reasonable to regard any part of the 395K sale price as being the consideration for the disposition of the buildings.
Stanley v MNR, [1972] SCC	T owned land and a building that was expropriated for the VSB for compensation of 90K, who allocated 20K to land, 61K to the building, and 8K to other items. T argued that the building had been sold for $200, the price that the school board received in exchange for the removal of the building.	Of the sum of 90K received by T, at least the sum of 47K (the original capital cost of the building) could reasonably be regarded as the proceeds of disposition of his depreciable property.
Canada v Malloney's Studio Ltd, [1979] SCC	T, which owned and operated a restaurant adjacent to a hospital that notified the T that it planned to expropriate the T's property for expansion purposes, entered into an agreement w/ the hospital pursuant to which it promised to deliver to the hospital vacant possession of the real property clear of all buildings in exchange for consideration of 280K.	Here the K demonstrably relates only to the sale of vacant land. Here the demolition involved no recipient, at least as regards the hospital.

TAXABLE CAPITAL GAINS AND ALLOWABLE CAPITAL LOSSES



Capital Gains and Losses

In computing a T's net income for a taxation year**, 3(b)** includes the T's 'net taxable capital gain'. This is determined by adding the T's 'taxable capital gains' for the taxation year (other than gains from disposition of LPP) and T's 'taxable net gain for the year from dispositions of LPP' under 3**(b)(i)** and deducting the T's 'allowable capital losses' for the year (other than losses from disposition of LPP and ABIL) under **3(b)(ii)**. The rules governing the computation of these amounts are contained in subdivision c of Division B of Part I of the Act – **ss 38-55**.

- **S 38** defines the 'taxable' portion of a capital gain and the 'allowable' portion of a capital or business investment loss as **½ of the amount of the gain/loss otherwise determined** under subdivision c.
- Under **39,** losses exclude losses on disposition of depreciable property, which can give rise to terminal losses under **20(16).**
- **41(1)** defines a T's 'taxable' net gain from dispositions of LPP as **½ of T's net gain from dispositions of LPP.**

**Where Ts dispose of property at a gain, it is generally to their advantage to characterize the source of the gain as capital and not business or property. Where property is disposed of at a loss, it is generally advantageous for Ts to characterize the source of the loss as business or property rather than capital.

CHARACTERIZATION

Under **39(1)(a),** a T's **capital gain** for a taxation year from the disposition of any property is: the T's gain for the year determined under this subdivision (to the extent of the amount thereof that would not, if **s 3** were read w/o reference to the expression 'other than a taxable capital gain from the disposition of a property' in **3(a)** and w/o reference to **3(b),** be included in computing the T's income for the year or any other taxation year) from the disposition of any property of the T. **39(1)(b)** defines a 'T's **capital loss** for a taxation year from the disposition of any property' as: the T's loss for the year determined under this subdivision (to the extent of the amount thereof that would not, if **s 3** were read in the manner described in (a) of this subsection and w/o reference to the expression 'or the T's ABIL for the year' in **3(d),** be deductible in computing the T's income for the year or any other taxation year) from the disposition of any property of the T.

- **39(1)(a) and (b)** define capital gains and capital losses as a **residual – as gains or losses that would not otherwise be included or deductible in computing a T's income**

Capital property is defined in **s 54** as any depreciable property, and any non-depreciable property that would produce a **capital gain or capital loss** upon disposition. Conversely, **inventory** is property where the gain or loss would be characterized as **income from business.**

- **The characterization of gains and losses as *capital* gains and losses generally depends on the tests by which courts determine whether property is disposed of in the course of a business or as part of an ACNT.**

- The key distinction is that w/ inventory, you intend to make a profit by selling it, whereas w/ capital property, you intend to make a profit by holding onto it.

Real Property

Includes 'any estate, interest or right' in land and fixtures, including a leasehold interest, but not including a mortgage secured by real property. Where property is not capital property (or eligible capital property – the goodwill of a business) it is characterized as inventory (*Friesen*).

Courts have generally interpreted the **secondary intention doctrine** to require the possibility of resale at a profit as a '**motivating' reason or consideration** for the T's decision to acquire the property. Courts have grappled w/ the characterization of the gain on the purchase and sale of **vacant land** – courts have been pretty willing to apply secondary intention doctrine for vacant land; less likely to apply this doctrine to land w/ a building on it. Where property is held for **personal use,** a gain or loss on the disposition of the property is generally characterized as being on account of capital – *Lemieux v Canada*, (1973) FCTD.

