STRUCTURE INCOME TAX

<u>3 Sources of Taxable Income:</u> (see s. 3)

- 1. Income from an **office & employment** – ss. 5-8
- 2. Income or loss from a **business & property** – ss. 9-37
    - Income from property is passive – rent, royalties, interest from loaned money
- 3. Taxable **capital gains**, allowable **capital losses**, deemed proceeds rules, and attribution rules
    - Only taxed half of the capital gains or losses

<u>4 Issues Address for All types Income:</u>

- **1. Characterization -** What is the thing you are doing?
- **2. Inclusion -** What is included in computing income?
- **3. Deductions**
- **4. Timing** – Alter what you are including/deducting this year vs. next year

<u>Functions of Government:</u>

1. Allocation function – Allocate resources of public goods through taxes

- In modern market economic we rely on markets but markets can fail b/c of public goods
- Public goods are goods that can't be restricted (ex. National defense), where people get the benefit of them whether they pay for them or not

2. Distribution Function - Tax ppl who do better in market and don't tax people who do worse - distribute money

- Tend to rely on market for distribution – but there is a big amount of luck for distribution in a market economy so need something to moderate the distribution

3. Stabilization Function – Use tax to stabilize aggregate variations in the market economy

- If the economy is in a recession then lots of unemployment and good time for gov't to either tax and spend or borrow and spend – stimulate economy
- Tax when things are good and use it to spend when things are bad – moderate business cycles
- Stabilization can happen 2 ways:
    - **Fiscal Policy** – tax and spend
    - **Monetary Policy** – central banks varying interest rates

<u>KEY STRUCTURAL ELEMENTS:</u>

- **1. Tax Unit** – Who is subject to the tax?
- **2. Tax Base** – What are you taxing? How is the tax assessed?
- **3. Accounting Period** – What period of time is income computed?
- **4. Tax Rates** – How is the amount of tax payable determined?
- **5. Tax Credits –** Reduce tax otherwise payable or provide direct payments (tax refunds)

Note: 1, 2, & 3 are found in s. 2(1)

S 2(1): Basic Charging Provision

"An income tax shall be paid, as required by this Act, on <u>taxable income</u> for <u>each taxation year</u> on every <u>person resident in Canada at any time in the year</u>"

- **Tax Unit:** "every person resident in Canada at any time in the year"
- **Tax Base**: "taxable income"
- **Accounting Period**: "each taxation year"

TAX RATE

s. 117(2) → gives tax brackets, progressive rates

- (a) Up to $40,726 – 15%
- (b) $40,727 - $81,452 – 22%
- (c) $81,452 - $126,264 – 26%
- (d) Above $126,264 – 29%

TAX UNIT

"Person" – *individual* human being

- **S. 248(1):** "**Individual**"- a person other than a corporation
- Since system uses individuals and progressive rates then strong incentive for income splitting

Income Splitting – Split income b/w yourself and a family member so the income gets taxed at lower bracket

Should income splitting be allowed?

- The US aggregates income of married couples, whereas Canada has always taxed individuals
- **Individual tax unit** – control principal
  - Creates a strong incentive to split income with low-income spouse or child
  - Couples/families with same total income can face diff tax burdens depending on share of aggregate amount received by each person
- **Spousal/family tax unit –** benefit principle – allocation tax according to benefits derived from income, benefits often shared and used as collective family unit
  - Discourages participation in the paid labour force by secondary earners

S. 56(2): Constructive Receipts

- Employee isn't allowed to say to employer "don't pay all my salary to me, pay some to my child"
  - Taxed back to employee – can't direct your income to be paid to someone else

"Resident in Canada" – Canadian residents subject to tax on their worldwide income

- Look at taxpayer's ordinary mode of living to determine if reside in Canada

ACCOUNTING PERIOD

S. 249(1): "Taxation Year" – Fiscal period

- In the case of an individual, a calendar year

S. 248(1): "Fiscal Period" – 12 months

Implications of Accounting Period:

- 1. Returns must be filed and tax paid on an annual basis
- 2. Division of continuous flow of income into discrete yearly periods creates incentives for taxpayers postpone payment of tax by attempting delay recognition of income to subsequent taxation years or acceleration the recognition of deductions or credit to current taxation year
- 3. When income subject to graduated tax rates, an annual account period may cause relative hardship to taxpayers whose income fluctuates in single years compared to taxpayers whose income is more consistent from year to year

TAX BASE

S. 2(1): Tax base = taxable income

- Inclusions, deductions and exemptions

S. 2(2): Taxable Income = Income +/- Division C

- Division C = ss. 109 – 114.2

****Section 3: Defines taxpayer's income =** Adds amounts in (a) and (b) and subtracts amounts in (c) and (d)

S. 3(a): Total income from source (source = office, employment, business, and property)

- "*Including w/o restricting*" – other sources apply – subdivision D or unspecified source
    - Unspecified– income from source not mentioned (***Schwartz*** – characteristic source of income)

Income – Receipt has some sort of periodical aspect, reoccurring in nature – **consumption + change net wealth**

- **Capital** – stock of wealth at a point in time
- **Consumption/Expenditure** – use of income at a point of time or over a period of time
- If doesn't have reoccurring nature then *less likely* to be considered income

Source – 4 identified sources, and sources in subdivision D and could have sources no in ITA

- Something capable of producing income and you expect to earn income from it
- **Capital accretion** – gain in value of property is not income from a source, it is taxed under 3(b)
- **Gifts & inheritance** – not included as income from a source, lottery winnings not taxable

S. 3(b): (TCG (other LPP) + Net gains from disposition LPP) – (ACL (other than LPP) – ABIL) = Net Taxable Capital Gains

- **S. 38: Taxable Capital Gain (TCG)** – ½ of taxable gain taxable; **Allowable capital Loss (ACL)** – ½ capital loss
- Can only deduct allowable capital losses against taxable capital gains

Personal-Use Property – if property goes down in value then assumed to be b/c of personal use

- Losses are personal consumption – no deduction, but if the property goes up in value then gain gets taxed

Listed Personal Property (LPP) –Property goes down in value, but not b/c you used it, but b/c market changed

- Subcategory of personal use property – allows to deduct loss if this type of property goes down in value
- Only can deduct losses from gains of LPP → net gains LLP

S. 3(c): 3(a) + 3(b) – deductions subdivision e = Total income sources + Net Taxable Capital Gains) – deductions subdivision e

- If deductions in subdivision e are allowable as deductions from a source then deduct in (d) and not if (c)

S. 3(d): 3(c) – losses from 4 sources of income (s. 4(1)(a)) – ABIL

- **ABIL = Allowable Business Investment Losses** – can be deducted against all sources of income (1/2 loss)
    - Used if lose everything private corp and have no taxable gains, but allowed losses be deducted

S. 3(e): The amount calculated in s. 3(d) is the income

S. 3(f): if 3(d) < 0 then income = 0

S. 111: Loss Carryovers – 2 main types of Losses

- **1. Net Capital Losses**: Allowable Capital Losses for the year > Allowable Taxable Gains
    - Unlimited carry forward – can only deduct against net capital gains so carry forward forever
    - Carry back 3 years
- **2. Non-Capital Loss**: losses from sources of income + ABIL > s. 3(c)
    - Amounts can be carried over and deducted when computing income in <u>other</u> years
    - **S. 111(1)(a)** – carry forward 20 years and carry back 3 years
        - So in current taxation year, can deduct non-capital losses from the preceding 20 years

TAX CREDITS

Deductions vs. Tax credits

- **Deductions** – come off of the top, so they are worth more to ppl who have higher income b/c it reduced stuff computed at highest marginal rate
- **Credits** – Subtracted directly form amount of tax otherwise payable or credited to taxpayer as payment of tax – results in reduction of tax otherwise payable or tax refund where no tax otherwise owing
  - Doesn't differ depending on your income level – more equitable

Ex. Disability Tax Credit

- P1 income = $100K , P2 income = $100K but P2 is disabled ($20K expenses from disability) and gets recognition for this
- More accurate to compare P2 with someone who makes $80K – makes sense to take $20K off the top
- Instead P2 gets 15% tax credit, and are treated as having same income as someone not disabled (P1)

Purpose Credits:

- **1. Incentives** – if want people to invest in certain activities, then gov't will subsidize your investment by giving tax credits
- **2. Adjustment** tax payable to take into account different circumstances
  - Personal tax credits – exempts certain basic amount to live on (s. 118(1)(c))

Non-Refundable Credits – Credit subtracted directly from tax otherwise payable

- If income so low then non-refundable credit doesn't mean anything b/c not paying tax

Refundable Credits – Credit operates as an overpayment of tax

- Make credit refundable and even if income too low to pay tax still get money back from fed gov't

5 refundable tax credits in ITA

- **(1) GST** – s. 122.5;
- **(2) Medical expense supplement** – s. 122.51
  - Reimburses 25% uninsured medical expenses for low-income taxpayers
- **(3) Child tax benefit** – s. 122.6 - 122.64
  - Monthly payments to low-income families with dependent children
- **(4) Working income tax benefit** – s 122.7
- **(5) Children's fitness tax credit -** Reimburses 15% eligible fitness expenses of qualifying children

Criteria Evaluating Tax System:

- **1. Equity**
  - **Horizontal equity** – individuals who are similarly situated be treated the same
    - Hard to determine if individuals are similar for tax purposes
  - **Vertical equity** – taxpayers with differing incomes be taxed differently
    - Ability to pay – taxpayer with greater income has greater ability to pay
- **2. Neutrality**
  - Tax system should not affect people's choices
  - Choices should remain after tax what they would be in a world without taxes
- **3. Administrability**
  - To extent possible, tax system should be easy to comply with, provisions should be difficult to evade, easy for tax administrators to enforce, ect

STATUTORY INTERPRETATION

Modern Rule:

The words of an Act are to be read in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament

SOURCES INTERPRETATION

PRIMARY SOURCES

1. **Income Tax Act –** primary source Canadian income tax law
2. **Income Tax Application Rules**
    - Provide transitional rules to accommodate adjustments from pre-1972 rules to current scheme
3. **Income Tax Regulations** – provide additional details computation and collection of tax beyond statute
    - Can be changed more frequently then statutes
    - Same force of law as the Act itself
4. **Tax Treaties**
    - Apply where Canadian residents obtain income from other jurisdictions or non-residents derive income from activities in Canada
    - Prevents double taxation of income
5. **Other Statutes & Private Law**
    - *Interpretation Act*
    - Court will look to private law to fill in what's missing – private law governs legal rights and relationships to which the ITA applies absent specific statutory provisions to the contrary
    - Private law is determined in provincial law b/c Prov has jurisdiction over Property and Civil Rights

SECONDARY SOURCES

1. **Tax Cases**
    - Cases are all referring back to the ITA
    - Weight given to previous tax cases depends on level of court that arrived at decision and extent which reasoning applies to facts in subsequent cases
    - **Hierarchy Tax Cases:**
        - Before 1949: Exchequer Court of Canada → SCC
        - 1949 – 1972: Administrative tribunal → Exchequer Court of Canada → SCC
        - 1972-1991: Administration tribunals → FC (trial division) → trial de novo → SCC
        - 1991- Present: TCC → FCA → SCC
2. **Administrative Positions**
    - CRA produces docs that are publicly available (Income Tax Bulletins, Folio's)
    - CRA's best interpretation of what they think the legislation means
3. **Scholarly and Professional Publications**

ELEMENTS INTERPRETATION

5 Tools to Interpret Statutory Provisions:

- **1. Words of the statute**
- **2. Context which words are to be read**
- **3. Scheme of statute**
- **4. Object of statute**
- **5. Intentions Parliament**

WORDS

General principle – words understood in their ordinary sense

- Words read in ordinary in grammatical sense
- Meaning of word can't be determined in isolation – depends on context the word was used in

CONTEXT

Sometimes context tells you that words are not used in ordinary sense – particular commercial meaning

Internal Context – Within text, point to the words – everything contained within the Act

External Context – Assumptions bring to text you are reading, info from world outside the statute that sheds light to text's meaning

Associated Word Principle

- ***Sauvage (1983) SCC:***
  - **S. 56(1)(n)** – *scholarships, fellowships, bursaries or prizes*
  - Looked at words around prize to identify what "prize" included in this section

Limited Class Principle

- Use specific words in section to understand the general word
- **S. 5(1)** – salary, wages, and other remuneration including gratuities
  - "Remuneration" is the general word – understand it by looking at the other words
  - Annual bonus is remuneration – would fit with other words in the section

SCHEME OF THE ACT

Meaning provision depends on their relationships w other provisions & structural feature statutory scheme

- Court adopts approach that presumes coherence and tries to bring coherence to the scheme
- Assume that Parl doesn't use words unnecessarily and that they employ consistent methods of expression throughout each statute – identical words/phrases given same meaning
- Statutes contain no internal contradictions or inconsistencies

Principle Implied Exception – Specific rule will apply over the general rule

- ***Sauvage***: taxpayer saying prize under s. 56(1)(n) so that she wouldn't have to pay tax, the alternative was that it was an employment benefit
  - Court said it was a benefit but also a prize since s. 56(1)(n) is more specific rule

Principle Implied Exclusion – Read meaning into absence of words, gives effect to something not there

- Parl would have used certain words if wanted to achieve result, but didn't so they didn't want that result
- ***Schwartz (1996) SCC***: Lawyer entering K to work for health care company, but K terminated before he started – Q was whether this was taxable was a "retiring allowance" under s. 56(1)(a)?
  - Include amount received in respect of loss office or employer – argued can't be taxed b/c he was never actually had the employment
  - If Parl had wanted to include this type of situation they would have put it into s. 56(1)(a)

OBJECT/PURPOSE OF THE ACT:
Usually Act have multiple purposes, ITA purposes: raise revenue, be equitable, get people to do things (incentives)

Express Purposes – uncommon, don't generally see in ITA

Inferred Purpose – refer to academics, common sense, ect

INTENTIONS OF PARLIAMENT
Denotes a specific meaning parliament would have given the provision in context of fact situation

4 Kinds Parliament Intent:

1. Express Declarations
- Parl enacted specific rules to govern interpretation of other statutes (*Interpretation Act*)

2. Extra-Statutory Materials
- Those closely associated w drafting/sponsoring statute expressed viewed

3. **External Context** and **evolution** of statute/provision through successive amendments

4. Shared Linguistic Conventions
- Presumption Parl intended particular meaning by selection and arrangement of words
- Ex. Parl didn't intend to violate Charter or international law

CONSEQUENCES
Courts are in a better place than Parliament to see consequences of certain interpretations
If interpretation leads to absurdity or injustice then that is grounds to move away from that interpretation

INTERPRETATIVE DOCTRINES

STRICT CONSTRUCTION (-1984)
Dominant approach until 1984
Statutory language construed literally – if person comes within the letter of the law then he must be taxed
- Any ambiguities about imposing tax resolved in favour of the taxpayer
- Ambiguities about deductions/exemptions resolved against the taxpayer

Words & context are key
- Ignore the purpose of the statute, the intentions of parliament and the consequences
- Doesn't matter if produces unfair results – just follow exactly what the law says

MNR v MacInnes (1954) Ex Ct: APPLYING STRICT CONSTRUCTION

Facts	Husband gives cash & bonds to wife (M). M used $ to purchase other bonds, sold these bonds and bought shares in company, sold shares and invested in securities – received income. Husband taxed b/c he transferred bonds and this is $ from subsequent transfer. ITA 1948 s. 32(3) → "where husband transfers property to wife, he is liable be taxed on income derived from property or property substituted therefor"
Issue	Does "properly substituted therefor" include properly substituted for substituted property?
Analysis	If parliament wanted this to extend to multiple situations then they **<u>should</u>** have said that • If parliament wants to tax someone then they have to do it explicitly Another part of statute says "previous owners includes owners previous to owners" – inference that since they put it there and not here that they intentionally left it out here (**implied exclusion**) S. 32(2) doesn't expressly extend liability to be taxed on this income – therefore fails
Holding	Husband not liable to pay the tax
Ratio	***Even if goes against "spirit" of law – cannot recover tax without bringing subject within letter of the law – only look at the words of the section***
Note	Parl clearly meant rule apply multiple subs b/c if just 1 sub too easy for ppl to get outside the rule

PURPOSIVE APPROACH (1981-1991)

See shift in ***Stubart Investments (1984)*** – apply Drieder's Modern rule

- Plain meaning rule but in substantive sense, if falls within "spirit of the charge" then can be held liable

Before looking at the words, look at why the Act (or provision) was passed and give the words under interpretation that best accomplishes the purposes of the Act (or provision)

- Start with the purpose of the statute – can result in ignoring the words

Bonfman Trust (1987) SCC:

- Doesn't pay close enough attention to the words of the provision – goes too far focusing on purpose

NON-SUBTANTIVE PLAIN MEANING APPROACH (1991 – 2005)

Where:

- Provision is clear – no ambiguity application to facts → provision applies **regardless** of its object and purpose
- Language allows **doubt/ambiguity** – useful to look at object and purpose of the provision/statute

MODERN APPROACH (2005-Present)

Affirms Dreider's approach: examining words, context, scheme, objective, intention parliament, and consequences

Canada Trustco Mortgage Co v Canada (2005) SCC: AFFIRMED MODERN APPROACH

- All statutes, including ITA, must be interpreted in **textual, contextual and purposive way**
- When words of provision are precise then ordinary meaning of words plays dominant role
  - Can't read broad purpose or intention into legislation when words are specific
- ITA is dominated by explicit provisions so will largely be a textual interpretation
  - Shouldn't be confused w plain meaning approach – emphasized statutory context and purpose may reveal/resolve latent ambiguities, even where provision doesn't appear ambiguous

Will-Kare Paving & Contracting Ltd (2000) SCC:

Facts	T constructed asphalt plant - ¾ output from plant used in own paving business, ¼ sold to 3rd parties. T claimed CCA and investment tax credits – MNR said no. T said this was property used directly/indirectly by T in Canada primarily in manufacturing/proceeding "**goods for sale** or lease"
Issue	Should the ordinary meaning or the commercial meaning for "sale or lease of goods" be applied" • Commercial– K to sell or lease goods, need separate K for sale of the asphalt • Ordinary– at end day, don't know asphalt anymore and it's been sold w the services
Majority	**Commercial meaning should be used – doesn't get tax credits** • "Goods for sale or lease" is commercial concept, and this is a commercial statute • Scheme, parliaments purpose, and intentions of parliament isn't convincing majority
Minority	**Ordinary Meaning approach – T should get tax credits** • Doesn't use exact same words as commercial context – "sale of goods" • Start ordinary meaning and go to commercial if clear that is what Parl intended – not clear here • Majority of ppl file tax returns don't know technical meaning of "sale of goods" • Consequences of the two interpretations: ○ If T given 2 bills (1 service & 1 price asphalt) would get benefit, absurd b/c T didn't do that now doesn't get benefit
Holding	Taxpayer doesn't get the benefit
Ratio	***Look at the context of the act, as well as the intention of parliament to determine the meaning of words in the section***

*INTRODUCTION TO TAX AVOIDANCE

Tax Evasion – Illegal breach of specific statutory duties

Tax Avoidance – Legal efforts to order one's affair minimize tax – working w ITA to get result you want but goes against purpose of ITA

Gregory v Helvering (1935) US SC: **BUSINESS PURPOSE TEST IN US**

Facts	United Mortgage (UM) owned shares in Monitor Securities Corporation – MSC. Mrs. G owns all the shares in UM. Ms. G wanted sell her shares in MSC. UM sells shares to Averill Corp and Averill Corp gives the shares to Ms. G. Ms. G dissolves Averill and now she owns the shares in MSC directly and she sells them. **Definition reorganization**: transfer by a corp (UM) of all or part of its assets (MSC shares) to another corp (Averill), if immediately after the transfer, the transferor (UM) or its stockholders (Ms. G) or both are in control of the corp to which the assets are transferred (Averill). If there is distributed, pursuant to plan of reorganization, to a shareholder (Ms. G) of a corp to a party to reorganization UM) stock/securities of such corp (UM) or in another corp a party to reorganization (Averill), w/o surrender by such shareholder of stock/securities of such a corp (UM), no gain to distributee (Ms. G) from the receipt of such stock or securities shall be reorganized. Averill was only set up for a week and then was killed.
Revenue	Key argument was **substance over form**; also argued Ms G. primary purpose was to avoid tax
Analysis	Court rejects view that just having tax motivation doesn't get you the result • Engage in transaction but it is by a means that the law permits • This look like reorganization but isn't plan reorganization b/c **no independent business purpose**
Holding	G has to pay tax as if reorganization had no occurred
Note	Case results in diff attitude in US • Statute is meant to apply to real business transactions, not tax motivated transactions • Re-characterized what G had done in light of the economic substance – what did she really do US combines sham & economic substance– Averill sham corp b/c what really going on economically

SUBSTANCE & FORM DOCTRINE

Commissioners of Inland Revenue v Duke of Westminster (1936) HL: **SUBSTANCE OVER FORM**

Facts	In UK, couldn't deduct payment to personal servants. Duke scheme: instead of paying wages to gardener, signed over deed to pay him amount in next 7 years – said this now isn't part of Duke's income b/c he signed it over for next 7 years – gets deduction. In deed nothing says that gardener needs to keep working for him, gardener could quit w Duke and go work somewhere else and still get the money. Revenue department says Duke can't deduct money giving to gardener under deed. Revenue department argued substance of matter is gardener working for Duke and being paid.
Majority	**Duke doesn't have to pay tax** – substance is only what is derived from legal rights and obligations • **Legal substance** – look at legal rights & obligations, deed doesn't creates K since gardener doesn't have to keep working → Duke entitled to plan affairs around the Act
Dissent	**Duke has to pay tax** – substance of transaction was that remuneration was being paid to gardener • When look at agreement and interpret contextually, then what is going is an employment K • Legal substance = employment - Doesn't look at broader economic substance
Ratio	***Legal substance over form doctrine: substance is that which results from legal rights and obligations of the parties, ascertained upon ordinary legal principles***
Note	Legal substance is distinct from economic substance which was used in US approach above • In US substance over form means economic substance • UK – substance over form means legal substance over nomenclature

SHAM DOCTRINE

Sham - If you create the impression in the eyes of a 3rd party that you intend to do something but you never do

- Done something you pretend is other than what the real legal substance is
- Tax is assessed according to the transaction that these docs are designed to conceal

Sham brought back in ***Antico Paper Products v MNR (2015) FCA***

- Involved setting up offshore corporate entity – Minister argued sham (didn't argue GAAR has backup)
- Shows sham still alive and used today, but should always use GAAR as a backup in case sham not found

INEFFECTIVE TRANSACTION

Ineffective Transactions – Try to set something up but was sloppy about it – don't do everything necessary

- Court will look at what you actually set up and not what you tried to set up

BUSINESS PURPOSE TEST [no longer good law in Canada]

MNR V Leon (1976) FCA:

- Brothers set up companies so that all their money went into the companies
- Court said this was a sham and no business purpose for doing this – so don't get tax result
    - Court confusing sham and business purpose – this wasn't a sham, the companies were there
- FCA moving in business purpose direction

Stubart Investments Ltd Canada (1984) SCC: **REJECTS BUSINESS PURPOSE TEST**

Facts	Parent company and 2 other companies – Stubart (made food flavouring – very profitable) & Grover (made concrete, lots of losses). G's losses were about to expire (carry forward period almost over). S sold profitable business to G and G use losses to shelter S's profit from tax. G operated S's business until losses used up – G never did anything w S's company. Revenue Department said no business purpose for this – denied use of losses from G to offset profits from S.
Issue	Can a corporation, for the purpose of reducing taxes, route profits through subsidiary in order to avail itself form latter corp's loss of carry-forward?
Analysis	No sham – legal rights and obligations were those intended No incomplete transaction – all assets necessary to carry on business were transferred to G No principle that need a business purpose to a transaction in order for it to be recognized
Ratio	***Rejects proposition that transaction may be disregarded for tax purposes solely on basis that it was entered into by a taxpayer w/o an independent or bona fide business purpose***
Note	Overruled by GAAR, but still most authoritative statement on judicial anti-avoidance doctrines in CA

SPECIFIC ANTI-AVOIDANCE RULES (SAARs)

These rules can override legal substance

4 General Categories SAARs

1. Address Inclusions

- Ex. S. 6(1)(a) includes employment benefits

2. Disallowing/Limiting Deductions

- Particularly **s. 67** – general limitation on deduction of any expense that it must be "reasonable in the circumstances" – can't deduct something beyond what is reasonable

3. Timing

- Can't accelerate deductions or defer certain kinds of income

4. Deeming Provisions

- Regardless of legal relationships, for the purpose of ITA, going to deem those relationships to be something else – overrides legal relationships
- Ex. Ss. 6(3), 16(1), 65 – "regardless of the form or legal effect"
- S. 74.1, 75.1 – deem someone received income even when haven't & deem someone else not have it

GENERAL ANTI-AVOIDANCE RULES (GAAR)
Section 245

REQUIREMENTS USE GAAR:

1. Tax Benefit – Anything that gets you some sort of positive tax result
- Results from single transaction or series of transactions
- Defined in **s. 245(1)** – reduction, avoidance deferral of tax or increased refund of tax
  - Reduction compared to what?
    - SCC –compare benchmark transaction taxpayer would have done but for tax motive

2. Non-Tax Benefit Test – s. 245(3)
- If it is ***reasonable*** to conclude the transaction was primarily tax motivated then GAAR applies
- Doesn't say business purpose – wants to include personal benefits
- Weigh taxpayers tax motivated reasons and non-tax motivated reasons

3. Misuse or Abuse – s. 245(4)
- GAAR only applies if ***reasonably*** considered that the transaction would result in a misuse or abuse
- Misuse and abuse are really the same thing – just one test (*Trusco* + *Copthorne*)
- **Legal test, not factual test** – burden on Minister to make it clear what the policy was (scheme of Act) and what the abuse was→ abuse must be clear and unambiguous
  - Burden on mister prove reasonable abuse, but seems to be going back to clear and unambiguous
- **Abusive tax avoidance where**: (*Copthorne Holding v Canada*)
  - (1) Transaction achieves outcome the statutory provision intended to prevent
  - (2) Transaction defeats underlying rationale of the provision, or
  - (3) Transaction circumvents provision in manner frustrates or defeats, object, spirit or purpose

Tax Benefit + Non-tax Benefit Test = **Avoidance Transaction → s. 245(3)**
- People had problem b/c certain incentives ITA gives that encourage ppl to do things for the tax benefit
- 2 requirements to be characterized as avoidance transaction
  - 1. Transaction or part of series transactions that, but for the GAAR, would result, directly or indirectly, in tax benefit
  - 2. Not reasonably considered been undertaken/ arranged primarily for *bona fide* purposes other than to obtain the tax benefit

S. 245(2): Consequences (Remedy)
Tax consequences determined as is ***reasonable in the circumstances*** in order to deny a tax benefit that would result, directly or indirectly, from the transactions or series of transactions
- Tax consequences limited 2 ways:
  - 1. Must be reasonable in the circumstances – objective standard
  - 2. Must be determined in order to deny the tax benefit

S. 245(5): Determination Tax Consequences
- (a) Can go after deductions, exemptions, exclusions
- (b) Can relocate deductions or exclusions income, ect
- (c) Can say that isn't interest, that is gain of capital - Make something, something else
- (d) Can ignore stuff

INCOME/LOSS OFFICE OR EMPLOYMENT

S. 3(a) – taxpayer's income for year includes income from each office and each employment

S. 5-8: Rules for computing taxpayer's income or loss from office or employment

- **S. 5(1):** Defines taxpayer's **income** from office or employment
  - Salary, wages and other remuneration, including gratuities, received by taxpayer in year
- **S. 5(2):** Defines taxpayer's **loss** from office or employment
  - Amount taxpayer's loss, if any, for the taxation year from that source computed by applying the provisions of Act respecting computation of income from that source
- **S. 6 & 7:** Specify amounts that must be included in computing income from O/E
- **S. 8:** Specific amounts that may be deducted when computing income from O/E

2 Tax Consequences Income Employment vs. Income Office

- 1. Deductions permitted under **s. 8** for income from E less generous than for computing income from O
- 2. Employers required to withhold and remit income and payroll taxes for amounts paid to employees

Both workers and persons hiring usually prefer source of amount be characterized as business, not employment

CHARACTERIZATION OFFICE/EMPLOYMENT

Definitions in s. 248(1):

"Office": Position individual entitling the individual to fixed or ascertainable remuneration

- Usually a permanent or substantive position that exists independent of person who fills it
- **Includes:** corporate director; members of senate; house of common members; ect.

"**Officer**" – person holding such an office

"**Employment**": position of an individual *in the service* of some other person

- "servant" or "employee" means person holding such a position
- "Employee" includes officers

EMPLOYEES VS. INDEPENDENT CONTRACTORS

Contracts of service – employment
Contracts for service – independent contractor (classified as business)

Consequences of being Employee vs. Independent Contractor

1. Deductions – more beneficial to be independent contractor

- S. 9(1): independent contractors
- S. 5(1) & 8(2): Unless specifically permitted, don't get deductions from employment income

2. Employers have to pay various payroll taxes

- If have employees, have withhold income tax and pay It on their behalf – admin burden
- If independent contractor, employer doesn't have to pay employment insurance on their behalf

3. Withholding Tax

Test Independent Contractor vs. Employee ➔ **"TOAL RELATIONSHIP TEST"** (***Wiebe Door***):

1. Degree/absence of *control* exercised by alleged employer

- Employer can says what has to be done and how to do it
- If independent contractor, only told what has to be done

2. *Ownership* of Tools

- If employer owns tools then more likely employee, if you own tools then likely independent contractor

3. Chance of *profit* and risk of losses

- Employment – fixed salary/wage (usually by time)
- Independent Contractor – contract payment for specific result/piece of work

4. *Integration* employees work into employers business

- Look from perspective of worker, not from hirer (***Wiebe***)
- How much work comes from the employer
  - If all their work comes from 1 person then they are likely to be seen as employees
    - See that might just be getting lots of work from the one person - ***Dynamic***
  - If they get work from many different sources then more likely independent contractor

Wiebe Door Services Ltd v MNR (1986) FCA: **LEADING CASE – LOOK AT TOAL RELATIONSHIP**

Facts	Business repairing & installing garage doors– most business repairing. W had various garage door installers – specific understanding they were independent contractors and had to do own taxes.
Issue	Is the contract one of service (employment) or for services (independent contractor)?
TCC	Just b/c call independent contractors, doesn't mean are, just nomenclature – could be employees **Applying Test:** • (1) Indecisive - some control but not specifically telling them what to do • (2) Suggests independent contractor – owns truck and tools, only gets special equipment from W • (3) Suggest independent contractor – piece work, payed per job, so they are the more they make • (4) Employee – w/o independent contracts, W no business, not accessory to business, essential Workers are so integral that it overrides all of the other tests • **Note**: this is where TCC went wrong – not magic formula by looking at worker is integral to business or accessory to business, need to look at worker as a whole
FCA	W appeals to FCA and **FCA sends to back to TCC** • FCC doesn't like what tax court does – if do integration test then always going to find people are employees, why would someone use people if it isn't necessary? Should look **integration from perspective of worker**, instead of hirer to determine integration • How much of work comes from the employer? • If person only works for W then might offset what is determined from other factor No one thing in test is determinative – holistic approach where look at total relationship
Ratio	***Is there person who engaged worker perform services or is he performing them on own account?*** • ***Look at whole of various elements which constitute the relationship b/w the parties***
Note	**Should the GAAR apply?** • 1. **Tax benefit** independent contractors instead employees? Yes - deductions • 2. **Primarily tax motivated**? We are predicating it on yes it is • 3. **Abusive**? Scheme of act allows someone to be independent contractor and get deductions

SUMMARY – Test to consider if worker is employee

Wiebe Door - Test considers the total relationship b/w the parties. **Is the person who has engaged himself to perform the services performing them as a person in business on his own account?**

- If yes then K is K for service involving independent contractors (business)
- If no, then K is K of service b/w employee and employer

If employee – continue under office and employee

If independent contractor – move to business and property

INCORPORATED EMPLOYEES

Steps Incorporated Employee:

- 1. Employee sets up a private company ("me")
- 2. Terminate employment arrangement w employer
- 3. "Me" Company sets up employment contract w former employer
- 4. Employee employed by "me" company and owns shares of "me" company

3 Advantages Incorporating Employees:

1. Income Splitting

- Can give spouse or kids share in "me" company

2. Low Tax Rate – Private Corporation

3. Business Income – **More deductions** than for O/E relationship

- Corporation cannot be O/E (not "individual) –K b/w employer and "me" company business income

Would the GAAR apply to Incorporating Employees?

- **1. Tax Benefits**: Got 3 tax benefits from doing this (see above)
- 2. **Primarily tax motivated purpose**? - Primarily tax motivated, No valid business purpose
- **3. Abusive -** Rules allow this but it is contrary to scheme of the act
  - Say employee is independent contractor, or they first go through steps of independent contractor and then incorporated – is that abusive?

Engel v MNR (1982) TRB: **K B/W EMPLOYER AND CORPORATION – INCORPROATE EMPLOYEE**

Facts	E used to work for Global – had employment relationship. E's K with Global expire on Dec. 15. On Oct 20, E incorporated company – Reasoned. Oct 27 – E set up exclusive K w Reasoned. Nov 19 – K b/w Reasoned and Global for E's services.
Issue	Was Minister correct in including money given to Reasoned by Global as employment income for E?
Revenue Agency	Pre-GAAR case – revenue authority throws every anti-avoidance doctrine at it **1. Substance over Form** – doesn't matter what you call it, court will look at nature of relationship – E really employee b/c he is under absolute control of global, legal substance is employment **2. Ineffective transaction** – date makes it look suspicious, 3 weeks where breaking his K w Reasoned b/c isn't exclusively working for them since new K isn't set up with Global **3**. **Sham** – builds on legal substance over form – how thing was done shows that it wasn't meant to be done - docs didn't really intend to govern relationship **4. Business Purpose** – only reason did this was for tax reasons
Analysis	**Business Purpose** – primarily tax motivated – and if this is reasonable • E says wanted to expand freelance journal career, K w Global permitted him to do work for others but he had to get Global's permission in writing – don't really need to set up whole new corp, just renegotiate w Global so don't need permission • E says wants to charge mother for investment advice – could have done this w/o corporation • No business purpose test in Canada – reject it all together Look at **substance legal relationship** established • Corporation does exist, even though sloppy about setting things up, E terminated K with Global, K is b/w Reasoned and Global – **E isn't privy to that K** • E's K was actually terminated w Global – amounts paid to Reasoned, not E **No sham** – payments made from Global and other freelance employers were made to Reasoned
Holding	Amounts paid by Global to Reasoned were revenues for Reasoned and not income of E
Ratio	***If you incorporate right, and set it up carefully, make sure don't have K b/w employee and employer, but only b/w the employer and the corporation – then can incorporate employee***

Gov't introduces SAAR

Eliminates tax deduction and low tax rate benefits of incorporating employees

S. 18(1)(p): Shuts down incorporated employees ability to get tax deductions

Expenses that wouldn't be allowed deducted by employees now allowed to be deducted by these corporations

S. 125(7): Personal Service Business – don't get most of the deductions and don't get low corporate tax rate

- (a) & (b) The taxpayer or a related person who owns at least 10% of the shares of a corporation on behalf of which the taxpayer performs a service, and
  - Related person = connected by blood, marriage, or adoption
    - Related everyone above – parents, grandparents ect, and everyone below, and sibs
- T performing the service would, but for the corporation, reasonably be regarded as an employee of the 3rd party to whom services were provided
- Then the corporation will be the low corporate tax rate and restricted in the deductions they may claim in computing its income, **unless**
  - (c) Corporation employs in business more than 5 full time employees
    - Once get 5 or more full time employees then out of rule and get low corporate tax rate

Should the GAAR apply if you get all your children on the payroll under 125(7)(c)?

- Hard to say abusive – if didn't want you making family membs employees then they should have said that
- Does say full time – so hard to hire kids full time
  - So if have family business then still valid

Dynamic Industries v Canada (2005) FCA: **ADDS HISTORY TO EMPLOYEE ANALYSIS**

Facts	M owned shares Dynamic– transferred shares to wife (Ms. S). Ms. S family memb and specified shareholder (owns all the shares). M worked more through company and less through union. M was sub-contracting to other companies, including SILL, M managed for one of their mining companies – Ford. Dynamic entered K w Sill to provide project management work. For 4 years only contract Dynamic had was with SILL. M had authority over what jobs SILL would do. No security SILL to secure payments, sometimes M and Ms. S had to put money in company until SILL paid. Revenue Authority said that but for the existence of the corporation, M would be an employee of SILL
Issue	Would M be reasonably regarded as an employee?
Analysis	Look at tests from ***Sagaz*** and ***Wiebe Door***: **Control** – not a lot of control here; **ownership tools** – M owned all own tools; **Integration** – Revenue authority says that it is exclusive so M is employee, only worked for SILL; **financial risk** – not set up like employment relationship; **performance of tasks** Integration not determinative b/c SILL only worker b/c big work so monopolized M's time Court says can't just look at 4 year time slice – Dynamic was set up for a long time and M had done work through it – adds factor – ***history***
Holding	Judge failed correctly apply Sagaz factors
Ratio	***Sagaz Q: whether an individual is providing services to another person as an employee, or as a person in business on their own account – use Weibe factors but this case adds history***

533702 Ontario Limited v MNR (1991) TCC:

Facts	Brouwer Plumbing & Heating (BPH) owned by Dick. D's wife (J) was employed to provide services managing the showroom of his plumbing business. J provided services solely to BPH. J had company 533702 Ontario Limited.
Issue	Is it reasonable to regard J as an employee but for the corporation?
Analysis	**Showroom services had no commercial independence from BPH** • Goes through factors in Dynamic
Holding	533702 Ontario carried on personal service business
Note	If we modified the facts and said J had been doing this a while, and then started working with Dick and just got so much work from Dick that it was the only work she was doing • More like Dynamic and might say J's business is alright

Factors to Consider

Degree/absence **control** service by alleged employer	Individual works 1 person or number ppl (exclusivity)
Ownership of tools	Individual's principal workplace
Chance of profit and risk of loss	Hiring of helpers
Integration "employees" work into "employers" business – applied perspective worker (***Wiebe***)	Degree of responsibility for investment and management
Method of remuneration	Whether business is already established
Specific results test (contractor = specific results)	History of worker (***Dynamic Industries***)

INCLUSIONS O/E: REMUNERATION

3 sections to look at when calculating income from O/E: **5(1), 6(1) & 6(3)**

S. 5(1): General Rule Income O/E

Taxpayer's income for year from O/E: **salary**, **wage**, and **other remuneration**, including **gratuities**

- Common element: Cash compensation for service
- None of these terms are defined in ITA – court has said that they take on their ordinary meaning
- **Salary** – fixed payment made by employer, regular intervals (other than manual or mechanical work)
- **Wage** – amount paid regular intervals for time during which workman or servant is at employer's disposal
- **Gratuity** – Amounts paid to offer or employee of account of legally non-enforceable claim
- **Remuneration** – payment, reimbursement

S. 5(2): Loss O/E

Only get losses if have more deductions than income (very rare)

S. 6(1): More Specific Income O/E

(c) Includes **fees** received in respect of, in the course of, or by virtue of an O/E

- Includes director fees (another form compensation for service)
- Fixed payments in respect of an O/E

S. 6(3): Deemed Remuneration (Anti-avoidance rule)
Deems payments in connection w O/E that can be easily characterized as compensation for services as remuneration from O/E
Amount received
- (a) from payer to payee while payee is officer or employee; or
- (b) comes from an obligations arising from agreement with payee immediately before, during, or immediately after employment

AND, is either: (irrespective form and legal effect)
- (c) an inducement
- (d) a compensation for service (remuneration); or
- (e) consideration for covenant

is deemed to be included as remuneration from O/E under s. 5 (included in income from (O/E)

Remember: (1) Income from Source – fully taxed, (2) Capital – ½ taxed, (3) Gift/Windfall – not taxed

INDUCEMENT PAYMENTS – s. 6(3)(c)

Inducement Payment - inducement to accept office or enter employment contract
- Not taxable under s. 5(1) – not remuneration for services under O/E
- S. 6(3) deems most inducement payments taxable
    - But by virtue of (a) and (b) - it doesn't apply where inducement is made by someone other than payee's current or future employer

Curran v MNR (1959) SCC: **UNCLEAR WHAT CASE STANDS FOR – S. 6(3) DOESN'T INCLUDE PAYMENT 3RD PARTIES**

Facts	Brown (B) owned shares in Calta Assets. B and Calta owned shares in Federated Petroleum. Calta Assets & Federated Petroleum owned shares Home Oil. B wanted to replace manager Home Oil w T. T working for Imperial – getting $25K/yr + pension. T and B entered agreement – B agreed give T $250K for consideration loss of pension rights, chance for advancement and opportunities for employment – whether or not T agreed work for B, B paying the money to quit Imperial. T quit job, worked for Home Oil for yr, then quit. MNR says T should pay tax on the $250K.
Duff	**Is reasonable payment, regardless form/legal effect, as consideration entering employment K?** • In form (legal substance) – the contract says that this is money for T to quit his job **Does s. 6(3) apply – can this fall into (a) or (b)?** • (a) B is payer, but Curran works for Home Oil – B and Home Oil are separate legal entities
Ex Ct	This is income from an unspecified source, don't have to say employment income but it looks like income and therefore can be taxed (unspecified source in s. 3(a))

SCC	Substance of the matter or "**essence**" – substance/essence of K was to get T's services
	• Martland – essence of matter was acquisition of services
	• Kerwin – substance was engagement of Curran to work for B, payment was for personal service
	S. 6(3) doesn't apply – payer was B, not B's companies so s. 6(3) doesn't apply
	  • Says can't use s. 6(3) but then uses fact B is essentially the payer to rule against T
	Legal Substance argument made by court
	• True nature payment is found in K and *surrounding circumstances*, looks at K in light of circumstances and fact another K entered into where Curran went to work for B's company
	  ○ THIS IS EXACTLY WHAT 6(3) SAYS NOT TO DO

Holding	Curran has to pay tax on this amount – income within meaning of s. 3
Ratio	***If true substance of agreement which T is paid is engagement of T to work for employer or related person, then payment is for personal service and income under s. 3*** ***s. 6(3) doesn't capture payments by 3rd parties (anyone other than the employer)***
Note	No reason why s. 6(3) was used – unclear what this case standards for

GRATUITIOUS PAYMENTS

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

****Goldman v MNR (1953) SCC:*** **LEADING CASE GRATUITIOUS PAYMENTS**

Facts	G on committee of shareholders of comp that was going into receivership (office), raised issue remuneration for members of committee. Chair said no remuneration "as such", but members might get leftover $ after lawyers paid. G got $7,000/yr for 2 years. G argued payments windfalls
Analysis	This was gratuitous payment – income → payments for services rendered in connection w Office • Understand G would be paid for his services Just b/c services completed when payment made and not assurance from beginning that services would be remunerated doesn't prevent amount from being taxable income
Holding	Payment was remuneration and not a gift → G loses – pays tax
Note	This case was prior to 5(1) specifically including gratuities

Gagnon v MNR (1965) Ex Ct: **DOESN'T HAVE PAYMENT FOR NORMAL DUTY**

Facts	T received award $170 after making recommendation under Gov't Canada Suggestion Award Plan.
Holding	$170 taxable as gratuity payment – payment for service - remuneration within meaning of s. 5(1) • Parl expressly authorized awards as extra awards or compensation paid to public servants for service performed in addition to their normal duties – awards within "other remuneration"
Ratio	***Immaterial particular service not performed in execution normal duties of their position in O/E***

Seary v MNR (1979) TRB: **if no O/E ≠ gratuity**

Facts	Professor denied tenure, sued to get tenure – while suing got paid $1K/month (not teaching) + $15,000 lump sum when eventually got tenure and stopped legal action.
Issue	Are these amounts taxable?
Analysis	$1000/month not taxable since Prof held no office or employment at time when they were paid $15,000 taxable gratuity under s. 5(1)
Holding	Taxed on the $15,000 as gratuity
Ratio	***Can't fall within gratuity if not holding O/E at time payment is made***
Note	Duff: monthly payments in context employment relationship – should have applied • s. 6(3)(b)+(e) – deemed remuneration; • s. 6(1)(a) – taxable benefit in respect of, in the course of, or by virtue of O/E; or • s. 3(1)(a) - income from unspecified source

Yaholnitsky-Smith v MNR (1991) TCC:

Facts	T, teacher at group home, got financial assistance from employer to pursue education program – no obligation to return to former employer.
Issue	Is this payment taxable under income from O/E?
Holding	Financial assistance remuneration under **S. 6(3) –covenant** →Payment taxable • T didn't establish payments received cannot reasonably be regarded as having been received by her in consideration for her covenant – covenant made before, during and immediately after termination of employment with group home
Duff	Court got this wrong - no real agreement since employer didn't get anything in return

STRIKE PAY

Strike pay is rarely taxable

Strike Pay: Payment provided by union, typically in respect of **non-performance** of services

- S. 8(1)(i)(iv): Union dues deductible
- S. 149(1)(k) Unions given tax-exempt status

Loeb v Canada (1978) FCA:

Facts: T received $786.56 under employment K with teacher's federation during strike. Contract entered into on anticipation of strike, and enabled teachers to continue making contributions to teacher's fund.

Holding: Payment taxable – deemed employment income from the union (s. 6(3)_

- Rejected T's argument that arrangement was sham w/o legal substance
- Parties created bona fide legal relationship

Ratio: ***Even if on strike, payments during strike can be employment income***

Ferris v MNR (1977) TRB:

Facts: T worked for newspaper – was on strike. Members of union ran separate paper while on strike. Distributed profits from paper as strike pay.

Holding: Income from a business venture – taxable

- Placing taxable income from commercial venture within union and then getting it back by way of distribution doesn't render it tax-exempt → form cannot change the substance

Ratio: ***Where union is used to distribute funds then not tax-exempt***

Canada v O'Brien (1985) FCTD:

Facts: Unions representing employees of Van newspaper published own newspaper during strike – distributed profits as strike pay (similar to *Ferris* except union ran business instead of members).

Holding: Not taxable – the distribution was strike pay, not profit from business

- Since union ran business – didn't except that the newspaper was being operated by the members of the union, since most members didn't even work at it

Ratio: ***Need specific facts in order for strike pay to be taxed similar to Ferris and Loeb***

Canada v Fries (1989) FCA & SCC: **STRIKE PAY RARELY TAXABLE**

Facts	Gov't employees went on strike – agreed to pay employees after tax salary while on strike. Normal strike pay would be $10/week, but T got $880 for 3 weeks. • CRA - payment quality income (periodic, complete substitute income, not capital or gift, no other way to tax) & there was contract to withdraw services in exchange for money – should be taxable. • T argues return of capital - paid into strike fund and now just withdrawing from it – not taxable
FCA	Fund is **taxable** b/c community pot – possible to get more than you paid in (not capital return(• Taxable under 3(a) as income • Not windfall or capital gain – so almost by default income • Source of payment was strike fund – dues paid by union members were source of T's strike pay
SCC	Benefit of doubt goes to taxpayer – not convinced income so **taxpayer wins** • Not convinced strike pay comes within "income from a source' within s. 3(a)
Ratio	***Rare that strike pay is taxable***
Note	FCA decision reversed by SCC – SCC decision only 4 lines long

TORT DAMAGES

Tort damages are not taxable

When taxpayer gets damages personal injury or death, compensation includes special damages for **lost earnings**

Cirella v Canada (1978) FCTD: **DAMAGES PERSONAL INJURY NOT EMPLOYMENT INCOME**

Facts	T got into crash - got tort damages - \$34,400, \$14,500 special damages loss of income while injured. CRA – tax \$14,500 as income, argues, s. 5(1), 6(1)(a), 6(3) – income from employment, also argues 3(a) – income from a source. Also business income since T set up own company after accident
Issue	Should the money for loss of income be taxed as income from employment?
Analysis	Amount is not assessable as income from T's business • Individual is an "asset" of the business – damages awarded for damage to assets are taxable • But employee is not an "asset" so damages for injury to them is not taxable Not employment income – no services rendered, payment made b/c no services could be rendered • Not salary, wage, gratuity or other remuneration of employment • Damages are a surrogate for employment income - surrogatum principle (originally surrogate principle only for business, but in 2005 SCC extended it to employment income) Is amount income in nature that it can be regarded as income from a source? (s. 3) • Income compensation righting wrong –look at tort damage as whole, can't pick apart amounts • Damages were capital gains – compensation for loss of earning capacity – not taxable
Holding	\$14,500 not taxable income
Ratio	***Damages from personal injury are not income in character – not employment income***

INCLUSIONS O/E: PAYMENT ON TERMINATION

COMPENSATION BREACH/WAIVER CONTRACTUAL OBLIGATIONS – s. 6(3)(e)

To apply it must: (*Moss*)

- 1. Relate to an obligation and raise from agreement immediately prior to, during or after employment AND
- 2. Derive from consideration for (c) accepting employment, (d) remuneration services, OR (d) covenant

Moss v MNR (1963) Ex Ct: **COMPENSATION GIVING UP RIGHTS TAXABLE S. 6(3)(E)**

Facts	M entered K with company. Contract allowed M buy shares of company or assets for 10% off (first refusal). Owner begins talks to sell assets of company. Owner offers M money to waive first refusal – M accepts and company pays him. MNR tried to include payment as income under s. 6(3).
Analysis	Not payment for services, so can't full under s. 5(1) BUT captured by s. 6(3) Covenant with regard to what employees is or is not to do – agreement to give up rights S. 6(3) applies – payment is taxed • S. 6(3)(b) – agreement made during period M was officer of and in the employment of comp
Holding	S. 6(3) applies – deems payment O/E income
Ratio	***Payments for giving up rights under an employment is taxed under s. 6(3) – covenant***

PAYMENTS ON/AFTER TERMINATION

Termination Payment/Retiring Allowances: On termination generally there is a "reasonable notice period" – employer can pay employee though do violate notice period – fired immediately but get compensation payment

- Taxable under **s. 56(1)(a)(ii)**

Potential ways to tax: (before s. 56(1)(a)(ii))

- (1) **S. 5(1) – salary/wage**; (2) **Surrogatum principle** (*Cirella*); (3) **S. 6(1)(a)** – **employment benefit**; (4) **S. 6(3) – deemed remuneration**; (5) **Capital receipt**

Quance v Canada (1974) FCTD: **EVEN BEFORE S. 56(1)(a)(ii) RETIRING ALLOWANCES TAXABLE**

Facts	Q worked for electrical appliances company. Q asked to resign but refuses. Company offers 6.5 months' salary to leave that day - Q says wants a year. Company pays him 9.5 months' salary and deducts tax for him to leave. Q tries to get tax back
Issue	Is payment Q received from employer to quit taxable?
Analysis	Taxable b/c quality of payment – replaced Q's normal income (kind of surrogatum principle) • Payments took "form" of income • Damages Q would receive for dismissal w/o notice would be to replace income he was deprived of by not being given reasonable notice – such award has quality of income • This payment has the quality of income – nature and quality of payment unchanged Rare cases where court found termination payments taxable
Holding	Q has to pay tax on payment – income
Ratio	***Retiring allowances taxable under 6(3) and surrogatum principle – deemed to be income***

S. 56(1)(a)(ii):

(1) Include in computing income of the taxpayer (a) any amount received by T on account of or in lieu of payment of, or in satisfaction of (ii) a retiring allowance → include amounts received but T in respect of loss of O/E

S. 248: Definition "Retiring Allowance":

Amount received by the T (2 categories retiring allowances)

- (a) on or after retirement of T from O/E in *recognition of T's long service*, or
- (b) in *respect of loss* of O/E of T, whether or not received as, on account or in lieu of payment of, damages or pursuant to order or judgment of competent tribunal
  - 2 issues litigated – whether payment is in respect of loss O/E and loss of O/E

Mendes-Roux v Canada (1997) TCC: **"IN RESPECT OF"**

Facts	T was informed her bureau would be closed and her services moved to Fredericton. She refused to move–got terminated on basis that she abandoned her position. Court found wrongfully dismissed – received $25K, uncertainty about what it included –some payment in lieu of notice (3 months' pay) but that was only $10,500. Minister assesses her on basis that all $25K is loss from O/E.
Issue	Is this payment "in respect of" loss O/E?
Analysis	<u>**Arguments for Revenue Authority**</u> • "In respect of" – broadest possible connection words • All of this stuff came to her b/c of the termination and was related to the termination • If don't include whole sum, ppl will try say it was related something else to make it non-taxable <u>**Arguments for Mendes**</u> • Damages for psychological injuries aren't taxable – so that amount isn't in respect of loss of E • If get damages for being terminated in cruel way and dignity was damaged then those kinds of damage payments are separate and not causally connected Sum for loss of wages, earned vacation, and earned sick leave are taxable Damages for mental distress and costs are not taxable b/c they are not "in respect of" O/E
Holding	1/2 of damages was for way she was terminated, and half was for loss of employment
Ratio	***Only taxed amount for loss E – "in respect of" doesn't cover everything receive on termination***

***Overin v Canada (1997) TCC:* TEST "IN RESPECT OF"**
Must place limitation on connection, otherwise everything can be said to be "in respect of" O/E
"But for" Test: ***Payment received "in respect of" loss O/E where payment wouldn't been received but for loss O/E***

- In addition but for test – **if purpose of payment is compensate a loss of employment then it may be considered as having been received "in respect to" that loss**

***Schwartz v Canada (1996) SCC:* LOSS O/E – also looked at whether linked to O/E or something else**

Facts	T lawyer, gets verbal offer employment from Dynacare. S supposed get salary $250K/yr + option acquire 1.25 shares at 1 cent/share. After receives formal offer, tells partners at his firm he is leaving. Before employment begins, Dynacare cancels K – S withdraws from firm and starts diff job for $175K/yr. Settle w Dynacare for $360K + costs (for stock options and lost salary). Stock options worth $267K. CRA says that all $360 is retiring allowance b/c all received in respect of loss of O/E
TCC	**CRA loses, not subject to tax** • Not retiring allowance b/c didn't lose O/E, never had it – not subject to tax under s. 56(1)(a)(ii) • Not subject tax s. 6(1)(a) as employment benefit b/c no employment • Not taxed s. 3(a) as income from source b/c ordinary concept income is reoccurring receipt Says could be regarded as capital receipt – disposition of course, could be treated as capital gain $360K mainly for embarrassment, anxiety, and inconvenience – only small part for loss of E
FCA	Agrees with TCC **– no retirement allowance** b/c no O or E Rejects TCC finding fact – says $342,000 for loss of stock options and salary Think it is taxable, not as employment income (since no employment) but income from a source • Source is the employment contract – taxable under 3(a)
SCC	FCA should not have reversed TCC's finding of fact – so 3(a) argument disappears, amount due to embarrassment, anxiety, and inconvenience – talk about 3(a) in decision is obiter Income in 3(a) can be from unspecified source – text makes it clear "w/o restricting generality" • Even though can have income unspecified source, this isn't – specific rule governs over general S. 56(1)(a)(ii) is more specific than 3(a) – SCC does s. 56(1)(a)(ii) analysis but forgets go back to 3(a) Definition employment says "in the service of" – employment here hasn't commenced • S. 80.4(1) – specifically says intended O/E, doesn't say in definition retiring allowance in s. 248(1) → **implied exclusion** (DD: could just be that when drafting retirement allowance def, they weren't thinking about someone who was terminated before they started **This isn't subject to tax under s. 56(1)(a)(ii)**
Ratio	***Loss of intended employment isn't taxable under s. 56(1)(a)(ii)***
Note	Strict construction, DD thinks it should fall under retiring allowance – arguable Q of whether a pre-employment termination payment is income from non-enumerated is unresolved This probably goes against intention of parliament

Should s. 3(a) apply in *Shwartz*?
- Doesn't have income like characteristics – lump sum, and not reoccurring
- Probably more capital in character than income

Definition "retiring allowance" hasn't been amended to include "intended employment" – so does this mean that parliament thinks that payments like in *Shwartz* shouldn't be taxable?