Factors to consider in characterizing proceeds from the sale of land:
(See also factors from *Taylor* p 47)

	Business Income/Loss	**Capital Gain/Loss**
Holding Period	Short	Long
Circumstances of Sale	Solicited offer w/o crisis	Unsolicited offer, or crisis such as threat of expropriation
Behaviour of T on Other Occasions	Frequently buys and sells land, or is in business as a developer etc.	Rarely buys and sells land
Method of Financing/REOP	Primarily bought w/ borrowed funds -> Trading intent	More equity -> investing intent
Using of the Property	Not for T's personal use	T's personal use
Secondary Intention to Profit from Resale (*Regal Heights*)	Yes	No

Regal Heights Ltd v MNR, (1960) SCC
F: Intending to put up a large shopping centre in Calgary, T spend $89K buying up land in the following circumstances: Sept 1952 - $70K for 40 acres of land for shopping centre; May 1953 - $15K for land on other side of road, purpose to provide ready access to centre; March 1954 – Some amount on nearby land where Ts intended to advertise the shopping centre. T got permission to rezone, had planning sketches done, etc. T aborted the operation when it realized that a large department store which it had hoped would be its anchor tenant decided to set up shop in the same neighbourhood, but on another site 20 blocks away. Over the course of 5 months from 1954-55, T's shareholders wound up the company and disposed of all the land at a fairly decent profit – about $135K. T would prefer to have the profit taxed as a capital gain, but the Minister says it ought to include the sale proceeds as income from business.
I: Is T's profit from sale of real estate in 1955 profit derived from ACNT and ∴ income from a business?
A: All efforts by Ts were of a promotional character. The establishment of a regional shopping centre was always dependent upon the negotiation of a lease w/ a major department store. This was an undertaking/venture in the nature of trade, a speculation in vacant land.
C: The proceeds are business income from an ACNT. Although T had a primary intention to set up a shopping centre, it knew its venture was speculative and always had a secondary intention to sell off the land at a profit. Profit is subject to taxation.

Racine v MNR,	Ts, each of whom had experience in the real estate business, borrowed money to purchase	Ts testified that it had been their intention to carry on the business

(1965) Ex Ct	land and machinery of a bankrupt corporation, which they sold 4-6 weeks later at a profit of approximately 20K each. Minister characterized the gain as business income from an ACNT.	indefinitely as a long-term investment. Court rejected Minister's further argument that they had a secondary intention to resell at a profit.

Administrative rules for change from investment purpose to inventory or vice versa:
Where real property is **converted from investment property to inventory,** it is the CRA's view that the ultimate sale of real estate that was so converted may give rise to a gain/loss on capital account, a gain/loss on income account or a gain/loss that is partly capital and partly income. Vacant land that is capital property used by its owner for the purpose of gaining or producing income will be considered to have been **converted to inventory** at the earlier of:

- The time when the owner commences or causes the commencement of improvements thereto w/ a view to selling it, and
- The time of making application to the relevant authority for approval of a plan to subdivide the land into lots of sale, provided that T proceeds w/ the dev't of the subdivision

A T who constructs buildings for sale and who originally intended to sell a particular building soon after it was completed may permanently convert that building **from inventory to capital property**:

- By establishing that the original intention to sell the building has been abandoned
- By capitalizing the cost of the building and the cost of the lot upon which it sits, in the T's financial records, and
- By making use of the building as a capital asset for a period of time in a manner that is more indicative of investing than trading

Personal-Use Property

Defined in **s 54**. **40(2)(g)(iii)** disallows the deduction of capital losses from the disposition of personal-use property – deems loss from personal-use property to be nil. **46(1-6)** have further rules relating to **personal-use property**.