If someone deliberately structured something to get around paying tax - GAAR would likely apply

INCLUSION O/E: GENERAL BENEFITS s. 6(1)(a)

S. 6(1)(a):
Include in computing income from taxpayer as income from O/E: (a) Value board, lodging, & other benefits of any kind received or enjoyed by T, or by person who doesn't deal at arm's length with taxpayer, in respect of, in the course of, or by virtue of T's O/E

S. 251: Definition "non-arm's length relationship"
(1): "**Arm's Length**" (a) related person's deemed not deal w each other at arm's length;
(2): "**Related Persons**" are individuals connected by blood relationship, marriage or CL partnership or adoption
S. 251(6): Connected by blood if:

- Child or other descendent or sibling, // Connected by marriage – sibling in law, parents in law, ect // Common law partnership // Adopted child (other than brother or sister)

S. 251(1)(c): **Q fact** whether persons not related are, at particular time, dealing with each other at arm's length

TEST: Amount taxable under s. 6(1)(a) if:

- 1. It is possible to characterize thing as benefit;
- 2. Nexus b/w benefit and T's employment; and
- 3. Benefit can be valued in monetary terms

CHARACTERIZATION BENEFIT - s. 6(1)(a)

Need to determine scope "benefit" – specifically mentions "board", "lodging" and "other benefits"

TEST: A received a **taxable benefit** within meaning of s. 6(1)(a) if: (*Lowe*)

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

Lowe v Canada (1996) FCA: **BENEFIT = MATERIAL ADVANTAGE**

Facts	T account executive at insurance company. Policies sold for company by independent brokers. To encourage brokers sell policies, insurance company told brokers that if they sell enough policies then get trip New Orleans. Worker at insurance company gets enough brokers gets to go to New Orleans too – T got to go w his wife. T & wife spent time in meeting and touring. Revenue Authority assessed T on basis cost trip per person $2,353–some business related – 38% business related for T, so take 38% off $2,353 - what is left is benefit. Wife - 25% business related stuff –Minister included portion of trip on basis T received **tax benefit under s. 6(1)(a)**
TCC	Finding fact that trip primarily business motivated – Minister erred by allowing only 38% as business portion expense incurred by T only 20% of costs represented taxable benefit
Analysis	Not a taxable benefit – trip is **primarily business motivated** • Trip was about building relationship with independent brokers If primarily business trip with **incidental** personal benefit then don't assess benefit there • No part T's trip expense should be regarded as personal benefit unless that part represents material acquisition for or something of value to him in economic sense
Holding	Not a taxable benefit with s. 6(1)(a)
Ratio	***Benefit = economic benefit; if going on trip primarily business purpose then not taxable benefit***
Note	What if T and wife went for 3 days but brokers left after 2, is this different? • Would you say 1/3 enjoyment and 2/3 not? If primarily business related does that exclude personal benefit - Go down 1 day business meeting but stay for week – say flight is business since need flight regardless of how long go for

TAXABLE BENEFIT?

YES - taxed s. 6(1)(a)	NO - not taxed under 6(1)(a)
- **Business Trip** with personal aspects (***Lowe***) - **Accounting Services (*Cutmore*)** - **Xmas Parties (*Dunlop*)** - **Free meal –** more incidental personal benefit (***McGoldrick***) - **Tax equalization** payments US employees posted in CA so employees received same wage as in US (***Grenhart***) - **Legal Fees –** if personal expense employer pays (***Pellizari***) - **Legal Expenses** defend criminal charge (***Clemiss*** – defend fraud and conspiracy against company)	- **Clothing Allowance** – if just restored to economic position before employer ordered expense incurred (*Huffman*) - Employees don't receive benefit where required to wear **distinct uniform** while carrying out duties **(CRA Bulletin)** - **Moving Expenses** – if employer sends back home (*MacInnes*) or if T moved for employer (*Pollesel*) - **Xmas parties** if available to all employees and doesn't exceed $100/person (***CRA Bulletin***) - **Memberships** paid by employer where T didn't want membership – mainly benefit employer (*Rachfalowski*)

***Huffman v MNR (1988) TCC, aff'd (1990) FCA:* clothing allowance – not taxable benefit s. 6(1)(a)**
Facts: T detective - gets $500 clothing allowance. T said during work clothes get destroyed
Holding: Court concluded payment should not be considered as conferring benefit under s. 6(1)(a)

- T simply being restored economic situation he was in before his employer ordered him to incur expense

CRA Bulletin: Employee didn't received taxable benefit where he is required to wear a "distinctive uniform" while carrying out duties of employment

***Pollesel v Canada (1997) TCC:* Moving expenses – not taxable benefit s. 6(1)(a)**
Facts: T's employer reimbursed T for moving expenses when he accepted job w employer. Minister assessed that reimbursement was taxable benefit under s. 6(1)(a).
Holding: Allowed T's appeal from assessment
Ratio: ***If employer moves employee b/c transferred from one establishment to another or b/c accepted employment at place other than location former home, reimbursement moving expenses not taxable benefit***

***MacInnes v Canada (2003) TCC:* Moving Expenses – no gain – not taxable s. 6(1)(a)**
Facts: T received payment upon retirement from military to cover cost moving Trenton to his original home in NS.
Holding: Not taxable benefit within s. 6(1)(a)

- Military just moved T back to where he came from – received no economic gain, advantage or benefit

Where employer gives money for T to return home after employment no taxed under s. 6(1)(a) – no gain

***Cutmore v MNR (1986) TCC:* Accounting services – taxable benefit s. 6(1)(a)**
Facts: Employer paid for all senior employees to file tax returns w accountant provided by employer – bona fide business reason for insisting employees do this. Employees said no benefit.
Holding: Value of accounting services taxable benefit within s. 6(1)(a)

- Fact employee doesn't have to pay accountant is benefit

***Dunlop v Canada (1998) TCC:* Christmas Parties – taxable benefit**
Facts: T reassessed by including benefit for annual Xmas parties hosted by his employer. Employees ate, drank and enjoyed amenities of hotel at Xmas party.
Holding: Taxable benefit

- Benefits were not trivial and doesn't matter that they were unilaterally conferred

CRA Bulletin – employer provided parties or social events are not taxable benefits if they are generally available to all employees and cost doesn't exceed $100/person

McGoldrick v Canada (2003) TCC aff'd (2004) FCA: free meal at work – taxable benefit
Facts: T gets free meal at café during shifts working at casino. Casino is on reserve and far away from other places to eat. T said he didn't enjoy the meal.
Holding: upheld Minister's assessment including meal as taxable benefit

- Primarily for benefit of employer but personal benefit more than incidental – applied test in *Lowe*

***Grenhart v Canada (1996) TCC aff'd (1998) FCA:* tax equalization – taxable benefit**

Facts: T, US employee at TM who was posted in Canada, received tax equalization payment designed to provide equivalent after-tax income that formerly received in US.

Holding: Payment taxable as remuneration from taxpayer's employment s. 5(1) and benefit s. 6(1)(a)

Rachfalowski v Canada (2008) TCC: membership paid by employer –not benefit

Facts: T had golf membership paid by employer. T wasn't golfer and didn't want membership

Holding: Membership wasn't taxable benefit b/c it was primarily for the benefit of the employer.

- T used club occasionally to entertain clients and enhance company's image
- Membership was not an advantage to T

Note: Case make it look like taxable benefit is determined **subjectively**

- If T did like golf then would have been benefit, but since he didn't then not a benefit

Courts lean towards **objective**

Pellizzari v MNR (1987) TCC: legal fees – taxable benefit

Facts: T, her husband, and corp which she was employee, sole director, & sole shareholder charged w fraud. T assessed basis legal expenses incurred on her behalf of corp taxable benefit received by virtue of employment

Holding: Rejected T's appeal – found legal expenses were taxable benefit under s. 6(1)(a)

- Legal fees personal expenses and payment by corp constituted benefit to T - included in income (s. 6(1)(a))

Clemiss v MNR (1992) FCTD: legal expenses to defend criminal charge – taxable benefit

Facts: Where comp incurred legal expenses of $146,533 defend T against criminal charges of conspiracy to defraud the comp and theft comp property

Holding: Legal expenses properly included in computing T's income under s. 6(1)(a)

- Charges didn't involve charges to company

CONNECTION/NEXUS TEST - s. 6(1)(a)

For amount to be benefit under 6(1)(a) it must be in respect of, in the course of, or by virtue of O/E

***R v Savage (1983) SCC:* LOOK CAPACITY THAT GIFT IS GIVEN**

Facts	T employed research assistant. She completed 3 courses on management. Under policy of employer, she got $110/course she finished – she got $300. CRA assessed the $300 as a tax benefit under s. 6(1)(a). T argued prize under s. 56(1)(n) (for prize to be taxed has to be over $500)
FCA	Not taxable b/c benefit has to be remuneration for services – not within 5(1) or 6(1)(a)
Analysis	Doesn't have to be remuneration for services – just need **connection** to employment • Courses aren't unrelated to work – took course to improve knowledge and efficiency and increase her opportunity for promotion
Holding	Payments received by S were in respect of employment – fall within s. 6(1)(a)
Ratio	***Is the benefit conferred on the T as an employee or simply as a person?***
Note	S 56(1)(n) was added in response to this case - scholarships

CRA Bulletin IT-470R – 3 categories of training

(1) Specific employer related training - Not taxable; (2) General employment training - Not taxable benefit (ex. First aid, stress management); (3) Personal training - taxable benefit

***Waffle v MNR (1968) Ex Ct:* doesn't matter who provides benefit**

Facts: B/c T met quota in sales promotion campaign, was awarded free Caribbean holiday.

Holding: ***Doesn't matter if the employer provides the benefit as long as T gets it in the course of employment***

- T argued that it wasn't employer who gave him the benefit, it was someone else – court says it doesn't matter – got the benefit in the course of employment

***Giffen v Canada (1995) TCC:* free travel = taxable benefit**
Facts: T required to fly a lot for employment – got a huge amount of frequent flier points – worth a lot of money – got assessed that the value of the points were a benefit within s. 6(1)(a)
Holding: Free travel was the taxable benefit

- Benefit available only to employees who travelled and who were members of a frequent flyer plan – G argued not a benefit in respect of employment b/c had to join to get points, court said no

Ratio: ***If benefit is received in respect of employment, it doesn't matter that some other condition that is unconnected with the employment must also be met***

CRA Bulletin: Not going to assess points from flying as benefit unless T exchanges them for cash

***Mindszenthy v Canada (1993) TCC:* gift from employer – taxable benefit**
Facts: CEO gave T rolex watch. CEO deducts the price. CRA wants T to pay tax on the watch, but T says it was gift and therefore should not be taxed.
Holding: Found it was a taxable benefit – no clear evidence that gift was given to T as personal gift and not in capacity as employee

VALUATION S. 6(1)(a)

Need to assess value of benefit in order to determine the amount to be included in 6(1)(a)

Detchon v Canada (1995) TCC:

Facts: Employees got to send kids to school for free – T argued should use marginal cost, CRA argued fmv
Holding: Court determines value is average cost – total cost educate whole class divided by # students in class
"Value" of benefit in s. 6(1)(a) is calculated using average cost (overturned in *Spence*)

Spence v Canada (2011) FCA: FAIR MARKET VALUE – use objective value

Facts	Employees of private school get to send their kids to school for lower amount
Issue	How should the value of the benefit be assessed?
Analysis	Have to use **fair market value** b/c it is the only fair measure • Benefit = difference b/w what price would be and what the employees pay • Cost basis if unfair b/c depending how efficiently school runs things then cost changes ○ Can't assume that value of benefit to employee = cost of benefit to employer
Ratio	***Use fair market value to determine value benefit to employee – value that employee saves***

***Schroter (2010) FCA:* free parking pass from employer = valued fmv**
Facts: Free parking pass given to employee so he could park in employer's office.
Holding: Parking pass benefit in respect of employment – valuation pass was full fmv
Valuation for benefit of free marking is fmv

***Richmond (1998) TCC:* Free parking – T doesn't use it often**
Facts: T provided year-round reserved parking by employer. T argued that since usually walked to work (only used spot once per week), the fmv of annual parking spot shouldn't be added to his income
Holding: Since property was available to T it was a benefit to him – taxable benefit was fmv of annual spot
Doesn't matter if T uses the benefit, value at fmv for time benefit is available to the T

Toronto Parking Authority (2010) TCC:
Facts: Free parking space provided to employees by Toronto Parking Authority
Holding: Free parking spots are taxable benefit – value of benefit is market rates charged in relevant parking lots
Use market rates charged in parking lots to value benefit of free parking from employer

***Waffle (1968) Ex Ct:* Rejects subjective evaluation**
Facts: T said that free Caribbean vacation for 2 should be taxable at subjective value to the T.
Holding: Valuation is the cost of the vacation
Not a subjective valuation – look at how much benefit costs

Wisla (1999) TCC: **valued ring at scrap value – significantly less than cost employer**
Facts: Minister included in T's income value gold ring given to employees for 15 years' service with employer.
Holding: Ring was benefit in respect E, but b/c ring was stamped with corporate logo, its value was substantially reduced – value of ring is equal to the scrap value
CRA Bulletin: merchandise gifts to employees

- If employee rewarded by employer with non-cash items, then fmv of award included in employees income
- If item personalized with corporate logo, fmv of item may be negatively affected

Jelles (1996) TCC:
Facts: T employed as resident caretaker of apartment building. Got taxable benefit of suite that lived in 5 nights a week, but stayed in home on weekends and holidays – T included $250/month as benefit
Holding: T required to be on call 24 hours a day in suite as part of caretaking duties – rejected Minister's assessment of including value of $965/month
Court can take into account the enjoyment of the benefit when finding the value of it

INCLUSIONS O/E: SPECIFIC BENEFITS

Scholarships, Bursaries, & Fellowships – s. 56(1)(n)

S. 56(1)(n): Scholarships, bursaries, ect

T must include in income the amount received from scholarship, fellowship, bursary or prize for achievement in field of endeavour ordinarily carried on by T (but not prescribed prize) exceeds scholarship exemption in s. 56(3).

- If get scholarship, fellowship, bursary or prize for achievement in respect of, in the course of, or by virtue of O/E then not in s. 56(1)(n), **taxed under s. 6(1)(a) as employment income**

S. 56(3): Exemption Scholarships, Bursaries, ect

Elements to exemption: (a) **Fully exempt tax**; (b) Deduction literary/art grants; (c) $500 exempt (mostly for prizes)

Scholarships, fellowships and bursaries included under 56(1)(n) as income but generally exempt under 56(3)(a) UNLESS receive in respect of O/E (taxable - employment income) or in course business (taxable - business income)

S. 6(1)(a) says "**received or enjoyed by T or person who doesn't deal at arm's length with T**" – added person who doesn't deal at arm's length in response to this case

- NOW: if someone who T doesn't deal at arm's length with receives benefit from T's employer then T can be taxed for it as a taxable benefit under s. 6(1)(a), UNLESS s. 6(1)(a)(vi) applies

S. 6(1)(a)(vi) – don't include amount received by individual other than T under program by T's employer designed to assist individuals to further education – provided T deals with employer at arm's length and reasonable conclude benefit is not substitute for salary or wage

O'Brien v MNR (1967) Can Tax App Bd:
Facts: T's employer paid for T's wife and children to travel b/w UK and Canada.
Holding: Value of the travel was included in T's income as taxable benefit under s. 6

- Benefit b/c: (1) T personally enjoyed fam's comp, saved money on their travel; or (2) Fam membs T is responsible enjoyed benefit, and wording s. 6(1)(a) broad enough include that benefit to income of T

Dimaria v Canada (2008) TCC: **scholarship to non-minor child of employee not taxable under 6(1)(a)**

Facts	T employee at Dow. Dow established a higher education reward program (HEAP) where children of employees could get a $3,000 scholarship. T's son went to university and got this scholarship. HEAP required student have at least 70% average in high school, only 100 awards available each year, limit never reached. Get HEAP scholarship for each year of undergrad degree.
Issue	Is the $3K a scholarship or a benefit?
CRA	Scholarship included as employment benefit under s. 6(1)(a) and fully taxable To be scholarship under s. 56(1)(n) there has to be some criteria which has higher than entrance requirement for institutional and limited number – need standards for scholarship • 70% too low and 100 awards never met – not scholarship, employee benefit under s. 6(1)(a)
s. 6(1)(a)	**Not taxable benefit for T under s. 6(1)(a)** – benefit is going to T's son ○ Try distinguish from *O'Brien* and *Detchon* b/c T wasn't relieved of financial obligation Reasons why HEAP is not benefit received or enjoyed by T: • 1. T wasn't enriched by the $3,000 – payment made directly to T's son • 2. T had no legal obligation to support his son or pay for university • 3. T had no legal right to receive money from the HEAP • 4. T had no right to recover amount from HEAP from his son • 5. T didn't negotiate w Dow to have HEAP award included as an employment benefit • Only person economically enriched is T's son
s. 56(1)(n)	**Qualifies as scholarship under s. 56(1)(n)** • Point of scholarship is to help students pursue education – easy to get but still a scholarship • No double taxation (being taxed under s. 6(1)(a) and s. 56(1)(n)) b/c s. 56(1)(n) specifically excludes scholarships received in respect of office or employment **Factors to consider if amount is scholarship/award within meaning of s. 56(1)(n)** • **1. Are there limited # scholarships available in the program?** • **2. Is there assessment or selection process as to whether or not applicants meet the criteria?** • **3. Are there objective criteria used in assessment of selection?** • **4. Is the scholarship based on some merit?**
Holding	Amount is included in T's son income as a scholarship
Ratio	***Scholarships from parents employer are taxed at the hand of the recipient and beneficiary; scholarships to non-minor child of employee are not taxable as benefit to employee under 6(1)(a)***
Note	Amendments 6(1)(a) reverses ratio from this case – includes benefits received or enjoyed by person who doesn't deal at arm's length with employee

HOUSING ASSISTANCE – s. 6(23)

S. 6(23): Employer-Provided Housing Subsidies

Amount paid or value of assistance provided by any person in respect of, in the course of or b/c of T's O/E in respect of cost, financing, use, or right use, a **residence**, is benefit received by individual b/c O/E

- This section was enacted in response to a bunch of cases – overturned *Splane* and *Hoefele*

S. 80.4(1): Compute amount of benefit if mortgage interest subsidy

Housing assistance on relocation employee included income regardless form assistance is received

Splane v MNR (1991) FCA: **mortgage interest payments – no economic benefit**

Facts: T transferred Ottawa to Edmonton – compensated employer for increased mortgage interest payments

Holding: No economic benefit of any significant value was conferred upon T

- Employer restored T economic situation was in before he undertook assist employer by relocating

Note: Reimbursement for **moving expenses** is not a taxable benefit under s. 6(1)(a) – ***Pollesel*** & ***McInnes***

Canada v Hoefele (aka Krul(l v Canada (1996) FCA: **mortgage interest subsidy – no benefit**
Facts: T transferred Calgary to Toronto and received mortgage interest subsidy from employer to compensate T for increased interest charges
Holding: Rejected Minister's argument that subsidy was a taxable benefit under 6(1)(a)

- No economic gain accrued T as result subsidy - Fundamental requirement 6(1)(a) unfulfilled

Pezzelato v Canada (1995) TCC: **reimbursement to buy new house – taxable benefit**
Facts: T, employee of Construction Company, transferred to Toronto. Received reimbursement interest of $13,125 on money T had to borrow to buy a house in Toronto when he couldn't sell former residence
Holding: Payment was taxable benefit within meaning of 6(1)(a)

- Payment was to reimburse P for interest on loan to buy a house in Toronto

Phillips v MNR (1994) FCA:
Facts: T worked CNR and received $10,000 relocation payment after transferring Moncton to Winnipeg
Holding: Payment "enabled T to acquire a more valuable asset" and increased his net worth

HOUSING LOSS – s. (19-22)

S. 6(19): Housing loss is taxable

Amount paid in respect of a house loss (other than an eligible housing loss) to a T in respect of, in the course of, or b/c of, an O/E is deemed to be benefit received by T at that time b/c of an O/E

- Include this amount as benefit under s. 6(1)(a)
- Reverses *Ransom* decision

Ransom v MNR (1967) Ex Ct: s. 6(19) reverses this decision

Facts: T got relocated to Montreal, had to sell house at a loss. Employer T for loss of value of house. Minister assessed this as taxable benefit under s. 6(1)(a)
Holding: Not benefit b/c forced to move b/c of employment, just put T in position would have been

S. 6(21): Definition "Housing Loss"

Based highest fmv in the last 6 months – amount fmv exceeds amount you actually dispose of house for

In respect of residence of T means amount, if any, by which greater of

- (a) **adjusted cost base** of residence at that time to T, and
- (b) **highest fmv of** residence within 6-month period that ends at that time

Exceeds

- (c) if residence disposed of by T before end of 1st taxation year that begins after that time, the lesser of
  - (i) **proceeds of disposition** of the residence, and
  - (ii) **fmv** of residence at that time, and
- (d) in any other case, the **fmv of the residence** at that time

S. 6(20): Taxation of Eligible Housing Loss

First $15,000 tax free and tax ½ amounts above that

Amount paid in respect of an eligible housing loss to T in respect of, in the course of, or b/c of an O/E is deemed to be benefit received by T b/c of O/E to extent amount, if any, by which:

- (a) ½ of the amount, if any, by which total all amounts each of which so paid in year or in preceding year exceeds $15,000

Exceeds

- (b) total of all amounts each of which is an amount included in computing T's income b/c of this subsection for proceeding taxation year in respect of the loss

S. 6(22): Definition "eligible housing loss"
Housing loss in respect of an eligible relocation of the T

- **S. 248(1): Eligible Relocation**
  - (a)(i) Relocation enables T to carry on business or be employed at location in Canada
  - (a)(ii) enables T to be a student in full-time attendance at post-secondary level
  - (d) Distance b/w new residence and new work location is not less than 40km greater than distance b/w old residence and old work location

Example Eligible Housing Loss Calculation
Housing loss compensation $50K but spread it over 2 years – yr 1 get $25K and yr 2 get $25K

- Year 1: $25,000 - $15,000 = $10,000, ½ taxed = $5,000 taxable benefit
- Year 2: don't get another $15,000 exemption b/c used it up in year 1
  - ½ total amount paid yr 1 + yr 2 that is more than $15,000 minus amount included income in yr 1
  - ½ x [$50,000 - $15,000] = $17,500 - $5,000 = $12,500 taxable benefit

Thomas v Canada (2005) FCA: **Eligible Housing Loss**

Facts	T offered job to work for St. John's shipping. T didn't stay at St. John Shipping very long (less than yr). During period of time that he did work at St. John shipping he moved to NB for Ottawa – bought large piece of property. T build nice house on property – total cost of land and home was $850,000. T terminated from St. John's shipping and moves back to Ottawa. As part of termination, St. John's shipping agreed buy his house at cost ($850,000) – fmv had fallen, was only worth $758,500. Revenue authority viewed T as having benefited from housing loss.

Analysis	**<u>Calculating housing loss using s. 6(21):</u>**
	• Diff b/w greater of the cost and the fmv within 6 months – fmv didn't go up
	  ○ Amount under 6(21) is (a) – cost is higher than fmv
	• T disposed of residence to employer – so use lesser of proceeds of disposition and fmv
	  ○ Proceeds is $850K and fmv is $758,500 – so use fmv
	• Housing loss = $850,000 - $758,500 = $91,500
	<u>Is this an eligible housing loss?</u>
	2 Q to ask: (1) Was this eligible relocation? And (2) Is the loss in respect of the eligible relocation?
	• Eligible relocation – does this location occur to enable T to carry on employment in Canada?
	No loss respect eligible relocation – didn't enable T continue employment, enable undo employ

Holding	Not eligible housing allowance – housing loss isn't in respect to eligible relocation • Evidence doesn't show loss occurred to enablement employment in Ottawa • Loss attempt convert what would have been fully taxable retirement payment into ½ taxed Housing loss as defined in s. 6(21) – so $91,500 deemed a **taxable benefit** under s. 6(19)
Ratio	***To have eligible housing loss, the loss had to have occurred to enable T to carry on employment***
Note	Could consider this a retiring allowance under s. 56(1)(a)(ii) – fully taxable

DEBT FORGIVENESS – s. 6(15)(a)

S. 6(15): Forgiveness Employee Debt
For purposes of s. 6(1)(a)
(a) A benefit deemed to have been enjoyed by T at any time an obligation by debtor is settled or extinguished; and
(b) Value of benefit shall be deemed to be the forgiven amount at time in respect of the obligation
Deems benefit and deems the value but doesn't have the nexus test so it works together with 6(1)(a)

S. 6(15.1): use definition forgiven amount in s. 80(1)

S. 80(1): "Forgiven Amount" = A - B
Lesser of the amount which obligation was issued and the principal amount of the obligation (A)

- Usually principal is amount that it was issued

Amount, if any paid, at the time in satisfaction of the principal amount of the obligation (B)
Take amount of obligation subtract amount T has paid of the principal = amount left of debt = benefit when employer forgives this amount

McArdle v MNR (1984) TCC: **BROAD NEXUS TEST FOR DEBT RULE**

Facts	T gets terminated and has debt outstanding to the employer. Employer agrees to forgive debt.
Analysis	There is nexus with employment b/c wouldn't have forgiven debt if wasn't for employment • There was direct nexus b/w forgiving the debt and T's employment
Holding	The debt forgiven is a benefit due to s. 6(15) and is included under s. 6(1)
Ratio	***Broad nexus test – just need to have not forgiven debt if T wasn't in employment***
Note	Call it retirement allowance or debt forgiveness then it will get taxed

INTEREST FREE & LOW INTEREST LOANS

S. 6(9): Interest on Employees Debt

Where amount in respect of loan or debt is deemed by s. 80.4(1) to be a benefit received in taxation year by an individual, amount of the benefit included in computing the income of the individual for year as income from O/E

S. 80.4(1): Calculation Benefit to Employee for Interest to Employees

Nexus Test: "B/c of or as a consequence of a previous, current or intended O/E"

Contemplates different kind of loan arrangements:

- 1. Employer gives loan directly to employee with no interest
- 2. Employee borrows money from bank,, employer provides interest subsidy - pays directly to bank

Calculation under s. 80.4(1): **Benefit = [(a) + (b)] – [(c) + (d)]**

a = amount interest payable at prescribed rate

- Definition of prescribed rate found in s. 80.4(7), and Reg 4301 (gives interest rates) – usually 1%
- If direct loan employer to employee and no interest then deemed benefit 1% of amount employer loaned

b = amount interest that is paid by employer or related person

- Employee gets money from bank and employer gives interest subsidy to the bank

c = amount interest paid by the employee to the lender

d = part of (b) that the debtor (employee) reimbursed to person in (b)

Effect of s. 80.4(1): Requires individual whom provision applies include as benefit amount equal difference b/w prescribed rate & amounts paid by debtor either as interest or reimbursement of interest paid by the employer

S. 80.4(3): Exception to s. 80.4(1)

(a) 80.4(1) doesn't apply if there is commercial rate of interest of debt and employer doesn't pay to bank

- If have loan directly employer - employee at low interest rate & no commercial rate then rule applies
- Rule doesn't apply if employer makes employee pay commercial rate of interest on the loan

(b) if in taxation year the loan is forgiven, then don't include any amount of any interest benefit

- Have interest free loan outstanding, in years before it is included, but if forgiven - don't apply interest benefit rule, just tax forgiven amount

HOME PURCHASE LOANS & HOME RELOCATION LOANS

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

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

S. 80.4(7): Home Purchase Loans

Get loan b/c of O/E that is used to acquire or repay loan or debt that was received or incurred to acquire a dwelling

S. 248(1): "Home Relocation Loan" (note: this definition different than eligible relocation")

Loan received by individual where individual commenced employment in Canada, and by reason moved from residence in Canada at which, before the move, the individual ordinarily resided to a residence in Canada at which, after the move, the individual ordinary residence if:

- (a) Distance b/w old residence and new work location is at least 40km greater than distance b/w new residence and new work location
- (b) Loan used to acquire a dwelling

S. 80.4(4) & (6): Interest on Loans for Home Purchases or Home Relocation

If prescribed rate falls over time of loan then computation falls but if goes up it is locked for 5 yrs

- Prescribed can't increase for 5 years – amount under 80.4(1)(a)

S. 110(1)(j): Deductions Permitted for Home Relocation Loan

Deduct lesser of 3 amounts – usually (ii)

- (i) where s. 80.4(1) deems benefit in respect of at least one loan that is not a "home relocation loan", the benefit that would have been deemed if s. 80.4(1) was only applied to the "home relocation loan"
- (ii) Amount of interest for year that would be computed under s. 80.4(1)(a) in respect of the home relocation loan if the home relocation loan had a principal balance of **$25,000** and if loan was issued more than 5 years ago, if it had been extinguished after five years
    - **FOR EXAM: (ii) will usually just entail multiplying the prescribed rate at beginning of initial five year period by $25,000**
- (iii) total benefit deemed under s. 80.4(1)

Canada v Hoefele (sub nom Krull v Canada) (1995) FCA: **NEXUS TEST for s. 80.4(1) and 80.4(4)**

Facts	T moved from Calgary to Toronto – determined house in Toronto costs 1.55x house in Calgary. Company offered pay increase in interest charge on mortgages (ex. If house cost $100,000 then deemed to cost $155K in Toronto – owner eligible interest subsidy of on on interest of $55K.
Issue	Did T receive the loan b/c of their O/E?
Analysis	S. 80.4(1) requires close connection b/w loan/debt and employment • Didn't get loan b/c of employment – got loan b/c wanted to buy a house, got the interest subsidy b/c of his employment - no strong causal connection • "b/c of or as a consequence of employment" → different test than s. 6(1)(a) – "in respect of" • In s. 6(1)(a) only need the slightest relation It is loan in respect of O/E but it is not loan b/c of O/E
Ratio	***Need stronger connection for "b/c of" O/E than to show "in respect of" – 80.4(1) requires strong causal connection***
Note	Overturned when s. **80.4(1.1)** added - "Reasonable conclude that, but for individual's previous, current or intended O/E, or services performed or to be performed, the terms of loan/debt would have been diff, or loan would not have been received or the debt would not have been incurred"

OPTIONS TO ACQUIRE SECURITIES – s. 7

Options – In employment they are typically provided w/o direct cost to employees, employees get rights to buy

- **Exercise price/strike price** – Amount employee has to pay to buy
- **Option Price** – If employees have to pay to get the option
- If exercise price < fmv you would pay → "in the money", options are already worth something
  - Generally options aren't issued "in the money" – they are issued at fmv of security at the time
- Options have some value even if they aren't "in the money"

TIMING:

Taxable moment is when employee acquires the shares (not when employee is issued the option)

- Often time of acquisition of the shares is the same as time of disposition of the shares
- Exception in **s. 7(1.1)** - If get certain kinds options on certain kinds shares for Canadian-controlled private corporations then gov't wants to encourage it and going to change the timing of the inclusion
  - Deferral – don't have include amount in 7(1) when acquire shares, include the amount when dispose of shares

S. 7: Inclusions for Options to Acquire Securities

S. 7(1): Employee Stock Options

Included as employment benefit the full amount of any gain resulting from (a) acquisition of securities or the (b) disposition of an option to acquire securities (has to be from qualifying person)

(a) **Tax: fmv at time acquire securities – (Exercise Price + option price)**

- Ex. Right to acquire shares at $10/share, fmv is $25/share – getting taxed on $15
- If it cost you $1 to buy option then that is subtracted – getting taxed on $14

(b) Dispose option to someone else, **tax = proceeds from sale – option price**

S. 7(7): Definitions

"**Qualifying Person**": Corporation or mutual fund trust

"**Security**": (a) if corp – a share in the capital stock of the corporation; (b) if mutual fund trust – a unit of the trust)

S. 7(3)(a): Excludes 6(1)(a)

If you have an agreement to issue securities then you are in s. 7 and not in s. 6(1)(a)

S. 7(5): Nexus Test

Benefit needs to be received in respect of, in the course of, or by virtue of employment to use s. 7

S. 7(4): Application 7(1)

If individual ceases to be an employee before s. 7(1) applies, then s. 7(1) applies as if they still were an employee and as though the employment still exists

S. 7(1.7): Rights cease to be Exercisable

For purposes of s. 7(1)(b), if rights cease to exist (generally b/c amalgamation with another company), 7(1) still applies – get consideration for fact that the rights cease to exist

- Deems the cancellation of an option to constitute a transfer or disposition and deems amount received on cancellation to be the proceeds of disposition

<u>DEDUCTIONS FOR EMPLOYEE STOCK OPTIONS:</u> s. 110(1)(d) & (d.1)

S. 110(1)(d): Get to deduct 1/2

Amount equal to **½ amount** of the benefit (provided security meets conditions)

- Common share in company and **not** in the money (exercise price is not less than fmv when option issues

S 110(1)(d.1): deduct 1/2

Where security is share in Canadian controlled Private Corporation and held for 2 years

***Taylor v MNR (1988) TCC:* NEXUS TEST & SCOPE OF EMPLOYMENT IN S. 7(5)**

Facts	T engineer for private company who provided consulting to resource companies (B and G). to enhance companies reputation, B and G invited T to become director (office). T gets, in connection with the office, a stock option for each of the companies: B – 50,000 shares at $2.70/share; G – 15,000 shares at $3.75/share. Getting the options are free. T acquires 20,000 share of B while they are trading at $5.40 and acquires 30,000 share B while trading at $4.40. T acquires rest 15,000 while trading at $16.50.
Analysis	Requirement of s. 7(1) is that T must be "employee" of corporation • T argues that he is an officer and not an employee; court says no, director is an office and holder of an office is an officer, and officer is an employee → **director is employee** **T makes 2 arguments**: (1) directors are employees but don't have "employment" and (2) even if employee and was in employment, he didn't receive stock option by virtue of such employment (1) Definition of employment in s. 248(1) – position of individual in service of some other person • If used this test then director wouldn't be in employment • Court uses broader definition of employment – implicit that all employees are in employment (2) **"in respect of" – widest possible scope** – just requires some connection b/w employment and benefit - T given options in return to perform as a director S. 7(1)(a) should be read with s. 7(5) – agreement with employee for option acquire securities taxed. Employee includes officer. S. 7(5) says in respect of "**the** employment" • "the" in s. 7(5) is referring back to s. 7(1)(a) – "the employment" in s. 7(5) isn't being used in sense in s. 248(1), but **employment being used in broader sense of s. 7(1)(a)**
Holding	Benefits T received are taxable pursuant 7(1) since T received benefits by virtue of his employment
Ratio	***S. 7(5) and s. 7(1) should be read together – "employment" read broadly*** ***"In respect of" – nexus test very broad, just requires some connection b/w employment & benefit***

O/E: ALLOWANCES – s. 6(1)(b)

S. 6(1)(b): Personal or Living Expenses

Include in computing income of T as income from O/E all amounts received by T as allowance for **personal or living expenses** or as allowance for any other purpose, **<u>except</u>**

- **(vii)** reasonable allowances for <u>travel expenses</u> received by employee from employer for traveling away in the performance of the duties of the employee's O/E
  - Traveling away from the municipality where employer's establishment which employee ordinarily worked or employee ordinarily reported
- **(vii.1)** Reasonable allowances for use of <u>motor vehicles</u> received by employee from employer for traveling in performance of duties of O/E
  - Don't have to be going outside the City – can use if job requires you to drive around the city
  - Allowance received by T for use of motor vehicle in connection with or in course of T's O/E deemed no reasonable where allowance not solely based on km – **s. 6(2)(b)(x)**
    ➔ Reasonable allowance if based on number of km driven

<u>3 Criteria to define Allowance:</u> (*MacDonald*)

- **1. Arbitrary amount**
- **2. For specific purpose**
- **3. Discretion of recipient how to use it**

MacDonald v Canada-AG (1994) FCA: **Criteria on Allowance**

Facts	T worked for RCMP and was moved from Regina to Toronto. RCMP said that since Toronto is more expensive to live in, going to give $700/month housing subsidy. CRA says taxable under s. 6(1)(b) for personal living costs
Issue	Is the housing subsidy an allowance within the meaning of s. 6(1)(b)
Analysis	Housing subsidy has all the legal characteristics of taxable allowance: • Arbitrary - $700 is predetermined "rounded amount" – not calculated in respect actual cost • Money was to subsidize M's accommodation cost – personal/living expense – purpose • T received the money totally in his discretion – not told how to spend it
Holding	This is an allowance – treated as income and taxed
Note	***Splane*** would suggest not taxable benefit b/c just reimbursing T for what he would have had to pay

CRA distinguishes b/w allowance, reimbursement, and accountable advance

Allowance – Any period or other payment that employee received from an employer, in addition salary or wages, w/o having to account for its use

Reimbursement – Payment by employer to employee to repay employee for amounts spent by employee on employer's business – for specific purpose, not at discretion of recipient

Accountable Advance – Amount given by employer to employee for expenses to be incurred by employee on employer's business and to be accounted for by the production of vouchers and return of any amount not to spent

Blackman v MNR (1967): **SOJUNRING VS. TRAVELING**

Facts	T worked company transported goods & ppl. T lived Halifax but required live Montreal for lengthy periods for employment– 240 days. Received daily amount cover various out pocket expenses while not home ($4/day). Clearly allowance – arbitrary, for out pocket expenses & discretion.
Issue	Is this an exempt allowance b/c it is allowance for travelling in duties of O/E? see s. 6(1)(b)(vii)
Analysis	T ordinarily worked and reported Halifax – so he is outside of Halifax when receiving the allowance Q is whether T is **traveling in the course of his duties in O/E** • T is sojourning - Sojourning = living somewhere for long period of time – he is staying in Montreal for length period of time – lived their temporarily
Holding	T isn't traveling – he is sojourning – has to pay tax on this amount (personal living expenses)
Ratio	***If T found to be sojourning, as opposed to traveling, then doesn't fall within exemption and has to pay tax on allowance from employer***
Note	Class discussion of traveling vs. sojourning – look at: • **Time** – traveling going to be for a shorter period of time • Traveling moving around **place-to-place** – sojourning has more **stability** • **Type accommodation**: traveling – hotels; sojourning – rent something for long period time **Case decided before s. 6(6)**

Can use other provisions of ITA to determine what is reasonable (ex. $30K is reasonable car allowance) – *O'Connell*

O/E: EXCLUSIONS – S. 6(6)

Bouchard v MNR (1980) TRB:

Facts: T worked for Quebec gov't in Quebec City. Part time employed at University of Sherbrook – paid him $1500 allowance for travel and living expenses under K with university.
Issue: Was the travel in performance of the duties?
Holding: Taxable - s. 6(1)(b) – s. 6(1)(b)(vii) doesn't apply – Quebec City to Sherbrooke voluntarily incurred by T

S. 81(3.1): response to *Bouchard* - **Exempt** reasonable allowance/reimbursement travel expenses when incurred in respect of part-time employment, provided: part-time duties performed at location not less than 80km from individual's ordinary place of residence and place of other employment/business

- **Work part-time at place and have another job that is 80km away – traveling 80km in exempt**

S. 6(6): Employment at Special Worksite or Remote Location

When computing T's income from O/E, shouldn't include any amount received or enjoyed by T in respect of, in course of or by virtue of O/E that is value of or allowance (not in excess reasonable amount) in respect of expenses incurred for

- (a) **taxpayers board or lodging** for period at
  - (i) **special work site**
  - (ii) **remote work location**
  - If period during which T required by T's duties to be away from T's principal place of residence, or to be at special work site/location, was not less than 36 hours
- (b) **transportation** b/w location referred to in (i) and (ii)

Exemption s. 6(6) is for **board & lodging** provided directly by employer or allowance given to T, and **travel** b/w remote location/special worksite and principal place residence of T or where T usually performs duties

S. 6(6)(a)(i): Special Worksite

Location which duties performed by T temporary, if T maintained at another location a self-contained domestic establishment as T's principal place residence

- Seems to reverse situation in ***Blackman***
  - Not a remote location, has principal place residence in Halifax and can't be reasonable expected to return daily from Montreal and Halifax

S. 6(6)(a)(ii): Remote Work Location

Location, which, by virtue of its remoteness from any established community, the T couldn't reasonably be expected to establish and maintain a self-contained domestic establishment

S. 248(1): **"Self-contained Domestic Establishment"**

Dwelling-house, apartment or other similar place residence which place a person as general rule sleeps and eats

SPECIAL WORK SITE – s. 6(6)(a)(i)

Guilbert v MNR (1991) TCC: **Duff thinks case wrongly decided – ignores definition special work site**

Facts	T took job in QB City as editor of newspaper – permanent position but he took it on temporary basis on assumption that in short period of time he would be made editor of paper in Ottawa owned by same company. Employer provide T with apartment, free of charge. Worked in Quebec City for 3 years and quit job few months after learning he wasn't going to be made editor in Ottawa. Maintained home near Ottawa where he went on weekends while working in QB City. Kids lived with T during school year in QB City. T only occupied apartment 50% of the time, occasionally when T was in Ottawa, apartment was used by other employees of the newspaper. T claims apartment is taxable benefit exempt under s. (6)(a)(i) – special work site
Analysis	Parliament was mainly referring to construction workers, mining workers and people of that sort in s. 6(6)(a)(i) – blue collar workers
Holding	Newspaper premises cannot be work site or special work site within meaning of parliament

Note	**How to decide if read s. 6(6)(a)(ii) properly?**
	• T getting value of board and lodging provided – benefit under s. 6(1)(a)
	Is the employment **temporary in nature**?
	• T would say it was temporary – didn't intend stay at newspaper long
	• Newspaper paid for apartment, which is weird thing to do for permanent employees
	• CRA assesses on commencement of duties to determine whether T's position is temporary
	    o If, at time you start, it will be 2 years or less then it is temporary
	    o T thought employment would be 2 years
	Did T maintain at another location a **self-contained domestic establishment**?
	• Yes, had place in Ottawa
	Which was his **principal residence**?
	• Kids are with him during the school year but wife lives in Ottawa all the time
	• He couldn't reasonably commute b/w residence and place of work – would take 2 hours
	• Could make argument principle place residence wasn't Quebec City

Key issues to determine special work site:

- 1. Temporary nature of duties
- 2. Where is principal place of residence

Jaffar (2002) TCC: **Interprets special work site**

Facts: T was employed as system analyst. Employment contract provided that he would work at the Pennsylvania office if directed to do so at client's office. T assigned to New York for 1 year and 3 months. Employer paid for T's apartment and expenses for traveling to Toronto on weekends to visit his family.

Holding: these amounts don't have to be included as income under s. 6(1)(b) as allowance for personal expense or living expense b/c exempt under s. 6(6)(a)

- "Special work site" – ***unusual place where employee does their task -*** Could be any place in the world

Rozumiak (2005) TCC:

Facts: T hired for 3 year by Port Authority to open Chicago office for purpose soliciting more shipping business.

Holding: New office special work site – amounts paid by employer cover T's rent and other expenses while in Chicago were covered by s. 6(6)

CRA Interpretation Bulletin – IT-91R4:

- S. 6(6)(a)(i) "duties performed by T were temporary in nature" – refers to duration of duties performed by individual of project as a whole
- "Temporary" – duties will be considered temporary nature if it can reasonably be expected that they will not provide continuous employment beyond period of 2 years. Considerations fact for expected duration employment:
  - **Nature of duties** to be performed be employee
  - **Overall time estimated for project**
  - **Agreed period of time** for which employee engaged according to employment contract

T has to establish maintained another location as principal place of residence

Barrett – T was separated from house, couldn't get exemption since didn't maintain another self-contained domestic establishment – didn't have anywhere else to live

Spannier – worked in Form McMurray for 20 days and lived at friends in Kelowna's – even though didn't pay for house, court found that T maintained a principal place of residence – got deduction

If not reasonable to expect T to commute then location can qualify as special work site (***Charun***)

REMOTE WORK LOCATION - s. 6(6)(a)(ii)

Test: Location by virtue of its remoteness from any established community, the taxpayer could not be reasonably expected to establish and maintain a self-contained domestic establishment

Dionne v Canada (1996) SCC: **ESTABLISHED COMMUNITY**

Facts	Working in Hudson Bay – town had 400 ppl and a co-op store. T rented apartment but employer paid him "isolation premium" and provided trips back to where he lived - $14K. T says this should be exempt b/c remote work location.
Analysis	CRA not established community if: **Lack essential services** or such services not available within reasonable commuting distance such of: food store, clothing store, housing, and access to certain medical assistance and certain educational facilities This isn't a remote work location within the meaning of the act
Holding	T doesn't get the exemption in s. 6(6)(a)(ii)

CRA Interpretation Bulletin – "Remoteness"

- To determine if remote from established community look at:
  - Availability transportation
  - Distance from established community; and
  - Time required to travel that distance
- Generally, if travel to nearest established community of population at least 1,000 is less than 80km, then won't be considered remote

CRA Bulletin: defines "Established Community"

- Location will not be considered an established community if it lacks essential services or such services are not available within reasonable community distance
- **Essential services includes**: basic food store, basic clothing store, housing, and access to certain medical assistance and education facilities

O/E DEDUCTIONS – S. 8

S. 8(1): Most deductions for O/E found here

- Deductions pair up with the exclusions: 6(1)(b)(vii) - 8(1)(h); & 6(1)(b)(vii.1) –(8)(1)(h.1)
    - Can't get deduction if it is a reasonable allowance within s. 6(1)(b)
    - So use s. 6(1)(b) where employer gives you an allowance for travel expenses, and use deduction if you had to pay for expenses you shouldn't of or more income added to salary for the expenses

S. 8(2): Limitation

Limits amounts that may be deducted in computing T's income from O/E to amount listed in s. 8

- Has to be specifically listed in ITA to get the deduction – can't make argument that it is reasonable

TRAVEL EXPENSES – 8(1)(h) & (h.1)

S. 8(1)(h): Travel Expenses

Allows T to deduct amounts expended by T in the year for **traveling** in the course of O/E

- Where:
    - (i) T ordinarily required carry on duties of O/E away from employer's place of business; AND
    - (ii) T required under employment K to pay travel expenses incurred in performance of duties O/E
- Nexus test: "in the course of"
- (iii) Can't deduct if T received allowance for travel expenses that, under s. 6(1)(b)(v-vii) was not included in conducting T's income for the year
- Generally accepted "traveling expenses" in s. 8(1)(h) includes cost of transportation, accommodation, and meals that are consumed during the period of travel

S. 8(1)(h.1): Motor Vehicle Expenses

Allows T to deduct amounts expended in respect of motor vehicle expenses incurred for traveling in course of O/E

- Basically same as (h) but with motor vehicle expenses

Requirements for s. 8(1)(h) & (h.1):

- 1. Travel in the course of office or employment
- 2. Ordinarily required to carry on duties away from employer's place of business
- 3. Required under contract to pay for travel/motor expenses
- 4. Not in receipt of reasonable travel/motor allowances (not allowance exempt from tax under 6(1)(b))

S. 8(10): Certificate of Employer

For deductions under (h) and (h.1) the employer needs to fill out a form saying that you were required and expected to incur these costs – makes it clear that duties were required as part of employment

Luks v MNR (1958) Ex Ct: **NEXUS TEST – "IN THE COURSE OF": commuting**

Facts	L worked in Toronto area as electrician. Worked for 3 employers at 3 locations – 1 in Oshawa and 2 in TO. To get to jobs he had to commute, 47 miles to Oshawa, 8 miles and 9.5 miles to TO. Required to provide his own tools – no place on worksites to store – T said b/c of that and he needed them for his job, then his cost of getting to jobs should be deductible. Wanted to deduct depreciation of the car and operating expenses.
Issue	Did T expend amounts "in the course of" O/E?
Analysis	Commuting is not "in the course of" O/E – traveling to where duties as employee began *Ricketts v Colquhoun (1926) HL*: London barrister wanted deduct expenses of traveling London to home – Court found not deductible b/c has to get there for duties to begin, and then when he completes his duties he travels home. → dangerous b/c UK has different statutory test
Ratio	***Commuting expenses to and from employment place is not "in the course of" O/E***
Holding	Doesn't get to deduct travel expenses
Note	This would have been difference result if T argued he was in independent contractor • Gets K at home and every time he is leaving for business reasons and it is deductible • Provides own tools, works at different locations – no working exclusively for 1 person Didn't argue independent contractor b/c arranged through union – employee of union

Chrapko v Canada (1988) FCA: **allowed to deduct if away from "usual" work**

Facts: T worked for Jockey Club at 3 different locations – 2 in TO and 1 in Fort Erie. T lives in Niagra Falls (closer to Fort Erie than TO). T wants to deduct traveling to all 3 locations. Worked in TO 75% of the time.

Holding: Can't deduct for TO but for Fort Erie can deduct – no real principle behind this decision

- Can't deduct for TO b/c that is where he is going most of the time but can deduct for Fort Erie b/c he is traveling to a place of work away from place which T usually worked

Ratio: ***If traveling to place of work away from place where you usually work then can deduct that expense***

MNR v Merten (1990) FCTD:

Facts: T work at different locations in Calgary and seeks to deduct automobile expenses to travel to different sites. Sometimes he would go back to office and sometimes he would just go straight to new place

Holding: Allowed deduction – said *Chrapko* recognized that a ***T can deduct expenses for travelling from his home to place of work as long as that place of work is other than place which he "usually" works***

Luks rational no longer apply preclude deductibility where travelling itself not performed in service employer

Evans v Canada (1998) TCC: **expands the deduction**

Facts: School psychologist travels from home to different schools - doesn't usually report to employers place of business. Sought to deduct travel costs in excess of allowance given by employer. Wanted to deduct travel expenses from home to 1st school and last school to home – if she first went to employers work and then went to 1st school that would be deductible – so seems arbitrary if this wasn't also deductible

Holding: Get to deduct additional amount – has to take books with her so everything deductible

- Completely inconsistent with *Luks* (he had to take tools with him)

Toutov v Canada (2006) TCC: **travel away from "base of operation"**

Facts: T worked out of home in Kingston and often drove to meet clients in Ottawa

Holding: all travel from home to meet client's deductible

- Home was base of operations and that is where work as an employee

Ratio: ***All travel do from your base of operation is work in the course of your employment***

MEALS – s. 8(4)

Section 8(4): Special Rule for Meals

Can't deduct meal as travel expense under s. 8(1)(h), unless meal was consumed during time when T was required to be away from municipality where ordinarily reported for at least 12 hours

- Ordinarily is interpreted as meaning usually (*Healy*)

Note: subject to **s. 67.1 –** where there is personal benefit (meal, entertainment, etc.) ½ expense deductible

Healy v Canada (1979) FCA: **deduct out of pocket expenses**

Facts	T lived in TO – worked for racetracks. Had to travel to Fort Erie for work. Tried to deduct meals.
Issue	Were the meals consumed during period when T was required to be away from municipality where he would normally be report to work deductible?
Analysis	Allowed to deduct – falls within s. 8(1)(h) (now disallowed by s. 8(4)) • T ordinarily reports to TO so when he reports to Erie, he falls under the statute • Municipality where T usually worked was TO **Objective of s. 8(1)(h) – enable employees who are required by their employment to work from time to time away from place which usually work, to deduct out of pocket expenses**
Holding	Allowed to deduct

HOME OFFICE – s. 8(1)(i)(ii)

S. 8(1)(i)(ii): Office Rent

T deduct amounts paid by T for office rent, where payment required under K employment (implied term in K)

Prewer v MNR (1989) TCC:

Facts	T owned home. Deducting part of mortgage interest and utility expense.
Analysis	Own home so technically not rent – but court said it can be called office rent and can be deducted
Ratio	***Can use this deduction even if own home – don't have to pay "rent"***
Holding	10% residence attributed to "home office"

Felton v MNR (1989) TCC: **overturns Prewer**

Facts: T had office in home, which was required under his contract for employment. T deducted 1/6th of his household expenses – as "office rent" under s. 8(1)(i)(ii)

Holding: Court refused the deduction

- If parliament had wanted to include people who own home then would have said that in section

"Office rent" can only arise from landlord tenant relationship

Thompson (1989) FCTD: court preferred Felton approach over Prewer – plain meaning of "office rent"

S. 8(1)(i)(iii): Supplies

Cost of supplies consumed directly in the performance of duties of O/E

- Use to expand deduction to people who own - includes things like electricity and utilities
- **CR Bulletin IT-352R2**: includes fuel, electricity, light bulbs, cleaning supplies, and minor repairs

S. 8(10) applies for 8(1)(i)(ii) and 8(1)(i)(ii) as well → need certificate of employer

S. 8(13): Limitation to Deductions for Office Rent

(a) Can't deduct amount any work space self-contained domestic establishment, except extent work space either

- (i) place where individual principally performs duties of O/E; or
- (ii) used exclusively during period in respect of which amount relates purpose earning income from O/E and used regular & continuous basis meeting customers in ordinary course performing duties O/E

(b) Can't report **loss** based on deduction from office rent

(c) Can carry expenses forward (indefinitely) if loss is disallowed

O/E: MOVING EXPENSES s. 62(1)

S. 62(1): Moving Expenses

Can deduct amounts paid by T as or on account of moving expenses incurred in respect of eligible relocation, subject restrictions (a)-(d)

- **Nexus Test:** "in respect of" – broad

3 questions to ask in s. 62(1):

- Is there a moving expense?
- Is it an eligible relocation?
- Is it subject to limitations in 62(1)(a-d)

Moving Expense s. 62(3)

S. 62(3): Definition "Moving Expenses

Includes expenses incurred as: (not exhaustive list)

- (a) travel costs // (b) transportation/storage costs // (c) meals & lodging while moving // (d) cost of cancelling old lease // (e) costs for selling old house // (f) legal/registration fees to buy new house // (g) interest/insurance/property tax for old house up to $5000 // (h) changing legal docs to new address
- Does not include costs (other than in (f)) incurred by T in respect of acquisition of the new residence
- Some of these subsections also have **narrower nexus tests** than in (1)

Storrow v Canada (1978) FCTD: **ONLY DEDUCT COSTS INCURRED TO EFFECT TRANSFER**

Facts	S moved Ottawa to Van – claimed difference in houses as deduction. Also claimed as a deduction the mortgage attribution to higher cost, land registry fees, and fees for new dishwater and locks
Issue	Can S deduct these expenses that aren't listed in s. 62(3)?
Analysis	s. 62(3) says "includes" which means that the list is open disputed outlays were not moving expenses in the natural and ordinary meaning of the word – they were out of pocket expenses
Holding	Court disallowed these deductions
Ratio	***Costs incurred in connection w the acquisition of a new residence are not deductible – only can deduct costs incurred to effect physical transfer of T, household, and belongings***
Note	This case came out before 62(3)(f) and the postamble in 62(3)

Ball v Canada (1996) TCC: **house/job hunting – not deductible**

Facts: T was accountant living in Newfoundland, spent $1,739 to drive to Waterloo with wife to look at business opportunities, houses, and schools for their son – claimed as moving expense later when moved to Waterloo.

Holding: disallowed deduction

S 62 does not allow the deduction of expenses for house and job hunting – not "in the course of"

Critchley v MNR (1983) TRB: **Costs for transporting pet - deductible**

Facts: T wanted to deduct moving expenses - $19 vet charge for tranquilizers and rabies shots incurred when moving the family dog.

Holding: Deduction of the $19 allowed

- Considered dog as member of household, so expense for physical transfer can be deducted

Expenses to physical transfer a member of the household is an allowable deduction, pets are members

  - **Note:** cost of transporting horse though is not deductible – not considered member house (***Yaeger***)

"Selling costs" given broad interpretation

- If amount was incurred to complete the sale then it is properly deductible (***Pollard***)
- Look at T's direct and immediate payments to effect the sale (***Collin***)

Eligible Relocation

S. 248(1): "Eligible Relocation"

- **(a) Purpose Test** – move occurred to enable T to work at new location in Canada (or allow T to be full-time post-secondary student)
- (b) & (c) T ordinarily resided before relocation at a residence (old residence) in Canada and ordinarily resided after relocation at a residence (new residence) in Canada
- (d) Must work at least 40km closer to new work location – compare old and new residence

Move enables T work location in CA ("new work location"), and move from where T ordinarily resided before move ("old residence") to where T ordinarily resided after move ("new residence") brings T 40km closer new work location

Applying definition "eligible relocation" to moving expenses raises 3 issues:

- **1. Distance of the relocation**
- **2. Purpose of the relocation**
- 3. Residences at which the **T ordinarily resided before and after the relocation**; and

DISTANCE RELOCATION:

Giannakopoulos v MNR, 1995, FCA: **SHORTEST NORMAL ROUTE**

Facts	G moved from Stony Plain to Edmonton – as crow flies, distance less than 40km. By driving it was more than 40 km - G drove. Before this case the court used as the crow flies to measure distance. As crow flies = straight line
Holding	Able to have deduction for moving expenses
Ratio	***Use distance on the ground for measuring distance in 248(1)(d) – must use shortest normal route***

Lund v Canada (2010) TCC: **use shorter distance to determine normal route**

Facts: Distance T's old residence to new location was 53 km by his suggested route, but 33km by revenue authority suggested route. T said that the traffic on 33km route resulted in longer commute time.