Burnet v Canada, (1995) TCC
F: In 1962 T and wife bought a house in West Van on a ½ acre lot, where they lived until 1980. They moved to a house in North Van that T had inherited from his father. They demolished the house in West Van and built a larger new home on the lot. Stated intention was to construct house for affluent market and sell it at a markup. Builder turned out to be unreliable and real estate prices decreased. Became apparent that cost of constructing new house was going to be significantly greater than anticipated. In 1981 they moved back to the new house where they lived until 1985. In 1985 they leased the property to a tenant for 1 year and moved into rented premises. In 1986 they moved back to the new house where they lived until it sold in 1987. A substantial loss was sustained on the sale and the T seeks to deduct that loss in the computation of his income, as a loss incurred in carrying out an ACNT. MNR denies deduction of loss on ground that new house was personal residence of T and wife and was personal use property that did not form part of business undertaking.
I: Was this an ACNT?
L: It is quite possible to speculate in one's principal residence, but **it requires fairly cogent evidence to justify the conclusion that the house where one lives has become an object of trade.**
A: At the point at which T moved out of old house and demolished it he converted what was clearly a capital property to inventory and notwithstanding the fact that he was forced for economic reasons to move back, when cost and interest rates escalated and the bottom fell out of the market, the West Van property never ceased to be an asset that was held for sale in the course of an ACNT. Consistent speculative intent that goes well beyond the normal hope that everyone has that he/she can sell his/her principal residence at a profit.

C: Deduction allowed.
R: Property held in an ACNT is inventory, not capital property, and ∴ cannot be characterized as personal-use property, which is a type of capital property.

Down v MNR, (1993)	T, who had bought and sold between 80 and 100 properties in previous years, sought to deduct a loss of $112K incurred on the sale of a house, which he acquired in February 1982 and resided in until December 1982 while he carried out extensive renovations.	Accepted T's testimony that he had acquired the house for the purpose of renovating and reselling it ASAP.
Jason v Canada (1995) TCC	T sought to deduct a loss incurred on the sale of a residence acquired by T in 1989 and sold in 1990. T had lived in residence for 8 months and acquired it w/ intention of using it as principal residence.	Purchase was 96% debt-financed – secondary intention to sell for profit at first opportunity. Purchase and sale constituted ACNT, loss from which was fully deductible.
McMillan v MNR (1987) TCC	T, who resided in a newly constructed house from 1981 until 1982, sought to deduct a loss on sale of house on grounds that the property was acquired as a speculative venture. T had purchased property w/ sole intention that it be built as a principal residence for himself – possibility of reselling property at a profit was not a motivating factor in T's mind at time of purchase.	Deduction disallowed.
Boudreau v Canada (1999) TCC	T purchased parents' principal residence in Feb 1993 for $110K and rented property to parents at below market rates under Dec 1994, when he sold the property to his sister for $103K.	Deduction of terminal loss and capital loss disallowed – personal-use property.
Sandoz v MNR, (1981) TRB	T acquired a condo for $42.5K in 1975 and sold it 2 years later for $40K, claimed a capital loss on grounds that he lived mostly at his cottage or w/ a friend, and had purchased the condo while in the process of a marital separation in an attempt to shelter his capital from legal attack by his wife's lawyer and also to provide a vehicle for financial improvement in his retirement.	T stored personal belongings in condo, put up curtains, lived in it occasionally, used the address – whether T resided there or not, condo was purchased for personal use.

COMPUTATION

For our purposes, **adjusted cost base = cost** (defined in **54**). **248(1)** defines **disposition or property**. **54** defines **proceeds of disposition**.

40(1)(a)(i): A T's **gain** for a taxation year from the disposition of any property in the year is: the amount, if any, by which the T's proceeds of disposition exceed the total of the adjusted cost base to the T of the property immediately before the disposition and any outlays and expenses to the extent that they were made/incurred by the T for the purpose of making the disposition

- Gain = proceeds – (ACB + transaction costs)

40(1)(b)(i): A T's **loss** for a taxation year from the disposition of any property in the year is: the amount, if any, by which the total of the adjusted cost base to the T of the property immediately before the disposition and any outlays and expenses to the extent that they were made or incurred by the T for the purpose of making the disposition, exceeds the T's proceeds of disposition of the property.

- Loss = ACB + transaction costs – proceeds
- **40(1)(b)(ii)** requires Ts who realize a capital loss to recognize the full amount of the loss in the taxation year in which the property is disposed of by defining the amount of the capital loss in any other year as nil.

SUMMARY

Office and Employment	Business and Property	Taxable Capital Gains and Allowable Capital Losses	Other
Characterization **Inclusions** **Deductions**	**Characterization** **Inclusions** **Deductions** **Timing**	**Characterization**	**Subdivision d:** **- Retirement Allowance** **- Prizes** **- Scholarships, fellowships and bursaries** **- 3(a) unspecified source** **Windfalls (non-taxable)** **Non-Taxable Capital**