Holding: disallowed deduction

Where 2 routes both be considered normal, the shorter route by distance should be used for calculating distance

Nagy (2007) TCC: **look at shortest route and normal route of public**

Disallowed deduction of moving expenses on basis he moved 34.6 km closer to new work location

- Not a robotic approach – look at realistic measurement of traveling distance
- Look at shortest route one might travel + notion of normal route to the travelling public

PURPOSE RELOCATION

Dierckens v Canada (2011) TCC: **NO TIME LIMIT**

Facts	D got new job, then 10 years later moved closer to job. Tries to deduct moving expenses. CRA said that move didn't enable T to be employed, already been there for 10 years.
Issue	Does the relocation "enable" T to be employed?
Analysis	Dictionary: "Enable" = make possible (narrow), facilitate (broad) → court ignores dictionary **No time limit on deduction**, goes broad → should read time limit into "new" in definition
Holding	Expenses can be deducted – T moved closer to new job
Ratio	***No time limit on deduction – as long as meet requirements*** ***Eligigble relocatin just has to allow T to carry out work and doesn't not require new work location***

"To enable T to be employed" is not a requirement that T have employment at new work location before making a move to new location (***Abrahamsen (2007) TCC***)

Deduct moving expenses from income if move from residence ordinarily live to commence employment at new location – T is alone to determine the timing of the move, and the costs associated with the move → no timing expressed by wording of the Act (***Beyette (1989)***)

- The section only contemplates the requirement that the T commenced to be employed previous to the move for which an expense claim is made → **no timing requirement**

Gelinas v Canada (2009) TCC:
Facts: G was working in hospital 2 days a week, commuting 65 km each way. Gets new job at hospital, has to work 5 days a week. Moves closer to hospital - Tries to deduct expenses. CRA says no – not a new work location.
Holding: allows the deduction

- Doesn't need actual new location – changing something at work is enough to allow deduction

Test for enabling T to be employed is just whether something changes at work

Whole bunch of cases where it says "new work location" so you **need a new location**
DD: wrong – test is whether relocation enables taxpayer to work

Facilitation vs necessity for definition of "enable":
Facilitate: lower requirement

- Danger is that ppl could move for a lot of reasons
- Don't want people deducting if move is primarily personal motivated
- Does the move facilitate you to be employed?

Necessary: stricter requirement

- Limits circumstances where T can deduct
- But in G then she wouldn't be able to deduct – wrong result

Ideal: something b/w facilitate and necessity – practical/reasonable maybe

Grill v Canada (2008) TCC:
Facts: T works at credit union in Abbotsford. Commuting 80km to work and then gets divorced and moves closer to job. Should T get moving expenses deduction?
Nothing job related about the move in this case, it is not ***motivated by employment***

T only entitled to deduct moving expenses from employment if relocated to new work location – wording of act contemplates that there be a new work location to qualify for moving expense deduction (***Moreland (2011) TCC***)

RESIDENCE BEFORE AND AFTER RELOCATION

3 kinds of cases:

1. Move only to one location but retention of former home

- Move somewhere and aren't sure you are going to stay so you hold onto your old house
- Ultimately settle in the new location and sell the former home

2. Temporary Relocations/Work

- Atlantic Canada workers go to Alberta for period of time and then go back
- Retain other residence

3. Move to one place for a while and then move on to another place (***Rennie***)

- Move happens in stages – court looks at how long relocation takes

Type 1: Move but retain former home

Ordinarily resident former home until permanently settle in new home even though aren't living at former home

****Jaggers v Canada (1997) TCC:*** **allowed deduction once old residence disposed and move permanent**
Facts: T lived place for 2 yrs but kept old residence and rented it. Made move permanent and wanted to declare it.
Holding: T allowed deduct cost of selling former residence more than 2 years after acquisition new residence

DD: Agrees with this case, disagrees with case below

Calvano v Canada (2003) TCC:
Facts: T moved from ON to BC but delayed selling house in ON for 16 months after renting it to tenant so that tenant's children could finish school year.
Holding: disallowed deduction of selling cost for ON house on basis T ordinarily resided in BC

- Rejected T's argument that resided in BC temporarily until sold house in ON

Neville (1979) TRB:
Facts: T - prof at Trent and accepted a gov't job in Winnipeg. T sought deduct moving expenses for when he resigned position at Trent, sold home and transferred belongings Winnipeg. Minister said T and his fam had lived in Winnipeg for 2 years in rental accommodations so Trent was no longer T's "old residence" at the time of the sale.
Holding: T wins – domestic arrangements prior to the move were temporary nature – T's old residence in Trent continued to be residence until sold.

Cavalier (2001) TCC:
Facts: T accepted teaching contract that required him to move from BC to AB. Wife remained in BC, mail addressed to BC and didn't change his bank account.
Holding: allowed deduction moving expenses to and from AB

Type 2: Temporary Work location

Ex. Atlantic Canada, not enough work and go to work in oil sands in Alberta and then go back home

- Court says ordinarily resident in Atlantic Canada – can't deduct moving expenses to get to AB
- DD: Not ordinarily resident in AB, but does seem to be a work related cost – seems too harsh

If employer paid benefit or allowance for travel, would that be taxable?

- **S. 6(6)** – remote work location or special work site
  - Travel back and forth where you keep a place ordinarily available to you

Turnbull (1998) TCC:
Facts: T maintained home in Newfoundland, worked in Edmonton and various places BC. T returned to Newfoundland ach year and listed Newfoundland place of residence on tax return.
Holding: disallowed deduction of moving expenses to and from - T was at all times ordinary resident Newfoundland

MacDonald (2007) TCC: **Factors that demonstrate move is temporary**
Facts: T, unable to find work on Cape Breton, worked in AB for 6 weeks.
Holding: Disallowed deduction moving expenses AB and back Cape Breton – T ordinarily resident in Cape Brenton

- Maintained NS drivers' license, continued cover by NS health insurance, did not take all his belongings to AB, CL spouse remained in NS, had 3 houses in NS, didn't purchase any property in AB, didn't relocate his bank accounts to AB, didn't change his mailing address to AB

Type 3: Move in Stages

Cases seem to extend the concept and go towards direction that **relocation can take a period of time**

Rennie v MNR (1989) TCC: **CAN'T BE ORDINARY RESIDENT 2 PLACES**

Facts	T has job in QB, then gets job in AB. T isn't sure job in AB will be long term so doesn't sell QB house – doesn't take all his stuff to AB. The moves to BC – still doesn't sell house in QB. BC job becomes permanent – sells QB house. T tries to deduct expenses when moving QB → AB and AB → BC and deducts cost of selling house in QB
Analysis	Expenses of moving Edmonton → Victoria are not deductible Effectively relocation Montreal → Victoria Can't ordinarily be resident at 2 places – can't be ordinary resident in Edmonton and Montreal • Expenses moving Montreal to Victoria are not allowed to be deducted but interim expenses are "Ordinarily Resident" – place where settled routine T's life regularly, normally, & customarily lives
Ratio	***Can't be ordinary resident in 2 places at once***

Ringham v Canada (2000) TCC: **relocation can be extended process – look at circumstances**
Facts: T lives Ottawa and accepts to do job in Budapest. Sells home and rents condo nearby while waiting for job. Travels to TO where employers office are and stays at hotel. Distance b/w house and condo is not more 40km, new work location far away, but going to condo isn't getting T 40km closer to Budapest. Job in Budapest doesn't come through but gets a job in TO and buys house in TO. He wants to deduct cost selling house in Ottawa. Revenue authority says no b/c didn't move 40 km.
Holding: Gets deduction – Revenue authority not taking into account T's situation

LIMITATIONS ON S. 62

*62(1) There may be deducted in computing a T's income for a taxation year amounts paid by the T as or on account of moving expenses incurred in respect of an eligible relocation, **to the extent that***

- *(a) they were not paid on the T's behalf in respect of, in the course of or because of, the T's O/E;*
    - If employer pays T's moving expenses then T can't deduct under this section
- *(b) they were not deductible b/c of this section in computing the T's income for preceding taxation year;*
    - Allows you carry forward forever – don't have enough income new work in yr 1, deduct some but haven't exhausted all deductions, yr 2 deduct more, if still have more then carry forward to yr 3
- ***(c)** the total of those amounts does not exceed*
    - *(i) in any case described in subparagraph (a)(i) of definition "eligible relocation" in s. 248(1), the total of all amounts, **each** of which is an amount included in computing the T's income for the taxation year from the T's employment at a new work location or from carrying on the business at the new work location*
        - Limits deduction and can't deduct the loss - Can only deduct expenses against income at new work location – can't shelter other income
- *(d) all reimbursements & allowances received T in respect of expenses included computing T's income.*
    - If get reimbursement or allowance then can deduct but only if you include it in income
        - If get an allowance 6(1)(b) would say taxable and can deduct the expenses

James v Canada (2001) FCA: **DD thinks this case is pathetic**

Facts	T is skilled in info technology. While in Calgary he gets offer to provide services to Liquor Distribution Branch (LDB) in BC – not clear if offer is from LDB or another company, CTG. Moves Calgary to Surrey and is required to incorporate company to receive fees from LDB – incorporates company called Steller. Payments go from LDB to CTG and then Steller – T is shareholder of Steller. Income is paid to him from Steller in form of dividends on the shares – taxable advantages having dividends – get credit.
Issue	Can T deduct moving expenses?
Analysis	Couldn't deduct moving expenses against dividends – only deduct moving expenses against employment or carrying on business • Dividends are not income from employment or business (they are income from property) T argues that he fell within the "spirit" of the Act • Court has some sympathy for him – T says could change character of money and say it is salary and then can have complete deduction
Holding	Dividends are not income from business or employment – cannot deduct moving expenses – has to change character of amounts paid to him from Steller to get deduction
Ratio	***Can only deduct moving against income from employment or business of new work – can't use deduction if income in form of dividends***

INTRO INCOME/LOSS BUSINESS OR PROPERTY

S. 3(a) – include income from B/P; s. 3(d) –loss from B/P deducted

S. 9(1): **Starting Point**: Income B/P

"A T's income for a taxation year from a business or property is T's profit from that B/P for the year."

- Profit is **net** (**Profit = gains – losses**) → Implies deduction reasonable expenses incurred to obtain income
- Income from B/P **fully taxable** – ss. 9(1) and (3)(a)

S. 9(2): Loss B/P

T's loss for taxation year from B/P is amount of T's loss, if any, for taxation year from source computed by applying provisions of Act respect computation of income from that source with such modifications as circumstances require

- Losses are **fully deductible** - **3(d)**

S. 9(3): Income/loss Property distinct Capital Gains/Loss

Income & loss from property don't include capital gains or losses from disposition of that property

CHARACTERIZATION B/P

S. 248(1): "Business"

Includes** a profession, calling, trade, manufacture, or undertaking of any kind whatever and an adventure or concern in the nature of trade but **does not include O/E

- "Includes" **– not exhaustive definition**
- **Profession** - An occupation that involves training and a formal qualification
- **Calling** - A business; occupation; profession; trade; vocation
- **Trade** - Business of buying and selling or bartering goods or services
- **Manufacture** - Production articles for use from raw/prepared material by giving to these materials new forms, qualities and properties or combinations whether by hand or machinery
- **Undertaking** - Ready to undertake an enterprise, task, involve some **danger or risk**
- **Adventure or concern in the nature of trade**
  - Adventure – unusual, exciting, or daring experience
  - Concern – a matter of interest or importance
  - In the nature of trade – some characteristic of a trading enterprise

Business = organized activity carried on for the purpose of profit

Smith v Anderson (1880): **Often Cited Definition "Business"**

Anything that occupies the time, attention & labour of a man for the purpose of profit is business

- Subjective Element – purpose is to make a profit
- Objective Element – occupies time, attention and labour of person

S. 248(1): "Property"

***Means** property of any kind whatever whether real or personal, immovable or movable, tangible or intangible, or corporeal or incorporeal, and w/o restricting the generality of foregoing, including (a) right of any kind whatever, a share or chose in action; (b) unless contrary intention evident, money; (c) timber resource property; and (d) work in progress of business that is a profession*

- "Means" - **definition is exhaustive**
- **Classic income from property:**
  - Dividends from shares **;** Rent/lease payments; Interest on borrowed funds**;** Royalties

***Morden (1961) Exch Ct:* Gambling Winnings – hobby or business**
Facts: T gambling for many years who sold race horses. Mainly playing cards and making lots of money. Revenue Authority said T made his money from a business – fully taxable
Holding: 2 Tests to determine difference b/w **hobby & Business**:
Objective Test – Can expect make $ over period of time – business ; can't reasonably expect make $ - hobby
Subjective Test - Try to determine what dominant object was, was conduct enterprise of commercial character or primarily to entertain himself

REASONABLE EXPECTATION OF PROFIT

***Stewart SCC:* Condo Tax Sheltering – reasonable expectation of profit (non-commercial situations)**
Facts: T borrowed heavily to buy condos – cost $90,000, borrowed $89,000. Condos rented out, rental income isn't high, interest expenses > income. Investments designed to produce losses for 10 yrs (use losses offset other sources of income, hope condos go up in value and sell as capital gain, ½ taxable). Revenue Authority said no reasonable expectation of profit b/c T's are expecting to lose money.
Holding: Buying condos entirely commercial – T has source of income and can claim the losses

- Revenue Authority using test wrong - where nature T's venture contains elements which suggest could be hobby, but venture undertaken in sufficiently commercial manner, venture considered business

Reasonably expectation profit test - assess subjective intention, if some kind of activity that isn't commercial

***Cohen v The Queen (2011) TCC:* REASONABLE EXPECTATION OF PROFIT – gambling**

Facts	T associate at Goodman's –$200K/yr. C learned decision make him partner was delayed – decided to become full-time play poker, but didn't resign– just stopped taking work and eventually fired. T say played poker 7-8hr/day. Reports winnings $81K but costs $203K (buying books, attending seminars, office supplies) – net loss $121K which he deducts against salary from firm. Revenue Authority says gambling isn't a business, it is a hobby and nothing can be deducted.
Issue	Was T in the business of playing Poker and thus entitled to deduct business losses?
T's	Doing this every day, went into this w intention make money –subjective test, and pure commercial activity, so *Stewart* and *Wall*, doesn't need to satisfy reasonable expectation of profit.
Analysis	**Reasonable Expectation of Profit** – asks how is T going to make this a profit, need to show how he is planning on turning this around to make money in order to be a business • T said he bought all these books to help him improve, and he is going to play bad ppl and win **Test: Can T reasonably expect to make money from this activity, even if subjectively intended to?** **Objective factors to determine subjective intention to profit** (*Modowan (1978)*): • (1) profit & loss last year; (2) T's training; (3) T's intended course of action; and (4) capability of venture to show profit – not exhaustive list Only need do test where personal/hobby element – if nature purely commercial don't need to do
Apply	**Not entirely commercial** –ppl gamble for fun –examine reasonable expectation profit to determine if business or hobby Did C intend to profit from poker activities and did he conduct activities in business-like manner? (1) Can't assess profit or loss in past year - T didn't carry on business in last year **(2)** Court didn't find reliable evidence of meaningful or formal training (3) T says had strategy play small stakes games and win $500K/yr –T didn't have reasonable business plan – didn't reference tournaments or a budget (4) No evidence support "venture" had capacity to show profit other than general statement it could. Only evidence that lost money consistently. Abandoned venture after 1 year which is short amount of time – inconsistent with venture having capacity for profit
Holding	T did not demonstrate he conducted venture in such a manner consistent with "business" – he cannot deduct losses b/c his gambling was not a business
Ratio	***Can T be reasonably expected to profit from this activity, even if he subjectively intended to?*** ***Only need to do reasonably expectation of profit test when some hobby/personal element***

Luprypra v Canada (1997) TCC**: pool playing – business**
Facts: T pool player – plays Monday - Friday. Play inebriated opponents while sober to raise chance winning
Holding: T carrying on a business

- T's system created a reasonable expectation of profit – carefully managed risks

Note: Often where element of skill involved the courts feel that it turns it into business income

***Leblanc v Canada (2006) TCC:* Expert Evidence – Beat online sport lottery**
Facts: 2 brothers figured out way beat online gov't run sports lotteries. Bet $10-$13 million/yr – hired helpers buy tickets. Made net returns several 100K consistently each yr. Bet a lot of money but lost 95% of time. Odds set by sportline but odds changing right up to start of game. Brothers bet a lot when odds really diff b/w what sportline said and what odds actually were at the start of game
Holding: Winnings not business income

- Relied expert T's brought in who said impossible beat system – said gambling activities personal in nature

MacEachern v MNR (1977) TRB: Treasure Seeking Profits - Business
Facts: T spends lots time and some money, finds sunken ship and takes treasure from it – sells gold and silver coins. Gets assessed on basis taxable income from a business. T argues hobby.
Holding: Taxable income from business

- Judge isn't clear – might have been hobby with potential for substantial profit – more akin to business
- At all times T intended to sell for profit anything of value recovered

Tobias v Canada (1978) FCTD: Treasure Seeking Losses - Business
Facts: T spent a lot of money searching for buried treasure and finds nothing – wants to deduct losses
Holding: T gets to deduct the losses – operation commercial in nature
Regardless high degree uncertainty, prospect of very substantial reward compensates T's time, money & risk

Cameron v MNR (1971) TAB: Windfalls – whale case
Facts: T is fishermen and was fishing for salmon and herring and he saw some orcas and caught one. This happened twice. CRA says that this isn't a hobby, this is a business
Holding: Not business income – T professional salmon fishermen, not whaler – outside normal sphere of business

- Two occasions are just fortuitous, maybe if it happened a 3rd time then would be a business

To carry on business need continuity – 2 times not business, 3 times then are in the business

ADVENTURE OR CONCERN IN NATURE OF TRADE

- **Some kind of commercial speculation where T is buying and selling things**

MNR v Taylor (1956) Ex Ct: **ADVENTURE IN NATURE OF TRADE**

Facts	T president CA Metal– subsidiary US comp. US parent allowed CA sub only buy supply metal 30 days in advance. Lead level started to rise so T asked US aren't to extend period buying to 3 months – US parent said no. T asked if he could personally buy led – US parent said yes. T purchased 1500 tons of led and sold to CA Metal Company at a gain of $83K
Issue	Is T's gain from the sale of led a capital gain or an adventure in the nature of trade?
Analysis	**Negative Propositions:** • Single transactions doesn't mean it isn't an adventure – don't need multiple trades • Don't need to do anything to goods to make them saleable • Don't need organization • Don't need to have engaged similar activities – fact transaction totally diff in nature from any other activity of T doesn't take it out of category of being adventure in nature of trade • No need intent to profit – not necessary but here intent to profit in general sense **Positive Propositions:** • **Nature & quantity** of subject matter makes it trading in nature (Guy buys huge quantity whisky, more than personal consumption could justify) • **Manner of dealing** – conduct of the T – is T acting the same was as a trader? • **Holding period** – cost of holding property so traders generally have short trading period • **Method of financing** – if interest expense > income, shows don't intended to hold long
Apply	1500 tons of led – clear going to sell it - Nature & quantity of subject matter trading in nature Dealing like a trader – never takes delivery of the led Intention not the key factor – shed by facts in case, don't establish that T intended to profit • T couldn't do anything with lead on then sell it – bought it solely to sell it to the company
Holding	Adventure in the nature of trade – taxed as business income
Ratio	***Look at: nature & quantity, manner of dealing, holding period, method of financing***

CRA Interpretation Bulletin IT-459: Test to Determine Adventure in Nature of Trade

1. Did T deal w property acquired by him in the same way as a ***dealer would ordinarily deal*** with it?
2. Does ***nature & quantity*** property exclude possibility that its sale was realization of an investment or otherwise of a capital nature; or that it could have been disposed of other than in a transaction of a trading nature?
3. Is ***T's intention***, whether established or deduced, consistent w other evidence pointing to trading motivation?
    - Courts have said intention is "the" factor and everything else is objective factors to consider

SCC affirmed test in ***Friesen v Canada (1995)***

Regal Heights v MNR (1960) SCC: **Secondary Intention Doctrine**

Facts: T bought land to develop mall, then department store they were counting on said going to move 3 blocks away. Subdivided land and sold off parcels

Holding: Inventory – business income from adventure in nature of trade (secondary intention)

- Original intention use land investment, but had secondary intention since knew land likely increase value

Note: Subsequent cases said hard interpret "secondary intention" – if means would sell at right price can't be the right test b/c everyone would sell at the right price

Secondary intention is motivating intention – would you have bought but for this intention?

INCLUSIONS B/P

S. 9(1): T's income from business or property is taxpayers "**profit**" from that business or property
- Open-ended → generally up to court to determine if money has B/P "**character"**
- **Profit is net** – Deduct reasonable expenses occurred for purpose gaining or producing T's income from B/P from the gross revenues obtained by the business or property

Gains Illegal Activity

No 275 v MNR (1955) TAB: **Income from prostitution – taxable as income from business**

Facts	MNR found T's income from business - taxed. T appealed said: income derived prostitution and should not be taxable b/c not derived business. Argued if business, not taxable b/c derived *malum in se* (sinful/inherently wrong) and not merely *malum prohibitum*
Issue	Is T's earnings from prostitution taxable?
Analysis	Prostitution is business within definition in s. 248(1) Court is not judging the rightness or wrongness of the activity – just judging the economic output • Courts are not concerned with source of T's income, or means taken to earn it – just concerned with whether income liable to tax within ITA If didn't tax income illegal business then ppl who engage in illegal activity would have an advantage Once courts satisfied income liable tax doesn't matter if business *malum in se* or *malum prohibitum*
Holding	Business income
Ratio	***Once court finds income liable to tax, immaterial if it comes from legal or illegal business***

Damages & Other Compensation

Surrogatum Principle: ***(London & Thames Haven Oil Whares v Attwool (1967) HL)***
Damages included as income if: (1) pursuant to **legal right**; (2) Amount in respect of which damages are received would have been included as income

Possible characterization:
- Business income – compensation for lost profits
- Capital receipt – compensation for lost assets, including loss of a separate business or long term contract constituting capital asset of enduring nature (*HA Roberts*)
- Non-taxable receipt – punitive damages (*Bellingam* & *Cartwright*)

Canada v Manley (1985) FCA: **DAMAGES BREACH OF WARRANTY – BUSINESS INCOME**

Facts	T entered agreement w L to find purchaser for controlling shares for company. T found someone but L refused to pay finder's fee - T sued L and gets $587K. T says damage payment is not taxable.
Analysis	T tries to argue that in *Atkins*, in employment, payments in lieu of damages aren't income – court says that is only for employment, doesn't apply for business Find character underlying amount that would been received that damages compensating you for
Holding	**T has to pay tax on the damages -** T isn't in nature of finding purchaser of shares but this was **adventure in the nature of trade** that T was going to get money out of – payment is in lieu If T had received finder's fee from L then it would have been profit from business
Ratio	***Look at what the damages are compensating for – if would have been income from business, then damages income from business***

MV Donna Rae v MNR (1980) TRB: determine proportion due to loss of income from business
Facts: T worked as a fishermen. USSR ship went through T's fishing area and destroyed lobster nets. T got compensation for the nets.
Holding: 70% compensation for nets (capital) 30% for lobsters (if sold get business income)
Determine portion of compensation due to loss of income for business – that part taxed as income from business

***HA Roberts Limited v MNR (1969) SCC:* Payments for cancelling contracts – capital payment**

Facts: T carried on real estate business and managed mortgages. Clients cancelled contracts and paid HA for compensation of termination of cancellation of the contracts.

Holding: Capital payment – 2 reasons:

- 1. Termination of Ks destroyed mortgage business – only had real estate business, so lost source of income – character is capital receipt (treated real estate business and mortgage business as 2 separate businesses)
- 2. Termination of K's terminated capital assets of enduring nature the value of which had been built up over years – contracts were capital themselves
    - This is easier argument for T's to make if want to say something capital in nature

If asset itself capital asset of enduring nature that relates to loss income producing asset - deemed capital-receipt

***Bellingham v Canada (1955) FCA*: Punitive damage award = windfall, not taxable**

Facts: T had property, property was adventure in the nature of trade. T received money under AB Expropriation act which required expropriating authority to pay additional compensation to persons whose land is expropriated when compensation offered by expropriating authority is too low. T got compensation land + additional payment.

Issue: How should this additional payment to T be characterized?

Holding: Payment non-taxable windfall

- Punitive damage award – award unrelated to issue of fair compensation
- No element of bargain or exchange – payment is simply a windfall and not taxable

Look to the underlying reason why compensation was given to T to determine if taxable income

CRA Interpretation Bulletin IT-206R: Determine if 1 business or separate

Depends on degree of **interconnection**, **interlacing** or **interdependence** - **Factors**:

- (a) Extent which the 2 options have common factors // (b) Whether operations carried on same premises // (c) Does one operation exist primarily to supply the other? // (d) Do the operations have differing fiscal end years? // (e) Do T's accounting systems record the transactions of both operations as if they were one business, or are separate and complete records maintained for each operation?

Cited in ***CIR v Flemming Company*** – turns on relationship b/w nature of K to T

Capital receipt	Non-capital receipt
Pe Ben Industries v MNR (1988) FCTD: **Facts**: Long term K transport supplies. K is terminated **Holding**: They are a small company, they lose the contract and that is most of their business	***CNR Company v MNR (1988) FCTD:*** **Facts**: Very big business; Get compensation for cancellation of K (same kind of K cancelled in *Pe Ben*) **Holding**: Not capital receipt b/c CNR is huge and can absorb shock and normal instance

Voluntary Payments

***Federal Farms v MNR (1959) Ex Ct:* Money from relief fund – gift/windfall**

Facts	Major hurricane – destroyed Holland March – significant flood and property damage. T lost crops due to flooding and suffered damage in field and erosion of farmland. T received $40K from relief fund – mainly for crop losses and other supplied, only covered ½ of T's losses. T spent money to rehabilitate farm. Minister said the $40K was taxable income - *J Glisket & Son v Green* & *Newcastle Breweries v CIR* – where trader dealing in commodity and for any reason part commodity lost, and replaced by cash by way of compensation, then *prima facie*, cash taken into account of profits or gains raising to trader from trade
Holding	T has no legal right to this money – **voluntary personal gift – payment entirely gratuitous** • T had no legal right to payment, not expectation, no K, nature was voluntary – personal gift
Ratio	***Characteristics of a gift: (1) no legal right; (2) no expectation; (3) no contract; (4) voluntary in nature; (5) not reoccurring → even if business context can get gift that is not taxable***

Sherley Campbell (1982) TRB: **compensation services**
Facts: T became famous - won 3 mile swim race. Then she was eclipsed when someone else swam across Lake Ontario (Marilyn). T attempted the crossing but gave up part way. Toronto Star paid T $600 up front and promised more money if she did the swim, Star paid her $5000 even though she didn't finish.
Issue: Was the $5000 taxable?
Holding: Taxable as business income – she substantially provided the service

- Taxable even though T had no legal right to the money and Toronto Star had no obligation to pay

If payment received for performance of service then taxable
Note: Contrast w Marilyn – no promise of money, Toronto Star promised someone else money but they didn't finish so Star gave Marilyn $10,000, along w other gifts → is that taxable?

- **Holding**: Windfall– no contract or feelings of obligation, she wasn't expecting it

Cranswick (1982) FCA: **Payment per share – windfall/gift**
Facts: Westin House CA owned by US company. US comp causes CA sub sell off division for less what it ought to - in interest of majority shareholder – minority shareholders unhappy. When hint lawsuit from minority shareholders, US Comp agrees pay either $3.35/share or buy shares $26/share (Economically equivalent). Assume shares trading at 26-3.35 = $22.65 → either sell shares $3 above trading price or get $3.35/share. If choose sell shares then capital gain. Wait to tax the $3.35 until share is sold.
Holding: Getting $3.35/share windfall → not taxable

- T says isn't normal way of getting money from shares, it was unexpected and had no legal right

DD: Court is confused, decision is wrong

Frank Beban Logging (1998) TCC: **Money from gov't – windfall/gift**
Facts: T was carrying on logging business. Business shut down by prov gov't. T complains about business being terminated – Prov Gov't wants to shut him up and gives him $800,000
Holding: Money from Prov Gov't windfall

- Gov't performing act of kindness

DD: This should just be treated as damage payment

Mohawk Oil (1992) FCA: **Compensation loss profits and expenditures – not windfall**
Facts: T got $6 million in settlement of claim of damages from negligent construction of waste oil reprocessing plan.
Holding: payment received partly income in recognition lost profits, and partly capital recognition capital outlay

German (1959) TAB: **Unexpected money from gov't – gift/windfall**
Facts: T gets $20 from AB gov't (dividend). MNR added amount T's income – wanted extra $6.60 of tax
Holding: $20 not taxable – entirely gratuitous

- Amount was nature of gift or windfall that was unexpected
- Dividends are generally taxable as income from property – but here money was just called dividend

McMillan (1982) TRB: **3rd party compensation – windfall/gift**
Facts: T has long term K which ends and T gets compensation, not from person who terminates the K, but from insurance broker who enters K with person who terminated the K
Holding: Windfall – since came from 3rd party then it wasn't expected – no legal obligation for 3rd party
DD: Just a damage case, court gets confused – should be taxed

Fortino (2001) TCC: **Non-Competition Agreement – windfall/gift**
Facts: Fortino owned grocery stores, and buyer of chain wanted make sure didn't compete - Paid not compete
Holding: Payment not to compete windfall
DD: Doesn't make sense, if selling business just tell them pay you less for business and then give you non-competition money

Manrell (2001): **Right to compete is not "property" – can't tax as capital gain**
Facts: T received amounts in exchange for agreement not to compete with purchaser of his business.
FCA: Payments not taxable - right to compete is not "property"

Prizes & Awards

Abraham v MNR (1960) TAB: **Prize won by chance – not remuneration for services**

Facts	T ran IGA – purchased products from Loeb. Loeb had draw where IGA dealers could win a car. Tickets for draw accompanied deliveries – no extra charge. T won car but accepted $2,275 instead (already had a car). T gets assessed on basis that $2,275 is business income.
Holding	Money was won by chance – non-taxable prize
Ratio	***If prize is won by chance and not represented to T as remuneration for services then not taxable***
Note	What if when you ordered from Loeb you filled out tickets and when you filled out enough tickets you got a car? Is that business income? • This would be business income – it is like the air miles – compensation in business context What if T had 50/50 chance of winning, what if he had 99.9% chance? • **DD**: when have ticket you have expected value which is taxable – courts don't go that way

Poirier (1968) TAB: **lucky draw – not income B/P**

Fact: T president of Ford dealer that, having met sales quota, participated in and won lucky draw

Holding: trip should not be including as income from B/P under s. 9(1)

- Origin of the advantage didn't have any of the characteristics of taxable income

S. 40(2)(f): Don't want to tax lottery winnings

T's gain or loss from disposition of (i) chance to win a prize or bet; or (ii) a right to receive amounts as prize or winnings on a bet, in connection with lottery scheme or pool system is nil

- Puts these into category of windfalls

Rother v MNR (1955) TAB: **Professional Architect Competition – not taxable**

Facts: T is professional architect, received $2,000 as 1/6 participants in design competition National Gallery.

Holding: Separate activity from business – not taxable gift/windfall.

- T didn't receive the $2,000 as services rendered for fee

MNR v Watts (1966) Ex Ct: **Professional Competition – Taxable if K entered into** (Limits *Rother* Decision)

Facts: T was an architect who entered a design competition conducted by Canadian Mortgage and Housing Corporation (CMHC) – received $4000 for being finalist + $15,000 for winning.

Holding: Characterized payments as taxable income from contractual relationship that had been created b/w T and CMHC by virtue of "entering into this competition by T"

S. 56(1)(n): Scholarships, Bursaries, ect

Include in computing income of T for taxation year, the amount, if any, by which

(i) total of all amounts (other than amounts received in the course of business or in respect of employment) received by T in the year, each of which is amount received by T as or on account of a scholarship, fellowship, bursary or prize for **achievement in field of endeavour ordinarily carried on by the T**, other than a **prescribed prize** exceeds $500 exemption in s**. 56(3) – field of endeavour ordinarily carried on is low threshold**

Canada v Savage (1983) SCC: **doesn't need to be competition to have prize for achievement**

Facts	T received $300 from her employer on successfully completing 3 courses related to employment
Issue	Is the payment of $300 non-taxable by virtue of $500 exemption in s. 56(1)(n)?
Analysis	Prior to this case s. 56(1)(n) didn't exclude amounts received in respect, in course or by virtue O/E By reading other words ("scholarship", "bursary") – no requirement prize be won in a competition
Holding	This is a prize – taxable under s .6(1)(a) an s. 56(1)(n) – more specific rule governs over general so $500 exemption applies – not taxable
Ratio	***Not a requirement that the prize must be won in a competition in order to come within s. 56(1)(n)***
Note	Addition of "in respect of, in the course of or by virtue of O/E has reversed this decision • Gov't said if it is from employment then it should be fully taxed Also in response to Savage carved out prescribe prize

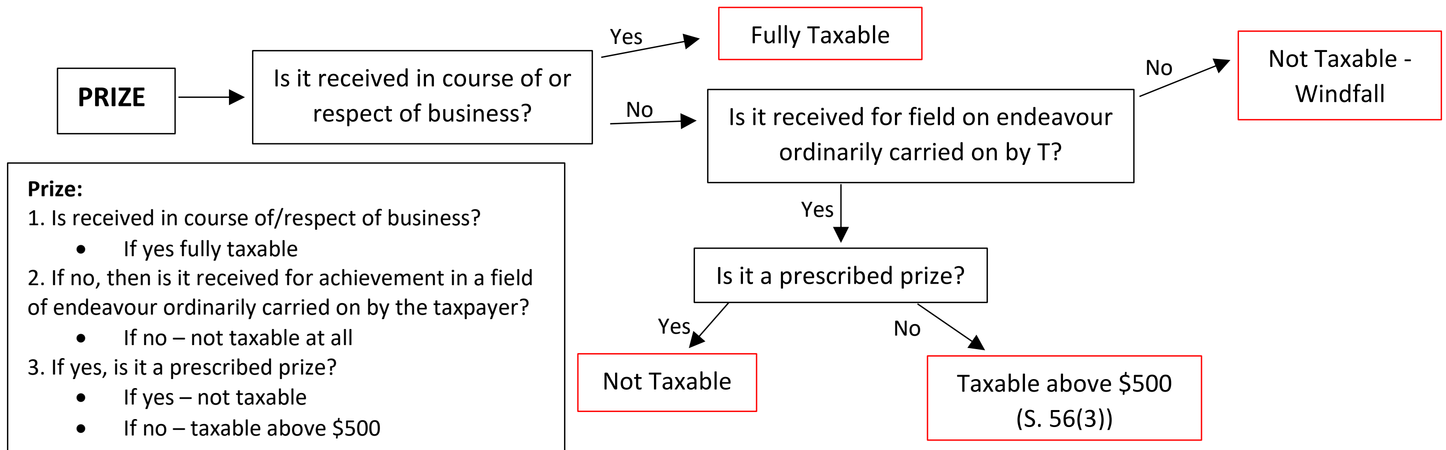
Turcotte v Canada (1997) TCC:
Facts: T went on gameshow in Quebec. Answered all sorts of questions – history, Quebec culture. Won $19,000
Issue: Is this a prize for achievement in a field of endeavour ordinarily carried on by the taxpayer?
Holding: Court says that this doesn't rise to level of field of endeavour

Reg 7700: "Prescribed Prize"

Any prize recognized by general public and that is awarded for meritorious achievement in the arts, the sciences or services to the public but does not include any amount that can reasonably regarded as having been received as compensation services rendered or to be rendered

3 requirements for prescribed prize:

- 1. Recognized by general public – consider amount publicized to the public
- 2. Awarded for meritorious achievement in arts, sciences or services to public
- 3. But not amount reasonably regarded as having received as compensation services rendered



Foulds v Canada (1997) TCC: **Found prescribed prize**

Facts	T involved in music industry - operated music management business – Principle function was to manage a band called Real World. Band was recipient of 2 music awards – both went to her as manager. T didn't include amount in income b/c thought they were an exempt prescribed prize. For Minister can tax can argue prizes received in course of business (fully taxable), and in alternative that it was a field of endeavour ordinarily carried on and isn't prescribed.
Analysis	**Wasn't received in the course of her business** – not reoccurring (doesn't look like source of income), not connected with regular business since band mostly did covers and had to make original music for this award, wasn't remuneration – court thinking in course of business is what you get for services of business. **Definitely an achievement in field of endeavour ordinarily carried on by T** **Courts find this was a prescribed prize** – very well advertised
Holding	Not taxable – fall within s. 56(1)(n) but are a prescribed prize
Ratio	***Unclear what recognized by general public means when defining prescribed prize***

Labelle v Canada (1994) TCC: **general public is not people who are involved**
Facts: T wins prize for accounting case competition.
Issue: is this a prescribed prize?
Holding: T wins – not b/c it is recognized by general public, but b/c Crown didn't argue it

- It is a prize for meritorious achievement in accounting science of writing cases
- Needs to be a general public – not public of people who write accounting cases (Ex. Advertised on radio)

General public is beyond just competitors in the realm of the competition

***Knapik-Sztamko v Canada (2014) SCC*: Compensation for service exception in prescribed prize**

Facts: Opera star gets grant from an opera foundation for $80,000 - for coaches, voice training, her to living. Revenue authority says this is carved out from a prescribed prize

Holding: This is a Prescribed Prize

- Not received in course of business – she was just starting out, she didn't have a business
- Achievement in field of endeavour normally carried on
- Revenue authority says no a prescribed prize b/c is compensation for services –
  - Understanding that money will advance her career
  - Not compensation for services – she doesn't render services to the foundation

INTEREST INCOME PROPERTY

Section 12(1)(c): Interest

Any amount received or receivable by the T in the year (depending on the method regularly followed by the T in computing the T's income) as, on account of, in lieu of payment of or in satisfaction of, interest to the extent that the interest was not included in computing the T's income for a preceding taxation year

- **Received** = cash basis, get money
- **Receivable** = don't have cash but have legal right to the amount (Accrual Basis)
- If included the amount in the preceding year then don't include it

Characterization

3 elements to interest: (from Constitutional cases)

1. Compensation for use or retention of money/debt owing (principal)

2. Interest referable to principal sum (cases have moved away from this – Duff thinks this is right)

- Lend someone $100 for a year at 6% interest – it is 6% of the principal sum ($100)

3. Interest accrue day by day

- % of principle sum per year – at end of year owe amount, but can figure it out each day how much owe

Huston v MNR (1962) Ex Ct:

Facts: T got award under compensation scheme, interest component – payments received from war claims fund

Holding: not interest b/c just another way of computing compensation award

Even though called interest, were simply grants b/c ***T had no property or legal or equitable right of any kind in amount to which alleged "interest" was computed***

***Perini Estate v MNR (1982) FCA:* Leading Canadian Case on Interest – Legal Interest**

Facts	T owned share in ARS – sold shares - Agreement for sale said: (1) $660,000 initially; 2. Additional payments (share of profits), not exceeding $1.2 million; 3. "Interest" on additional payments, computed at annual rate of 7% from closing date to date of each additional payment. T received "interest" of $14,031, $28,431, and $119,262 = $160K. Minister characterized money as interest income and included in computing T's income under 12(1)(c). T wants to say "interest" is capital as part of sale price b/c if "interest" then fully taxable as income from property.
Analysis	If applied definition from constitutional cases above then this wouldn't be interest – T can argue not accrued day by day – don't know what the principal is Case distinct from *Huston* – in *Huston*, until the award is granted there is no right to compensation from the gov't so can't accrue day by day. Here, the K retroactively established a principal amount owing – so can accrue day by day
Holding	Interest within meaning of s. 12(1)(c)
Ratio	***Just b/c call it interest doesn't make it interest – can retroactively determine principal amount*** ***Compensation for use or retention of principal sum, referable to principal sum, day to day accrual***

Sherway Centre v Canada (1998) FCA: **expanded concept interest**

- Paid interest until principal repaid – found this was referral to principal sum
- DD: messed up concept of interest, stretched too far – ***can be payment that is payment of anything else that remains outstanding as long as principal sum remains outstanding***
    - As long reference something to principal sum then deemed interest, not matter what it is

Bellingham (1995) FCA: **punitive payment – not interest**

Facts: T received amount pursuant to AB Expropriation Act, authorizing payment "additional interest" on compensation awarded by expropriating authority if less than 80% of amount ultimately awarded
Holding: payment is punitive, not interest

Ahmad v Canada (2002) TCC: **Pre-judgement interest not "interest"**

Facts: T received $388K as pre-judgment interest after successful legal action against ON hydro for breach of K
Holding: Not interest

- Until you determine in judgment that you were wronged then don't have legal right to the amount
- No principal amount for interest to accrue until judgment determined T had been wronged

Coughlan v Canada (2001) TCC:

Facts: T received damages and pre-judgment interest after NSCA determined by-laws of company where he was director required to indemnify him for costs of defending himself in a legal proceeding.
Holding: Properly taxable under s. 1(1)(c) - payment was "interest on liquidated amounts wrongfully withheld

Greenwood v Canada (2011) TCC

Facts: T received interest payment of $53,314, along with tax refund following litigation with revenue department
Holding: payment was "interest" and not damage for improper seizure

Hall v MNR (1970) Ex Ct: **"in lieu" of interest**

Facts: T sold matured bearer coupons he clipped from CA bonds.
Holding: Amounts were received as payment in lieu of interest

Facts: T financing and borrowed a lot of money – said pay percentage of operating surplus, not principle amount
MNR v Yonge-Eglinton Building (1974) FCA: not interest, can't deduct

Anti-Avoidance – s. 16(1)(a)

Section 16(1)(a): Income & Capital Combined

Where, under K or other arrangement, amount can reasonably be regarded as being in part interest or other amount of an income nature and in part an amount of a capital nature,

- *(a) part of amount that can reasonably be regarded as interest shall, irrespective of when K or arrangement was made or form or legal effect thereof, be **deemed** to be interest on debt obligation held by the person to whom the amount is paid or payable;*

If reasonable regard amount as part interest and part capital then, amount reasonable to regard as interest shall, irrespective of legal effect, be deemed to be interest

- Can determine tax consequences on basis economic or commercial substance of K, not on the legal form

Tests that Court looks at:

(1) Normal business practice; (2) Selling price > fair market value; (3) Purpose of "capitalization" – s. 16(1): tax avoidance purpose – look at the negotiations; (4) Terms of contract – discount for upfront payments

$y_i = p(1+r)^i$ → interest rate at year i   PV = $\frac{a}{(1+r)^i}$ = present value (a = amount at year i)

Groulx v MNR (1967) SCC:

G owned farm, approached T to buy it. After negotiating T paid $395K, G would waive interest. Agreement: G sell large portion farm to T for $395K. No interest payable on balance outstanding unless instalments fell into arrears – interest rate 6% but if pre-pays get 5% discount.

$85K	Payable on closing - 1956
$15K	June 1, 1958
$25K	June 1, 1959
$50K	June 1, 1960
$50K	June 1, 1961
$50K	June 1, 1962
$50K	June 1, 1963
$70	June 1, 1964

	$85K
+ $15,000/(1.05)^2	=$13,605K
+ $25,000 /(1.05)^3	=$21,596
+ $50,000 /(1.05)^4	=$41,135
+ $50,000 /(1.05)^5	=$39,176
+ $50,000 /(1.05)^6	=$37,311
+ $50,000 /(1.05)^7	=$35,534
+ $70,000 /(1.05)^8	=$47,379
	= $320,736

Year	Principal Owing Before Interest & Payments	Interest @ 5%	Payment	Principal Owing After Interest & Payments
1956	$320,736		-$85,000	$235,736
1957	$235,736	+ 11,787	0	$247,523
1958	$247,523	+12,376	-$15,000	$244,899
1959	$244,899	+12,245	-$25,000	$232,144
1960	$232,144	+11,607	-$50,000	$193,751
1961	$193,751	+9,688	-$50,000	$153,439
1992	$153,439	+7,672	-$50,000	$111,111
1963	$111,111	+5,556	-$50,000	$66,667
1964	$66,667	+$3,3333	-$70,000	0

$11,787 + 12,376 = $24,416 → regard entire $15,000 as interest payment ($24,416 – 15,000 = $9163 of interest still to pay). So in 1959, take $9,163 + 12,245 = $21,408, so of the $25,000 payment, 21,408 is interest payment.

After 1959, payment > interest at 5% of principal amount → 5% amount as interest and remaining portion of instalment payment is capital

Court says reasonable to regard portion of payment as interest:

1. Normal business practices – normally if selling land to sell with payment schedule and interest

2. Selling price > fair market value - selling price = $395,000 over 8 years, fmv = present value = $320,736, dif in price b/w what can get today and what can get in 8 years is "interest" (court not aware of time value of money)

3. s. 16(1) anti-avoidance rule – "reasonably" – court reads tax avoidance purpose into s. 16(1)

- Purpose Test – wasn't ordinary farmer, sophisticated and he suggested deferred payments w/o interest

4. Late – pay extra 6%, Early – discount 5%

- Evidence in contract that pay attention to capitalization of interest

Holding: court says minister was right, part was interest

Vanwest Logging (1971) Ex Ct:

Facts: T bought right to cut down timber – paid $1.5 million upfront and $1.2 million over 5 years (total $7.5 million) – present value less than $7.5 million. No discount for early payments, but 6% interest on late payments. Minister used s. 16(1) to characterize as interest a portion of the instalment payments.

Issue: Is it reasonable to regard $1.5 million as interest?

Analysis: Looks at factors in *Groulx* – not reasonable regard as interest

- No evidence common practice in timber industry to charge interest – normal practice to pay for it over time b/c only cut it down over period of time
- No evidence parties capitalize interest or even thought about interest before
- Cost for late payments, but no discount for upfront payment (discount payments significant in *Groulx*)
- No evidence selling price > fair market value

Discounts & Premiums

Discounts – Acquisition debt obligation for amount less than amount repayable to creditor on maturity

- **Debt Obligation** - When you loan someone money you are getting a debt obligation – they have an obligation to pay you (capital property)
- Say to someone, I will loan you money – give you $950 and pay me back $1000 in a year – same as interest → discounted debt obligation

Premium – Loan someone money and get your money back + additional amount

Government Treasury Bills – standard debt obligation

- Buy treasury bill and care given right to payment at specific time in the future
- No stipulated interest rate on the treasury bills

O'Neil v MNR (1991) TCC: **look at interest rate to determine if discount/premium interest or capital**

Facts	T acquired Gov't of CA treasury bill - maturity value $200K for purchase price of $189,466 (return for $11,000). On maturity date redeemed and bought another treasury bill at $189,108 that will pay $20K. T argues that gain is a capital gain.

Analysis	Quote English Case: ***Lomax v Peter Dickson & Sons (1943)***
	• (1) Where loan made at or above reasonable commercial rate of interest, no presumption that "discount" which loan is made or premium which it is payable is in nature of interest
	    ○ Risk associated with premium and discount – if get normal interest rate that isn't reasonable to regard discount or premium as interest → capital in nature
	    ○ So if give reasonable interest AND discount/premium then regard discount as capital
	• (2) True nature of discount or premium is ascertained from all circumstances of the case
	• (3) In deciding true nature of discount or premium, following matters important to consider:
	    ○ Term of the loan, rate of interest expressly took or may reasonably be supposed to have taken the capital risk into account in fixing terms of the K

Holding	This is like a loan to Gov't of Canada – find difference b/w purchase price and maturity value → this is interest pursuant to s. 16(1) an should be included in calculation T's income from property pursuant to s. 9 or interest received pursuant s. 12(1)(c)
Ratio	***No interest obligation, reasonable to regard it all as interest – no interest payable, then deem interest to have accrued. If there is no interest on the debt obligation then deem the difference b/w maturity value and purchase price as interest***

<u>**Example**</u>

Get $1000 in a yr, interest rates right now 5%: PV = 1000/1.05 = 952.38

- Debt obligation that pays $1000 in a year would be priced at $952.38
- Accrued: 1000 – 952.38 = $47.62, so after 6 months accrued about $23.81 (ignore compounding each day)
- After 6 months debt obligation is worth $952.38 + 23.81 = $976.19 (if interest rates don't change)
    - If interest rates go up then price goes down, if interest rates go up price goes up

Interest rates drop to 2% right after you buy

- Value of debt obligation is: 1000/1.02 = $980.39 → if want $1000 in a year have to pay more
- Debt obligation has a gain b/c same bond is worth more
- Difference b/w $980.39 and $952.38 is a capital gain

Interest rates go up to 10%

- Value debt obligation is 1000/1.1 = $909.09
- Have a capital loss = 952.38 – 909.09

Calculate the present value and then compare the present value to the sale price (amount you would get today) → if **PV < sale price = capital gain; PV > sale price = capital loss**

Example: $1,000 t-bill sold for $990.15 after 6 months at time when interest rates fallen from 5.26% to 2%. Approx. $15 of gain characterized as interest, and remaining $15.15 characterized as capital gain

Characterization as interest where no stipulated rate of interest payable is no subject to specific inclusion under s. 12(9) and Reg 7000 (see below)

Timing Rules

S. 12(1)(c): Interest

Amount **received** (cash basis) or **receivable** by T depending method regularly followed by T in computing income

Permit taxpayers to account for interest on a received basis, receivable basis or accrual basis

- **Received** – Pay tax as get interest – cash basis
- **Receivable** – Pay tax on interest, even if haven't received money yet (let person defer payments for 2 yrs)
- **Accrued** – Interest earned over time at a fixed interest rate – whether received that amount or not you use the fixed rate to determine how much pay tax on (type of receivable)
    - Actual interest over period of time – ignore when payments are made

S 12(3) and 12(4) prevent deferring interest payments to the future

S. 12(3): Interest Income – corporation, partnership, unit trust

Include any interest on debt obligation that accrues to it at end of yr, or becomes receivable or received by it before end of the year, to extent interest was not included in computing income for preceding taxation year

- The earliest of received, receivable or pure accrual – end of fiscal year of corporation, partnership or unit trusts need to include interest accrued

S. 12(4): Interest from Investment Contract – individuals

If T (other than T in (3)) holds interest in, or a civil law right in, investment contract, include in computing T's income for year the interest that accrued to T to end of that day w respect to investment K on any anniversary day of the K, to extent that interest was not otherwise included in computing T's income for year or any preceding taxation year.

- When acquire debt obligation, calculate accrual on anniversary each year that you acquired the obligation
- If interest already included b/c **received** or **receivable** then don't include – picks up unclaimed interest

S. 12(11): Definitions: "Anniversary Day" of investment contract means

(a) *Day that is 1 year after the day immediately preceding the date of issue of the contract*
- Buy debt obligation on Jan 1 2015 – one day before is December 31 2014 – anniversary day Dec 31, 2015

(b) *The day that occurs at every successive one year interval from day determined under (a)*

(c) *Day which contract is disposed of* - Interest accrued up to the date that K is disposed of is subject to tax

S. 12(9): Deemed Accrual – serves anti-avoidance function, prevents deferral of claiming interest

*For purposes (3), (4), (11), & (14), if T acquires an interest in, or civil law right in, a **prescribed debt obligation**, an amount determined in prescribed manner is deemed to accrue to T as interest on obligation in each taxation year during which T holds interest or right in the obligation*

- If prescribed debt obligation, interest that determined in prescribed manner is deemed to accrue

Reg 7000(1): Prescribed Debt Obligation

(a) Particular debt obligation in respect of which no interest stipulated be payable in respect of its principal amount

- This is debt obligation in *O'Neil* – it would be prescribed debt obligation and would go to 12(9) → interest deemed to accrue every year

(c) Escalating interest

(d) Contingent Debt obligation - *Amount of interest to be paid is dependent on contingency existing after the year*

Transfers of Debt Obligations

Example:

Purchase price = $1000, pay 10% interest/ yr ($100). After 6 months worth $50 accrued interest + $1000 = $1050

- On face looks like capital gain, BUT from *O'Neil* if there is no interest payable then deem it interest accrue
- A sells to B – A bought for $1000 and sells for $1050 → A accrued interest $50, not a capital gain
- B waits and gets $100 of interest - S. 23 - allocate $100 b/w the vendor and purchaser of debt obligation

S. 20(14): Transfer Debt Obligation

Transferee gets interest accrued before transfer but payable after transfer

*Where, by virtue of **transfer of debt obligation** the transferee has become entitled to an amount of interest that accrued on the debt obligation for period commencing before the time of transfer and ending at that time that is not payable until after that time, that amount*

(a) shall be included as interest in computing transferor's income for transferor's taxation year in which transfer occurred, except to the extent that it was otherwise included in computing the transferor's income for the year or a preceding taxation year; and

*(b) may be **deducted** in computing the transferee's income for a taxation year to the extent that the amount was included as interest in computing the transferee's income for the year.*

- Allows deduction computing transferee's income for taxation year amount any accrued but unpaid interest at time transfer, to extent amount included under s. 12(1)(c) in computing transferee's income

Transferee includes 100 as interest received/receivable but gets deduction under s. 20(14)(b) for $50, so A gets taxed $50 and B gets taxed $50 (s. 53(2) – deduction $50 under 20(14)(b) subtracted cost debt obligation = $1000

S 52(1) & S 52(2)(l): Adjustments to ACB of Debt Obligation

S. 52(1) – amount included in transferor's income is added to selling price of debt obligation- no capital gain

S. 53(2)(l) – deducts amount added in ACB, makes sure no capital loss

Canada v Antosko (1994) SCC: INTERPRETATION S. 20(14)

Facts	Prov incorporated company financed by Board. Board loaned $3mil company from bank. Company defaulted on bank loan - board pay bank in full outstanding principal & interest – company in debt to board $5mil. Board entered agreement w taxpayers (A &T) – acquired all board's common shares in company for $1mil. Board delayed obligation repay debt for 2 yrs and T's had operate company in good and business-like manner, after 2 years if conditions met, Board sold T's $5mil debt + accrued interest for $10. T's satisfied obligation, Board sold them total debt of company. T received $38,335 company as partial payment interest – included interest as income pursuant s. 12(1)(c) and claimed deductions for amounts under s. 20(14)(b)
Revenue Authority	**Argument 1**: Can't get deduction under (b) unless inclusion under (a) **Argument 2**: Interest accrued debt obligation, before time transfer – says s. 20(14)(b) wasn't intended to apply to this – purpose provision where you effectively paid for interest and it would be wrong to tax you again → here bought $5 million of debt for $10 • Shouldn't give windfall to purchases o debt obligations
Argument 1	Other provisions where if you wanted to link (a) and (b) then they make it explicit • Just apply plain meaning of words – aren't linked • Debt obligation would be worth a difference amount if sold from someone exempt and someone who isn't b/c that would depend whether you are able to deduct it
Argument 2	Courts must view discrete sections of ITA in light of other provisions and purpose of the legislation, and must analyze given transaction in the context of economic and commercial reality, but such techniques cannot alter the result where the words of the statute are clear and plain and where the legal and practical effect of the transaction is undisputed
Holding	T entitled deduction interest accruing prior to transfer and payable after
Ratio	***Ability of T to claim deduction under s. 20(14)(b) is not dependent on inclusion by transferor under s. 20(14)(a) of same amount in calculation of income***
Note	This case was before the GAAR – would the GAAR apply now? Probably yes

B/P DEDUCTIONS: Profit & Income Producing Purpose

S. 9(1): T's income from B/P is **profit** from B/P

1st thing courts do/should do is pay attention whether expense is **ordinary expenses** in computing profit

- In order to figure out what is an ordinary deductible expense – look to ordinary principles of commercial trading or well accepted principles of business practice
  - **Objective Test** – if generally businesses deduct this amount → **Business practices test**

S. 18(1): General Limitations on Deductions B/P

In computing T's income from B/P, no deduction made in respect of:

*(a) Outlay/expense except to extent it was made/incurred by T for purpose of **gaining/producing income** from B/P*

- Outlay = cash; expense = legal obligation to pay
- **Subject test:** If didn't incur expense/outlay purpose gaining income, no deduct → **income producing test**

S. 67: Relates Computing all Income

No deduction for outlay or expense except to extent that outlay or expense was reasonable in the circumstances

Leading case ***65302 BC limited*** – downplayed business practice test and emphasized income producing purpose test

Illegal Payments

***Espie Printing v MNR (1960) Ex Ct:* ILLEGAL WAGES - DEDUCTIBLE**

Facts	Minister disputes right of T to deduct expenses incurred in carry out illegal transactions. Sums were incurred in circumstances suggesting that there was something illegal about them – illegal wages
Analysis	Normally wages are proper deductions so these are deductible – purpose of ascertaining profit or gain from business Illegality of arrangement with employees doesn't have any bearing on whether these wages were wholly, exclusively, and necessarily expended for purpose of earning income
Holding	Allows the deduction of the wages
Ratio	***Illegal payment/payments with questionable legality are themselves deductible***

If want to deduct bribes/kickbacks then T needs to provide sufficient evidence payments were actually made for purpose of gaining income – can be difficult b/c don't get receipt

- *Eldridge* – prostitute claiming bribes – not deductible b/c not proven
- *Muller's Meats* – kickbacks to chiefs – not deductible b/c not proof payment for gaining income
- *United Colour* – kickbacks to purchasing agents – deductible, enough evidence that T paid amounts

S. 67.5: Non-Deductibility Illegal Payments

No deduction in respect of an outlay or expense for purpose of doing anything that is an offense

- Makes bribes and kickbacks not deductible (reverses *United Colour*)

Neeb v Canada (1997) TCC:

Facts: T was drug dealer and was caught with pot and hash seized by drug enforcement agency - wanted to deduct $6 million dollars based on how much was seized

Holding: **disallowed deduction** - If allowed deduction it would be against public policy (no link to statute)

- Cost of lost inventory would normally be deductible in computing income
- Expense is for purpose of earning income, not a personal living expense T
- Need to find if reasonable in circumstances – might say not ordinary and well expected business practice b/c illegal - Most drug dealers aren't filing tax returns and trying to deduct

Note: All of these cases are before SCC gets *65302*

Damage Payments

Imperial Oil Limited v MNR (1947) Ex Ct: **Leading Cases Deductibility Damage Payments**

Facts	T shipped oil. One of its ships was leaving a harbour and collided with another ship – other ship sunk. T had to pay $526K for negligence – wanted to deduct in computing income. Revenue Authority disallowed deduction under predecessor s. 18(1)(a) (note: predecessor said: incurred wholly, exclusively and necessary for purpose producing income).
Issue	Is amount sought to be deducted excluded by s. 18(1)(a)?

Analysis	First go to s. 9(1), and then go to s. 18(1)(a) → both tests could be in application
	S. 9(1) Test → Is expense determined according to ordinary principles commercial trading or well accepted principles business & accounting practice? Is this an ordinary and well accepted expense?
	• Yes – reasonable risk – ordinary hazard of shipping and negligence of employees of T is expected → expense satisfies **objective business practice test**
	S. 18(1)(a) Test → Was it wholly, exclusively, and necessary for purpose of producing income?
	• Look at amount in light of entire operation – don't isolate amount to see if it produced income
	• **Nexus Test** – consider whether expense is connected with business – incidental to business
	  ○ Ask: Was this expense incurred as part of the operation by which T earns income?
	  ○ Subjective test but court looks at objective indicia for subjective purpose

Holding	Both tests satisfied – gets deduction
Ratio	***Was expense incurred part of operation which T earns income? Nexus– incidental & connected***
Note	Doesn't turn on "wholly, exclusively & necessarily" → might impose tighter nexus, so now nexus test doesn't need be as tight but idea of nexus test inherent in income earning purpose test

Davis v MNR (1964) TAB: **has to be incidental to T's business to get deduction**

Facts: Pig farmer got in accident while driving to look at pigs argued in course of business and therefore deductible
Holding: No deduction – not sufficiently connected to T's business

- Court said wasn't sufficiently connected to business

Note: What would be a situation where a pig farmer gets in an accident and could deduct it?

- Transporting pigs and get into an accident – damage payments deductible

McNeil (2000) FCA: **damage payments for breaking restrictive covenant – deductible**

Facts: T, chartered accountant, entered agreement to sell practice, to provide consulting and accounting serves to purchaser for 3 years, and refrain competing with purchaser within certain geographical area for 5 years. T required to pay damages after breached restrictive covenant
Holding: relied on 65302 – damage payments deductible expense under s. 18(1)(a)

- Payments were for the purpose of keeping his clients and business

Payment has to be connected with T's business in order to get the deduction

- **"remotely connected" – not deductible** (*Fairrie*– T broker - libel against gov't official – not deductible)
- **"Incidental to Business" –deductible** (*Herald* – newspaper published libel and got sued - deductible)

Royal Trust v MNR (1957) EX Ct: **Deduction legal expenses – incurred in connection w business**

Facts	Trust company – emphasis on developing relationships w clients. Company policy of requiring certain employees to join clubs and community organizations – company paid for member of clubs – resulted in business. Competitors followed same policy. Company wanted to deduct cost of memberships. MNR said personal living expenses – not incurred purpose earning income
Analysis	**S. 9(1) Test: well accepted principles business practice or ordinary principles commercial trading** • This is normal business practice - all trust companies did it, and evidence it got them business **S. 18(1)(a) Income Producing Purpose Test** – clearly purpose here was to produce income • Evidence that got business - don't need to show result since purpose test but it helps
Holding	Allows deduction of the memberships
Ratio	***9(1)– well accepted principles business practice (obj); 18(1)(a) – income producing purpose (sub)***
Note	This case took out accounting part of test in s. 9(1). Also decision reversed by s. 18(1)(l)(ii)

Fines & Penalties

Traditionally courts disallowed deduction of fines & penalties on grounds either that payments were not incurred for purpose of gaining or producing income or that deductibility would contradict public policy

Two-fold test:

- 1. Was expense incurred for purpose of gaining or producing income?
- 2. Would allowing the deduction be contrary to public policy?
- Court also commented that at least some of the penalties were "**inevitable**" or "**unavoidable**"

Lines of Cases:
(1)*Luscoe* (public policy); (2) *Alexander* (possible conduct business w/o fine); (3) Day & Ross, *Amway* (avoidability)

Luscoe Products v MNR (1956) TAB: **public policy**
Facts: Fine from selling cough medicine containing too much alcohol
Holding: Denied deduction - b/c if allowed deduction it would ruin incentive for them to stop putting so much alcohol →Public policy

Alexander von Glehn (1920) CA: **Could T have conducted business w/o incurring the fine?**
Facts: violated war time trading restrictions – got a fine
Holding: disallowed deduction on fine - Found fine wasn't connected with business

- Could have carried on business w/o getting the fine so it is not part and parcel with business

DD: thinks this is hard to say

Day & Ross v Canada (1976) FCTD: **Avoidability**
Facts: Trucking Company got fines for overweight trucking fees
Holding: Allowed deduction - occasionally trucks will be overweight – not real transgression of public policy
Note: decision was reaffirmed in *Amway (1996) FCA*
DD: Court forgets about 9(1) – if fine is unavoidable then might say part of ordinary business practice

****65302 BC v Canada (1999) SCC:*** **no avoidability or public policy arguments**

Facts	Egg and poultry producer – T sold eggs and chickens. Gets 1-D old chickens and keeps them until they start laying eggs – no way to know how many of the baby chickens are going to survive. Production eggs and chickens are subject to quotas – subject to fines if violated and over-quota levy. T deliberate decided to produce over-quota, could have bought more quota. T got caught and got $250K levy – wants to deduct levy.
Issue	Can T deduct the $250K levy for going over quota?
Analysis	Completely **rejects** ***Imperial Oil*** – now that got rid of words "wholly, exclusively ,and necessarily" shouldn't follow Imperial Oil nexus test • DD: when get rid of words it is just a looser nexus test, shouldn't get rid of nexus test altogether – court went farther than they ought, not clear role words played in decision in Imperial Oil **Avoidability** – avoidable sometimes linked to income producing purpose test – b/c avoidable then wasn't for purpose of earning income – court doesn't endorse avoidability • DD: this makes no sense – obviously was done for purpose of earning income **Public policy** - don't know what public policy is, only legislature can put in public policy
Holding	Allows deduction of the levy – no rule saying aren't allowed
Ratio	• ***Levies, fines & penalties incurred for purpose earning income deductible business expenses*** • ***Downplayed business practice test, emphasized income-producing purpose test*** • ***Rejected avoiability and public policy test – fines and penalties might be non-deductible where breach so "egregious and repulsive" that fine cannot be justified as having been incurred for producing income (not clear whether rejects incidental/remoteness test from imperial)***
Note	**s. 67.6** was in response to this. Even if not in Act, could think of situation where breach is so **egregious/repulsive** that fine could not be justified for deduction

S. 67.6: Non-Deductibility Fines and Penalties (introduced s. 2005)
No deduction in respect of any amount that is a fine or penalty (other than prescribed fine/penalty) imposed under law of a country by any person or public body that has authority to impose the fine/penalty

- If car gets towed on private property then not fine/penalty within meaning s. 67.6

***CIBC v Canada (2013) FCA*: Revenue authority probably won't succeed on egregious/repulsive argument**
Facts: CIBC involved w Enron and had to pay $3 billion arising out of scandal for damages. Revenue authority tried argue egregious and repulsive.
Holding: all linked to income producing purpose test → SCC must have meant that it was so egregious that it isn't connected with the business (DD: not sure that is what SCC was saying)

- Alternative argument is that rely on s. 9(1) – falls outside business of a bank
  - DD: better argument not ordinarily and well accepted

S. 9(1) doesn't have implicit morality test that could deny deduction of claimed business expense that is deductible under well accepted business principles and passes statutory tests of deductibility

B/P Deductions: Mixed Personal & Business Expenses

S. 18(1): Limitations on Deductions
(l) *No deduction made in respect of, an outlay or expense incurred by T*
(i) for use or maintenance of property that is a yacht, camp, lodge, or golf course or facility, unless T made or incurred the outlay/expense in ordinary course of T's business of providing property for hire or reward; or

- If you run a golf course then can deduct b/c running a business that is ordinary course of business

(ii) as membership fees or dues in any club, the main purpose of which is to provide dinning, recreational or sporting facilities to its members

See ***Royal Trust v MNR*** (above) for case about membership fees – that case reversed by s. 18(1)(l)(ii)

Home Offices – s. 18(12)

S. 18(12): Work Space in a Home
Notwithstanding any other provisions, in computing T's income from business,

(a) No amount deducted in respect otherwise deductible amount for any part ("work space") of a self-contained domestic establishment in which individual resides, ***except to extent*** *the work space is either*
  i. The <u>individual's principle place of business</u>, or
  ii. <u>Used exclusively for purpose of earning income</u> from B and used on regular and continuous basis for meeting clients, customers, or patients in respect of the business

(b) Where conditions (a) met, amount work space deductible not exceed individuals income for year from B
  - Can't generate a loss

(c) Any amount not deductible by reason of (b) in computing individuals income from business for immediately preceding taxation year shall be deemed to be an amount otherwise deductible that, subject to (a) and (b), may be deducted for year for work space in respect of business
  - Unlimited carryover over losses

Vanka v Canada (2001) TCC:
Facts: T was family physician who had office in downtown Montreal – saw patients from 8am-7pm Monday-Friday. Wanted to deduct expenses related to operation of home office where he saw one patient per week and got 7 phone class in the evening to assess medical files.
Holding: Allowed the deduction – office used on regular and continuous basis for meeting patients

- "Meeting patients" doesn't mean physically– physician met test making himself available by phone

***Ellis (1994) TCC*: applies s. 18(1)(b) to disallow deduction**
Facts: T, operated business producing and selling pottery and stained glass out of store built over flat-roof garage at her residence and connected to rest of house through interior passages, wanted to deduct losses from business in computing net income from all sources
Holding: applied s. 18(12)(b) - disallow deduction –work space was part of self-contained domestic establishment

Dufour (1998): **work space part of T's self-contained domestic establishment**
Facts: notary business in an office constructed in T's garage
Holding: office part of T's self-contained domestic establishment – physically attached, shares utility connections, and accessible from interior of T's home

Maitland (2000)
Facts: T operated bed and breakfast in residence. Lived on top and second floor and used main floor in business.
Holding: disallowed deduction of losses from business in computing T's net income from all sources
- Residence "clearly T's home" – fell within statutory definition of "self-contained domestic establishment"

Sudbrack (2000) TCC:
Court **allowed T to deduc**t losses incurred in operation of country in, even though family resided in the inn
- Separate living quarters of family, are essentially separate from the inn – separate living quarters are self-contained domestic establishment w/o including the rest of the inn

Broderick (2001) TCC:
Facts: T lived in basement and operated B&B ni rest of the house
Holding: Sudbrack distinguished b/c largely seasonal –residence fully available to T and his fam for 6 months of year

Lott (1997) TCC:
Facts: T sought to deduct losses from day-care business operated out of their home
Holding: rejected T's argument that s. 18(12) only applied when work space was a part of the self-contained domestic establishment, not when business was carried on throughout → "any part" includes the whole

Travel Expenses – s. 18(1)(h)

S. 18(1): Limitations on Deductions
*(h) No deduction made in respect of, **personal of living expenses** of T, other than **travel expenses** incurred by T while away from home in the course of carrying on T's business*
- First determine if normal business practice (s. 9(1)), then determine if personal living expense

Business practice test in (18(1)(a)) might exclude personal living expenses – wouldn't have to go 18(1)(h

Travel expenses incurred by T while away from home in the course of carrying on T's business are specifically excluded from personal and living expenses

Travel Expenses deductible where travel in the course of business from T's base of operations (*Cumming*, *Henry*, *Cork*), notwithstanding element of choice involved in selection base of operations (*Forstell*)

Cumming v MNR (1967): **Base of operation – home office**

Facts	Anaesthetist – lived ½ mile from hospital. Maintained home office – didn't have office at hospital, only had a locker. Goes to hospital in morning for operations and then goes home and works and goes back to hospital around 6pm – sought deduct car expenses – maintenance of car
Analysis	House is base of operation b/c that is where T does all administrative duties – all travel away is in the course of business so travel to hospital is deductible T couldn't carry out duties at the hospital – so it was necessary to successfully carrying on his practice to have a location of some sort off hospital premises – travel b/w 2required
Holding	Expenses fall within exception s. 18(1)(a) and are deductible – are travel expenses and not personal or living expenses
Ratio	***All travel away from T's base of operation for business is deductible***
Note	In this case T lives close to hospital – what if he moves 50 miles away – house is still base of operation but now seems like a personal decision and not business decision – s. 67 might come in

***Henry (1971) SCC:* deduction disallowed – T had separate office**

Facts: T, anaesthetist, sought to deduct expenses incurred in commuting b/w hospital and home (1.5 miles)
Holding: Disallowed deduction – T maintained separate office where records were kept and accounts were made up

- Distinguished from Cumming b/c here couldn't find differences b/w T and self-employed owner of any business who maintains a home from which he leaves in the morning and returns later

***Cork (1990) FCA:* home = base of operation → deduction allowed**

Facts: T maintained office in 1 room rental home – sought deduct expenses incurred in travelling to construction sites at which he performed services on drafting tables supplied by those for whom his services were rendered
Holding: Allowed deduction – used home as base of operation

Forstell (1991):

Facts: T, independent contractor, commuted to Toronto on weekly basis, where he rented small apartment that he claimed to use as office – he deducted money for traveling expenses.
Holding: Accepted base of operation was home and not Toronto – even though made his home base by choice

Randall (1967) SCC:

Facts: T, resident in Van, engaged in business managing horse-racing at number of race tracks in BC. Entered agreement to manage business affairs and transactions in Portland. Sought to deduct travel expenses.
Holding: allowed deduction – accepted Portland only 1 base single business carried on various geo locations

***Wasserman (1969) TAB:* carrying on business in 2 places – travel not deductible**

Facts: T operated furrier shop but resided 100 miles away – sought to deduct expenses incurred in travelling b/w.
Holding: T was carrying on business in both cities – not deductible when travel is from one business to another

A-1 Steel and Iron Foundry (1963) TAB:

Facts: T sought to deduct amount in respect of the expenses of a trip to Europe taken by president
Holding: only small portion of trip was devoted to business contracts – allowed 35% of total expenses allowed deductible, rest not deductible b/c personal expense
Where travel involves both business and pleasure, a portion of expense may be non-deductible

B/P: LIMITATIONS ON DEDUCTIONS

Reasonableness – s. 67

S. 67: General Limitation Deductions

No deduction on outlay or expense except to extent outlay/expense reasonable in the circumstances

- Often applied together with limitations in s. 18(1)(a) and (h)
- Generally only disallows part of the deductible expense
- May provide more flexible statutory instrument for achieving policy goals underlying s. 18(1)(a) and (h)

Cipollone v Canada (1994) TCC: Reasonableness of Expenses

Facts	T in business as professional humourologist – held humour therapy sessions. Had losses of $10K - $15K. Revenue Authority argues no reasonable expectation of profit (before *Stewart* and *Walls* which said only use that test when not purely commercial). Most of the expenses have a personal component to them (clothes, car, home office, travel, entertainment, etc.)
Analysis	Rejects there is no reasonable expectation of profit – this is a business that she gets revenue from BUT she is not deducting reasonable expenses – look at what is reasonable in these circumstances, **reasonableness relates to revenue** being brought in • DD: not good way do it – if just say deduction limited % total revenue then would never have loss – Act contemplates business losses so limited deduction percentage total revenue not right Minister didn't argue unreasonable under s. 67
Holding	Since minister didn't argue s. 67 – refer matter back to Minister to assess reasonableness
Ratio	***Look at if expense reasonable in relation to revenue - means never have a loss***
Note	Could be: (1) expenses relative revenue; (2) personal expenses - If personal could use s. 18(1)(a)/ 18(1)(h) to disallow

Mohammad v Canada (1997) FCA: **Reasonableness is separate from revenues**
Facts: T claimed rental losses resulting from deduction interest expenses on borrowed funds that T used to purchaser residential property. Minister disallowed on basis of no reasonable expectation of profit.
TCC: limited amount of T's losses under s. 67 on basis it was unreasonable for T to finance 100% of purchaser price.
FCA: Allowed T's appeal – reasonableness of expense assessed on its own and not collectively when measured against revenues - Measure reasonableness in terms of magnitude of expense – always look at objectively

- **Excessive or extravagant expenses** should be disallowed to be deducted under s. 67
  - Excessive or extravagant – could be b/c personal or in relation to revenue

Ammar v Canada (2006) TCC: **Excessive and Extravagant Test**
Facts: T in business of immigration consultant for students in Egypt. Rented apartment in Cairo for $4,000/month for a couple years (Could have stayed in hotel for cheaper)
Holding: Renting apartment was excessive and extravagant – unreasonable in the circumstances

- Could have found other accommodation for significantly less

Note: court also could have said portion was not for purpose of earning income
Ratio: ***Look at alternatives T could have done to determine reasonable expense***

Maduke Foods v MNR (1989) FCTD: **Non-arm length payments – apply s. 67**
Facts: T paid substantial salaries to shareholders spouse and children – spouse suggested should shrink wrap meat which saved them a lot of money.
Holding: unreasonable in the circumstances – excessive and extravagant
Note: this is really income splitting

Hammill v Canada (2005) SCC: **Investment in scam unreasonable if ought to know it was scam**
Facts: Someone in fake business of buying and selling gems – T invests a lot of money and seeks to deduct the loss
Holding: Whole thing is a fraud so no source of income – don't get deduction from loss b/c no source of income
Obiter: Investing in this thing isn't reasonable – ought to know it was a scam
Johnson FCA: **Flipside of Hammill – profits from scam**
Facts: T invests in ponsey scheme – early investor and gets money out
Holding: This was income - constructed it that wasn't really investing in the fraud – T loaned money and got interest payment, so source of income was interest income
If you lose money on scam, no source of income and can't deduct, if you make money then taxable

Ruff v Canada (2012) TCC: **if you are an idiot – no deduction**
Facts: T (lawyer) gets email from someone saying father died and family heirlooms are in container and wants help getting it out –and if help get it out then you can be trustee. T gives them money to get the container, and then they want him to go get container– flies to London, and then calls police and police say the people are probably going to kidnap them. Total T spends $400K – tries to deduct as part of law practice.
Holding: can't deduct expenses

- **Issue 1:** is this connected to his law practice?
  - This really had no connection w law practice, but manages to convince court it didn't since he was told he was going to be trustee
- **Issue 2:** Expense incurred for purpose earning income? Court finds yes
- **Issue 3**: not reasonable in circumstances within s. 67 – T shouldn't have believed there was a container

Seems to create new category, if you are an idiot the can't deduct

Meals & Entertainment – s. 67.1

Note: Don't get to s. 67.1 unless first satisfied s. 9(1) and s. 18(1)(a)

S. 67.1: Expenses on Food, ect – only 50% deduction

(1) *Amount paid/payable* ***in respect*** *human consumption* *food, beverages enjoyment entertainment deemed 50%*

- S. 67 limits deduction to be reasonable, then s. 67.1 limits deduction to 50% of that reasonable amount
- Note: for s. 62 (moving expenses), this section doesn't apply – don't have 50% limitation

67.1 (2): Exceptions*: (1) doesn't apply amount paid or payable by person in respect consumption where amount*

- ***(a)*** *food, beverages, or entertainment provided for, in the expectation of,* ***compensation*** *in ordinary course of a business carried on by that person providing food, beverages, or entertainment*
    - Covers if run a business – can deduct cost of food fully, also promotional samples covered
- *(b) Relates to* ***fundraising event*** *primary purpose is registered charity*
- *(c) is amount for which person is* ***compensated*** *and amount of compensation is reasonable and specifically identified in writing to person paying the compensation*
    - Lawyer goes out with client for lunch and give client a bill and ask for reimbursement
    - Person who pays bill is subject to 50% limitation
- *(d) Provide food or beverages or entertainment to an* ***employee*** *that is included under 6(1)(a) or s. 6(6)(a)(ii) (remote worksite) as employment then can deduct full amount b/c fully taxable*
- *(f) Business can have* ***6 parties/yr*** *and* ***fully deduct*** *the cost of those parties but entertainment and food has to be generally available to all individuals at business to get the full deduction*
    - Can't just have a party for senior staff – if you do then only going to get half of it

67.1 (3): Fee for convention

Pay lump sum fee for conference, get $50 a day for food, beverages, and entertainment

67.1 (4): Interpretation

- **"**Entertainment" includes **amusement** and **recreation**
- No amount paid or payable for travel on airplane, train, or bus shall be considered in respect of food, beverages or entertainment consumed or enjoyed while traveling
    - If get inflight meal then whole thing is deductible

Stapley v Canada (2006) FCA: **meaning "personal consumption" – doesn't have to be T**

Facts	T (real estate agent) made $100-150K from sale of residential properties. He bought gift certificates for his clients for food, drinks and sporting events. Revenue Authority said he can only deduct 50% of value of gift certificates b/c s. 67.1(1).
Issue	Should S. 67.1(1) apply to the gift certificates?
Analysis	Nexus test in s. 67.1(1) – "**in respect of"** → very broad "Human Consumption" – doesn't say whose consumption, presumably clients use them Purpose s. 67.1 – avoid letting people deduct things that were personal consumption, this wasn't T's personal consumption but they were consumed by someone T argues s. 67.1(1) should be limited to only included the taxpayer's personal consumption • S. 67.1(2) has lots exceptions – exceptions apply to consumption by someone else so if (1) only applied to own consumption, exceptions in (2) would be unnecessary Court thinks unfair to T to only allow 50% deduction but can't ignore words of the text • So many exceptions in specific areas, if parl wanted this exception they would have added it
Holding	s. 67.1(1) applies – T only gets 50% of the deduction
Ratio	***Personal consumption in s. 67.1(1) doesn't mean the taxpayer has to consume it***

Pink Elephant v Canada (2011) TCC: **if in course of business then get full deduction**
Facts: T carried on business providing public education courses, which held at hotels - included breakfast and lunch.
Holding: Catering expenses incurred by T for meals and beverages provided with the courses were subject to exemption in s. 67.1(2)(a) – it as in the ordinary course of T's business

- Deduct full costs – not 50%

Scott v Canada (1998) FCA:
Facts: T, courier who delivers packages by foot and public transit, sought to deduct additional food and water he consumed as part of daily routine – said food and water were his "fuel"
Holding: Deductible expense – rejected that this was personal and living expense
Note: S. 67.1 wasn't argued but would it apply?

- If Parl wanted exception for bike carriers would have put one
- Could say food and beverage here not linked with entertainment – this is fuel so s. 67.1 doesn't apply

Party Cases – s. 67.2(f)
Roebuck v MNR (1961) TAB:
Facts: Daughter of lawyer in Toronto and invited a bunch of clients to her Ba mitzvah
Holding: Not deductible - Purely social entertainment

- Not ordinary business practice

Fingold v MNR (1992) TCC:
Facts: Bar mitzvah of T's son and wedding of T's step-daughter. Company invited bunch of clients of the business
Holding: Can't deduct b/c clients didn't know they were being invited for business reasons

Grunbaum v Canada (1994) TCC
Facts: T sought to deduct amounts expended on wedding reception for T's daughter – said expenses proportionate to # business guests invited to reception, invitations sent through the company
Holding: Deductions for wedding expenses successful (does this overturn *Adaskin* and *Roebuck*?)

PROPERTY: DEDUCTION INTEREST EXPENSES

S. 20(1)(c)(i): Deductions Permitted Computing Income B/P - Interest
Notwithstanding *s. 18(1)(a), & (h)* (overrides these sections)*, in computing T's income from B/P, can deducted such amounts as wholly applicable to that source or such part of amounts as may reasonable be regarded as applicable:*

- *an amount paid in year or payable in respect of year (depending on the method regularly followed by the T in computing the T's income* (could be cash or accrual)*), pursuant to a legal obligation to pay interest on*
    - *(i)borrowed money used for the purpose of earning income from B/P (other than borrowed money used to acquire property the income from which would be exempt)*

  Or a reasonable amount in respect thereof, whichever is lesser

Deduction for interest on borrowed money used for the purpose of earning income
4 elements of this section:

- 1. Amount must be **paid in year or be payable in year** which it is sought to be deducted;
- 2. Amount must be paid **pursuant to legal obligation** to pay interest on borrowed money;
- 3. Borrowed money must be used for **purpose earning non-exempt income** from B/P
- 4. Amount must be **reasonable**, as assessed by reference to first three 3 requirements

S 20(3): Borrowed Money (deals with when someone borrows money to repay previous loan)
Where T uses borrowed money to repay money borrowed, borrowed money deemed to be used for purpose which the previous indebtedness was used or incurred, or was deemed by this subsection to have been used or incurred

- If you use borrowed money to repay borrowed money, then deemed to use current borrowed funds for the same purpose that the original borrowed funds were used

Trans-Prairie Pipeline v MNR (1970) Ex Ct*: Relied on by T in *Bronfman
Facts: Trans-prairie was company with shareholders – preferred shareholders and common shareholders (Preferred shareholders get fixed rate of return). T wanted to expand and had to borrow money – had to get rid of preferred shareholders. T borrowed $700K – paid $400K to get rid of preferred shareholders and used the $300K to expand. Wanted to deduct the interest on the whole $700K
Holding: Court have deduction on full $700K → looked at direct use and indirect use

Sterthal v The Queen (1974) FCTD:* Relied on by Revenue Authority in *Bronfman
Facts: T borrowed money and then loaned money interest free to his kids. Argued that by borrowing the money he didn't have to sell assets – so preserved a bunch of assets and therefore should get interest deduction.
Holding: Court said no to the interest deduction

***Bronfman Trust v Canada (1987) SCC:* DIRECT USE BORROWED FUNDS – BONA FIDE PURPSOE**

Facts	Bronfman set up trust – P beneficiary. Trust asset large shares in companies. Trust became worth $70 million – low income yield – trustees weren't trying earn a lot of income, trying to get capital gains (b/c weren't taxed). Trust paid out to P but since trust isn't earning income had to finance the payments, 2 options: (1) sell assets and pay P or (2) borrow money and give it to P – that is what they did. Trustees borrowed $300K to pay $500K, and $1.9 million to pay $2 million. Trust had to pay interest on borrowed money – sought to deduct interest payments.
Issue	Did trust use the borrowed funds for the purpose of earning income from B/P?
T	**1.Indirect Use:** Directly use of borrowed funds was to pay P, but indirectly were used to earn income b/c allowed them to retain assets – indirect use is to preserve income producing assets **2. Hypothetical alternative**: if trust had sold assets, paid P, borrowed money and repurchased same assets, then borrowed funds for purpose of earning income and get the deduction
#2	Court will look at what T actually did, <u>not what they could have done</u> • Crown acceded that if T had done it in order suggested then would have gotten deduction • SCC doesn't agree –might have been sham –considered sale and purchase constitute a formality or sham designed to conceal essence of transaction - borrowed money used for allocation to P (Not typical use of sham) Statute asks whether doing transactions for purpose of earning income from B/P • **Broad Test** –borrowed funds were to pay P, not earn income from B/P (didn't need sham) ○ DD: thinks court should have done this instead – more persuasive **Purpose w ref commercial & economic reality – what has T really used the borrowed funds for?**
#1	**Direct use** – if indirect, anyone w assets could say borrowed money helps them preserve assets **Purpose s. 20(1)(c)(i)** – encourage accumulation taxable income earning capital (no authority) This doesn't result as accumulation of capital that produces taxable income – this preserves assets not accumulate – T gives $2.5 million to P – really been reduction in income producing capital Distinguishes *Trans-Prairie* – money already in company, original use was okay, here if P had loaned money to trust and trust borrowed money to pay back then would be more like *Trans-Prairie* Problem arguing preserving assets produce taxable income by borrowing funds – interest expenses high, if take $2.5 million assets preserved, returns $10K/year, interest expenses way higher If want to use indirect have to show bona fide for earning income, and interest payments can't be >>> income form assets preserved
Holding	Don't get deduction of interest payments
Ratio	***Have to look at direct use by T – can't look at indirect uses or hypothetical alternatives***

Mark Resources v Canada (1993) TCC: bona fide use
Facts: Canadian company w US sub – US Sub had losses, losses can be carried forward for certain number of yrs but they expire. Borrowed US $ and invested it in the US Sub – got dividends which are generally tax free when they come back to Canada, except for holding at border – about 5% tax. Paid dividends back to Canadian company – which paid interest on loans. Income earned from US sub is all sheltered b/c of the losses. 5% tax on dividends and CA is deducting interest which is sheltering income produced in CA.
Holding: No deduction – picked up bona fide use, real commercial and economic realities
<u>Overriding ultimate economic purpose</u> which borrowed funds used was to enable T import losses from US sub

Robitaille v Canada (1997) TCC: **true commercial and practical nature of transaction**
Facts: T had law firm and wanted to buy a house. T takes out $100K of capital from law firm (no tax) and buys a house, borrows $100,000 from bank and puts it back to the law firm (This is the hypothetical from *Bronfman*)
Holding: denied deduction – all this done in same day and real purpose of borrowed funds was to buy the house.

- Focused on the real and practical manner and on the economic objectives sought by the transaction

Ludco Enterprise v Canada (2001) SCC: **Reverse much of Bronfman Trusts** – Duff hates this

Facts	Ludco borrowed a lot of money and contributed capital to Panama companies and Panama company bought secured investments. Panama companies paid dividends to L – not much b/c would reinvest money from the secured investments to make more income (Paid L $600,000 in dividends). L paid $6 million in interest from borrowed funds $5.4 million of losses on investment of shares. Sold contribution of capital in Panama companies for $9.24 million capital gain **Tax Consequences**: Capital gain taxed ½ of 9.24 = 4.62 + $600,000 of dividends = $5.22 million of income. But have $6 million interest expense – looks like a tax loss = loss $780,000 on investment. Investment lasted a long time, so interest deduction happening over years, and the capital gain happens at the very end (tax sheltering investment) **Revenue Authority**: Real purpose for borrowed funds isn't to earn income from B/P, but is to get capital gains or to shelter income from tax
Analysis	2 aspects of Bronfman – bona fide purchase and definition of income Bona fide purpose – Act says borrowed for **the** purpose – doesn't say bona fide or real • Any purpose is acceptable – just need "a" purpose – purpose here b/c got $600K • DD: can't read "the" to mean real but then reads "the" to mean "a" Income – doesn't have to be net income, could be **gross income** • There wasn't net income being earned but earned $60K dividends so that qualifies • Took income to mean gross income
Holding	Primary purpose was shelter tax in CA but there was purpose of earning income ($600K dividends)
Ratio	***"Income" means gross income, and not net income*** ***"purpose" requirement in s. 20(1)(c)(i) need not be bona fide but can be ancillary***
Note	Is court right that income in this context means gross income? • S. 9(1) says T income B/P is a T profits from B/P → exact same words are found in s. 20(1)(c)(ii) Income means gross income, despite fact words s. 9(1) specifically says means profit (net income) Makes Duff upset – just ignore definition of income from B/P in s. 9(1)

Singleton v Canada (2001) SCC:
Facts: T wants to buy house, takes out $300K from firm and buys a house. Borrows $300K and puts it back into firm (exactly same as in *Robitaille*)
Holding: Gets deduction
Majority – No series transactions concept written into ITA –have use borrowed funds for purpose earning income

- Trace current use borrowed funds –money went into the partnership – done and get deduction

Dissent – real use for borrowed funds was to buy the house

Bona fide purpose, hypothetical alternative being sham from *Bronfman* gone & all the broader arguments gone

Shell Canada (1999) SCC: **Look whether borrowed funds used for purpose earning income**
Facts: T borrowed money for US operations – could have borrowed money in US but decided not to. Went out and found country w higher interest rate to borrow money – higher interest rates meant that you except currency to decline over time. Functionally equivalent borrowing in US$. But can get diff tax treatment – when converted New Zealand dollars had foreign exchange gain which is a capital gain. Revenue authority said real purpose of borrowed funds was to get more deductions in New Zealand.
Holding: Using borrowed funds for business– **test whether used borrowed funds for purpose of earning income** – and they have. Interest rate was reasonable interest rate in New Zealand (end of 20(1)(c) says reasonable amount)

- Formalist and plain meaning approach to the provision

Lipson v Canada (2009) SCC: **GAAR case – didn't' apply for interest deduction**
Facts: Mr. Lipson wanted to buy house. For corp if you take money out of then taxable as a dividend. ITA allows spouses transfer property to each other w/o taxes. Ms. Lipson goes to bank and borrows money and buys shares in Lipson Family investment from Mr. Lipson (not taxable b/c spouse) and Mr. Lipson buys the house. Ms. Lipson takes mortgage and repays the loan – pays interest on mortgage and relies on s. 20(3) to say she used borrowed funds on mortgage for same use as original use (buy shares) which is valid purpose to get interest deduction.
Holding: GAAR doesn't apply on the interest deduction part – wasn't misuse or abuse of s. 20(1)(c)(i) and 20(3)

Stewart and ***Walls*** (2001): **Reasonable Expectation of Profit**

- Only use to distinguish b/w business and hobbies, don't use when purely commercial

Swirsky v The Queen (2014) TCC aff'd FCA: **if no reasonable expectation of income, no deduction**
Facts: T wants loan from family company. Ms. S borrows money from bank and buys shares from Mr. S and uses money to repay loan. Ms. S has interest expenses on amount borrowed to buy shares – no history dividends paid on shares. Ms. S seeks deduct interest expenses – MNR says no b/c never got anything for buying shares
Holding: Can't get interest deduction if no income– no reasonable expectation income test

TDL Group v Canada (2015) TCC: **need reasonable expectation income on use of funds**
Facts: Wendy's (US Company) owns Tim Hortons. TDL is CA Company and there is a US Tim Hortons. CA Company borrowed $300 million from Wendy's – buy shares of US sub Tim Hortons. CA Tim Hortons loans the money back to Wendy's, interest free. Interest payable by Tim Hortons CA to Wendy's – income from capital that Tim Hortons US gets nothing b/c interest free loan
Holding: No reasonable expectation income on use of funds by Tim Hortons CA b/c loaning money back to Wendy's at no interest rate

After ***Swirsky*** and ***TDL*** – some reasonable expectation of income test

- Say get $1 of dividend and interest expense is $4 million, does the $1 get you the interest deduction?
- *Ludco* would say yes

If you have a little bit of income then courts might say it isn't enough

- DD: read act again – 20(1)(c)(i) says income from B/P and means profit (according to (9(1))

Tracing Requirements

Bronfman Trust – If borrow funds and invest it into business then get deduction, if sell business and go on trip then don't get deduction anymore – trace the current use of the fund
Tennant v MNR – T borrowed $1 million, purchased million common shares of arm's-length corporation. T disposed of shares at declared fmv of $1000 in exchange for 1000 TWL shares. But T continued to deduct interest on full $1 million borrowed. Court found full amount of borrowed funds could be traced to interest in TWL.

Emerson v Canada (1985) FCTD: **Person loses source of income**
Facts: T borrowed $100K and bought shares and then company goes bankrupt
Holding: Tracing would say no longer using borrowed money for purpose earning income b/c company no longer there – lose interest deduction
If borrowed funds can no longer be traced to eligible use then deductibility if interest expense disallowed
Hill v MNR (1970) TAB: **Trace portions of money**
Facts: T sought to deduct interest payments on bank loan obtained to acquire home, 25% used for rental purposes.
Holding: Characterized remaining 75% of interest expense as personal living expense not incurred for purpose of producing income from B/P within 12(1)(c), 18(1)(a) and 18(1)(h)
Can trace portion of money allocated to use for earning income

Sinha v MNR (1981) TRB: **Look at purpose of use, not original purpose borrowed fund**
Facts: T borrowed $4,530 in form of CA student loan, did not use funds for educational or living expenses but invested cash in interest-bearing securities. When loan began to bear interest, T deducted payments, which were disallowed by Revenue Canada on grounds interest payments were not expended for purpose gaining or producing income from B/P within meaning s. 20(1)(c), but were personal and living expenses within meaning s. 18(1)(h).
Holding: Allowed deductions – T used funds to earn income regardless original purpose for which were borrowed.

Post – Brofman: Indirect use argument accepted in *Grenier* but not *Attaie*

MNR v Attaie (1990) FCA: **Direct use Test**

Facts: T left Iran, came CA and buys a home in TO. Borrows $54K to buy house – borrows at a high rate w favourable conditions for repayment b/c anticipating going to get money out of Iran –repay loan quickly - 10.75% interest rate. By time gets funds, interest rates at 14-16%. Could repay loan at 10.75% or take $54K and invest it and earn 14-16% - seeks deduct interest expense on $54K that could have used to pay off the loan but didn't. If deductible he is earning 4.25%. If interest isn't deductible then has to pay a total 3.75% - loss

Holding: Disallow deduction - based on direct use test, direct use was to buy the house, money is still in the house and can't say he is using the money for virtually different purpose

Test: Has T used the borrowed funds for the purpose of earning income?

Grenier v MNR (1992) TCC: **Possibility using indirect use**

Facts: T borrows a money to mortgage his house. Invests money in automobile garage business – at this point it is deductible – it's not source of the borrowing, it is the **use of funds**. T sells house – mortgage has to be repaid out of sale of house so he has less money to buy another house. So he buys another house, borrowed money and seeks to deduct interest on same amount of money from original mortgage that has gone into the business.

- 1. Has mortgage on house 1 and owes bank $54K – used those funds to invest in business
- 2. Sells house for $154K – uses $54,000 to repay mortgage
- 3. Wants to buy a new house, house 2, for $154K so he borrows $54,000 from bank

Holding: Allows deduction – indirect use of borrowed funds is to invest in the business

- Fair, just and reasonable answer that depends on indirect use
- Despite Bronfman trust saying use direct use, the door isn't totally closed on look at indirect

Note: borrow money repay mortgage, s. 20(3), deemed have used it for same purpose as original borrowed funds

Indirect use is not totally dead where courts think is reasonable and fair to give the deduction

B/P TIMING ISSUES: INTRODUCTION

S 9(1): General Rule Profit

T's income for taxation year from B/P is T's profit from that B/P for the year

GAAP = Generally Accepted Accounting Principles

- Look to accounting practices to help determine timing of inclusions and deductions

Business income typically computed on **accrual basis** – revenues included in computing T's income in taxation year which they are earned, even if they have not been received

Expenses deducted in taxation year which they are **incurred**, even if they have not been paid

CASH BASIS vs. ACCRUAL BASIS

Cash– received

- Included when you actually get the cash
- Deduction – outlay that is made or paid

Accrual – receivable

- Included when have legal right to the money
- Deduction – expense that is incurred or an amount that is payable

Generally accrual represents the truer picture; dividends generally included on cash basis

B/P TIMING ISSUE: INCLUSIONS

Test for profit for year is legal test

- Take into account accounting practices but not determinative
- Trying to look for **truer picture** of the taxpayers income

Matching Principle: Revenue & Expenses

Might have income received at 1 time, but income should be included later b/c better matched w other expenses

- Have significant expenses that produce income over time, then better to wait and deduct later on
- Matching principle is an interpretative principle but is **not a rule of law**

S 18(1)(a): General Limitation on Deductions

In computing the income of T from B/P no deduction shall be made in respect of an outlay/expense except to extent that it was made or incurred by T for purpose of gaining or producing income from B/P

- Rule contemplating both cash basis and accrual basis

S 12(1)(a): Services to be Rendered

Included in computing income T for taxation year as income from a B/P such of following amounts as are applicable

- *(a) any amount **received** by T in the year in the course of a business*
    - *(i) that is on account of services not rendered or goods not delivered before end of year or that, for any other reason, may be regarded as not having been earned in year or a previous year, or*
        - Includes unearned amounts received – goods or services that are rendered after end of the year, but have received the money now (include even though not earned yet)
    - *(ii) under an arrangement or understanding that it is repayable in whole or in part on return or resale to T of articles in or by means of which goods were delivered to a customer;*
        - Deposit - Deliver goods to customer and they pay you for the goods and they pay you for crate goods came in. Deposit also included

S 12(1)(b): Amounts Receivable

- *(b) any amount receivable by T in respect of property sold or services rendered in course of a business in the year, notwithstanding that the amount or any part thereof is not due until a subsequent year, **unless the method adopted by T for computing income from business and accepted for purpose of this Part does not require T to include any amount receivable** in computing T's income for a taxation year unless it has been received in year, and for purposes of this paragraph, an amount shall be deemed to have become receivable in respect of services rendered in the course of a business on the day that is the earlier of*
    - *(i) the day on which the account in respect of the services was rendered, and*
    - *(ii) the day on which the account in respect of those services would have been rendered had there been no undue delay in rendering the account in respect of the services;*

Amount receivable but not yet due unless method compute income doesn't require include income until received

Anti-avoidance – generally amount receivable when **legal obligation** to pay you, for services then typically not owed amount until bill given

- **Deemed to be receivable** on earlier (i) when bill is sent & (ii) day should have sent bill if you weren't delay
    - Means you can't wait to send bill until next taxation year – makes it receivable when would have given the bill if weren't trying to delay

S 12(2):

Paragraphs 12(1)(a) and 12(1)(b) are enacted for greater certainty and shall not be construed as implying that any amount not referred to in those paragraphs is not to be included in computing income from a business for a taxation year whether it is received or receivable in the year or not.

- These are just guidelines to assist, if some amount should be included b/c gives a true picture then it should be included, notwithstanding what these provisions say

West Kootenay Power and Light (1992) FCA: **no conformity principle – use truer picture**

Facts	T distributed electricity – sent out bills on 2 month billing cycle. At end of tax year, delivered some electricity but haven't billed for it yet. Possible for T to estimate unbilled revenue – look at electricity produced and estimate. 1979 – changed method from billed method (receivable depends on sending bill) to accrual method – estimate how much income going to get. 1983 maintain accrual for financial statement but go back to billed for tax – meant lower income in 1983.
Issue	Are these services receivable even though the bill hasn't been sent?
Analysis	Revenue Authority argues **Principle of Conformity** – can't adopt one method for accounting purposes and different method for tax purposes – court disagrees with this principle **<u>Court concludes that T should use accrual method, not billed method</u>** **Truer Picture** – incurred costs in generating electricity so would make sense to include revenue associated with these costs (matching) **Receivable** – T might say no receivable b/c bill hasn't been sent out o Even though can't send bill out, T still has legal right to the money – estimate amount owed Receivable – not enough that T has precarious right to receive the amount, must have **clear legal right,** though not necessarily immediate right, to receive it • Amount due when send out bill but receivable before b/c have legal right S. 12(1)(b) – T argue that it says that it is receivable on earlier of day bill sent out or deemed to have been sent out – doesn't fall here b/c not allowed to send bill out yet • Response – provisions says "services", electricity is good, so doesn't matter - amount is receivable • Also 12(2) says purpose is include amounts that would not be included b/c bill not yet delivered
Ratio	***No requirement conformity b/w financial statements & tax returns –need use method represents "truer picture" T's revenue and more fairly portrays income - matches revenue & expenditure*** ***Receivable – T must have clear legal, although not necessarily immediate, right to receive it***

Canderel v Canada (1998) SCC: **Relationship b/w accounting practices & computation profit**

<u>Facts</u>: Paid large amounts to have T sign 10 year lease – tenant inducement payment

<u>Holding</u>: shouldn't include payment over 10 years – include all when T got it

- Matching principle might suggest spread it out over life of lease – wrong
- Use GAAP as an interpretative aid – assistance

Matching principle is not principle of law, truer picture principle should be used

Guild of Canada v MNR (1956) Ex Ct: **Installment Basis**

<u>Facts</u>: T in business of selling magazines door to door. T says that he signed up ppl to buy magazines but doesn't sell that many. Doesn't include income from signing up b/c uncertain how much going to get. Also doesn't deduct all expenses from going out and trying to get people

<u>Holding</u>: Okay with installment basis of accounting – defer deductions until get income

- Accepted installment method on basis that it more accurately reflected T's income position

Ikea (1998): **Realization Principle**

<u>Facts</u>: T (Ikea) got tenant inducement payment to sign a long-term lease - received $2.65 million to enter into long term lease. T says shouldn't include the $2.65 million over the life of the lease

<u>Holding</u>: T has free discretion to use it so declare it now

Realization Principle – if have the money and can use it freely then can't defer income over period of time

B/P TIMING ISSUES: DEDUCTIONS

Cash vs Accrual Basis:

Cash – expenditures are not deductible until taxation year in which they are actually paid

Accrual - expenses deductible in taxation year in which **they are payable**, even if they not actually paid

- **Amount Payable** – have legal obligation to pay amount then deductible (flip side of receivable)

Inventory Costs

S 248(1): "**Inventory**"

*means description property, **cost** or **value** of which is relevant in computing T's income from business for taxation yr*

- Cost relevant in computing income from business, for inventory: **gross profit = proceeds – costs**

Ordinary business expenses is typically deductible in **taxation year which they are incurred**

Costs acquire/produce inventory generally deductible only in **yr which inventory is sold** or otherwise disposed of

Neonex International v Canada (1978) FCA: **Non-Homogenous Inventory**

Facts	T makes custom signs for sale – no inventory of completed signs, conditional sales K where title doesn't pass until each sign is paid in full. End tax year always some uncompleted signs that were in process being finished before delivered – work in process inventory (WIP). Until 1970, for tax and accounting purposes, T treated uncompleted signs was WIP – didn't deduct cost from working on sign until sign actually sold. 1970-72 – maintained for accounting, but for tax purposes deducted cost of partly completed signs
Analysis	True picture of income is not to deduct cost in years where haven't actually gotten the income **Consistency issue** – can't switch back and forth to get more deductions **Matching principle** – requires at end of year effort be made to identify costs incurred during period but which have no yet been expended in revenue earning process
Holding	Disallowed deductions – expenses incurred in connection with partially completed signs were bringing income in next taxation year, not year which they were claimed
Ratio	***Where items of inventory are unique and easily distinguished, defer deduction inventory costs until taxation year which inventory is sold or otherwise disposed of***

Homogenous Inventory

Deduct all expenses incurred in the year and add back cost of inventory that remains unsold at the end of the year

Gross Profit (GP) = proceeds resulting from disposition of property (P) - cost of inventory disposed of (C)

(C) = cost T's inventory at beginning of year (C_0) + cost inventory acquired or produced during the year (C_1) – cost of inventory remaining at end of year (C_2)

$$GP = P - C = P - C_0 - C_1 + C_2$$

Makes cost of inventory acquired/produced in taxation year relevant in computing T's income from business for the year, even if it has not been sold or otherwise disposed of during the year

Homogenous Inventory – Cost Changes throughout Year

Where inventory homogenous & numerous and acquired/produced at diff costs, it is impossible track cost of each individual item – so have assumptions about order which inventory is disposed of:

"First in, First out" (FIFO) – Inventory deemed to be disposed of in order which it was acquired/produced

- Inventory at the end of the year is comprised of the most recently acquired/produced inventory
- In times of rising costs, then lower cost inventory sold first and the C_2 is most expensive stuff

"Last in, First out" (LIFO) – Most recently acquired/produced inventory deemed to be sold first, so inventory that remains at end of year is deemed to comprise inventory acquired/produced in most distance previous years

- In times of rising costs, then higher cost stuff sold first and C_2 is less expensive stuff

Average Cost – Cost of all inventory available for sale in the taxation year is averaged

- Cost of inventory remaining at end yr is same cost inventory sold or otherwise disposed of in taxation yr

Revenue authority accepts FIFO And Average Cost approach but doesn't accept LIFO

MNR v Anaconda American Brass (1955) PC: **Can't switch FIFO → LIFO unless show physical flow**

Facts: T produced various metal products. 1947 – copper prices increasing. Up to now T used FIFO but then decide to switch to LIFO – costs going up so assume most recently produced copper is going into pipes and C_2 is originally acquired copper that is stilling in the warehouse. Stuff add back under C_2 is lower than if used FIFO approach

Holding: Accounting approach should follow physical flow of copper

- If can show copper sitting in warehouse is old copper bought at lower price then can use LIFO
- Highly unlikely copper in warehouse is copper bought in 1928 –can't switch FIFO to LIFO
  - But if could establish physical flow of inventory was closer to LIFO then could use that

Lower of Cost or Market Value (LCM) Principle/Rule

Generally add back cost of inventory that sits in warehouse at end of the year (C_2) but inventory that is unsold could have decreased in value, so it is worth less than it cost → unrealized lost (unrealized b/c haven't sold it yet)

- Codified that what should be added back in computing C_2 is lower of cost and the fmv
  - Notionally equivalent by adding back cost and then granting deduction for unrealized cost

Gives T implicit deduction for unrealized loss of the inventory

Ex: Produce $10 widget, widgets now worth $6 and have bunch of widgets left in your factory

- Normally under inventory accounting T would add back $10 x # widgets in factory
- LCM Says add back $6 – which is like adding back $10 and giving deduction for $4 (loss of value)

S 10(1): Valuation Inventory

For purpose computing T's income for taxation year from B that is not adventure or concern in nature of trade, property described as inventory shall be valued at end of year at cost at which T acquired property or its fmv at end of year, whichever is lower, or in prescribed manner. → allows deduction for accrued losses in value of unsold inventory by allowing it to be "written down" to its fmv if this is lower than its cost

Friesen v Canada (1995) SCC: **Plain meaning of s. 10(1)**

Facts: T had vacant land in AB for purpose re-sell for profit. Cost property relevant in computing income from business when sold – Inventory. In early 80's real estate market in AB tanked and value of land decreased from original cost. T wanted hold land but wanted claim decrease value in land – unrealized/accrued lost. Relied on LCM in s. 10(1) to do that – said this is inventory so should be allow to evaluate at lower cost or fair market value

Court splits: Iaccobucci uses plain meaning approach, but knows a lot about tax and says this isn't right but can't convince rest of court who say if we just read this then he gets the deduction

- Inventory relevant in calculating income in **a** taxation year – in yr sell property then relevant in computing tax in year so applies to inventory

DD: Plain meaning rule goes wrong:

- S. 10(1) - compute inventory lower amount, until actually sell property not computing income for business
- When multiple items inventory and adding back C_2 valuing inventory, but when have 1 item of property then don't compute income until sell it

Court reversed ***Friesen*** – enacted **s. 10(1.01)**

For purpose computing T's income from business that is adventure of concern in nature of trade, property described in inventory shall be valued at cost at which T acquired the property.

- If have adventure in nature of trade then don't get s. 10(1)

Friedberg v Canada (1993) SCC: **Realization principle trumps matching principle**

Facts: T speculating future markets buying and selling gold - Enter Ks buy and sell gold in future. Entered into agreements as price gold fluctuates - worth Ks goes up and down value – since buying & selling equal in value. At end 1 tax yr bunch Ks gone up value and bunch down. Dec 31 sold bunch went down value – generate losses. Jan 1 – sold all ones went up value. Kept doing this and kept getting bigger. Inventory is Ks – value all of it at value. Wasn't just relying lower cost of value rule –actually sold low value ones.

Holding: Realization principle trumps, violates matching principle – T succeeds

Note: CRA has since said to apply GAAR to anything like this – now GAAR would apply to disallow this

Realization principle is more significant than matching principle

Running Expenses

Traditionally expenses that cannot be easily matched w specific revenues (ex. Running expenses) deducted in year which they are incurred, even if amount deduction may be particular large and distort T's income for that year

Oxford Shopping Centres v Canada (1980) FCTD: **Leading case for running expense**

Facts	Agreement made by π, owner mall, w city Calgary – π paid City $490K to construct road interchange to make access to shopping center easier. Agreement said money was in lieu local improvement rate and taxes that might be payable. π said amount income expense and deductible in year of payment. Minister said amount deduction should be amortized over 15 years.
Issue	In computing income for tax, is π required to apportion the expenditure over a period of yrs?
Analysis	Does T doing this distort **true picture** of income for the year? • Deduct $490K wouldn't be true picture – might be better deduct over time b/c get benefit over time – court doesn't accept principle in this case Amount cannot be related to specific item – expenditure might not produce any benefit • No asset associated and entirely speculative about whether going to produce income for them Overhead expense that may distort the picture but doesn't distort more than anything else – would distort income by spreading it out over 15 years
Ratio	***"Matching Principle" applies to expenses related to particular item of income, doesn't apply to running expenses of business – deduct running expense in year which it was paid*** ***Running expense – not referable or related to particular item of revenue, deducted in year which it was incurred***

Cummings v Canada (1981) FCA: **lease pickups – running expense**

Facts: T constructed office building, incurred expenses (lease "pickups") to indemnify tenant for penalties and rental costs resulting from decision to vacate other office space.

Holding: Rejected crown argument that deduction for lease pickups should be amortized over term of the lease
Expenditure was running expense and in same category as advertising to get tenants or offer for rent - free period

Canderel v Canada (1998) SCC: **Tenant inducement payments – running expense (factually specific)**

Facts: T had business developing & managing commercial properties, spent over $1.2 million on inducements paid to tenants on signing of leases (3-10 year leases). For accounting purposes these tenant inducement payments (TIPs) were capitalized and amortized over term of lease, for tax purposes T deducted full amount of payments.

Holding: TIPs were ordinary running expenses

- Benefit brought into existence by lease inducement payments wasn't just get 1 tenant into building- got tenant and lots of benefits - Would be arbitrary to spread it over life of lease

Pre-Paid Expenses – s. 18(9)

S 18(9): Limitation for Pre-Paid Expenses – purpose of section is to provide "truer picture"

a. *No deduction made when computing T's income for taxation year from B/P to extent it can be* ***reasonably*** *be regarded as having been made or incurred:*
   - *Consideration for services rendered after end of the year;*
   - *As, on account, of in lieu of payment of or in satisfaction of, interest, taxes, rent or royalties in respect of period that is after the end of the year*
   - *As consideration for insurance in respect of a period after the end of the year*

(b) Such portion of each outlay/expense made or incurred as would, but for 18(9)(a), be deductible in computing T's income for subsequent year to which it can reasonably be considered to relate

Paid amount (taxes, rent, license, etc (doesn't include inducement payments)) but getting services at end of year

- If reasonably regarded as made or incurred then not deductible

If get payments and relate period after end year then deduct them in year which can reasonably considered relate
Disallowed immediate deduction of prepaid expenses for services to be rendered after the year – deductible in subsequent year to which expense "can reasonably be considered to relate"

Capital Expenditures

S 18(1)(b): General Limitations – Capital Outlay or Loss

In computing the income of T from B/P no deduction shall be made in respect of:

*(b) 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;*

Can't deduct outlay, loss, or replacement of capital

Result → even if outlay or expense made or incurred within meaning of 18(1)(a) (purpose of gaining or producing income from B/P), its deduction might be **disallowed** on basis it constitutes a capital loss or "**capital expenditure**"

- No deduction made in respect of an allowance in respect of **depreciation**, **obsolescence** or **depletion**

Capital Expenditure – gives rise to capital property, using property to earn income over time

- Not fully deductible in tax year which they are made/incurred – deferred in whole or part to subsequent tax years in which gains or losses are realized or deductions are permitted

Depreciation – physical assets that wear out over time

- If capital expense that can't deduct upfront, but if depreciable quality then deduct over time

Obsolescence – piece of equipment no longer used b/c obsolete

- Dispose of certain property b/c obsolete (terminal loss – s. 20(16))

Depletion – Resource - Don't deduct cost currently but deduct cost over time as deplete resource

Capital Property can be divided:

1. Non-depreciable capital property – Doesn't wear out over time (ex. Land, shares)

- Gains = proceeds – cost (gets included in cost while calculating gains)
- Only **tax ½** of gain or loss

2. Depreciable capital property – wear out over time, can deduct as soon as start using

- S. 20(1)(a) – allows capital cost allowance (CCA) - Regs and s. 13
- Allows for full deduction over time – full cost seen over time

3. Eligible capital property (hybrid non-depreciable and depreciable) – ie. Purchase goodwill of a business (skip)

  - S. 20(1)(b) – deduct portion cost over time (like the CCA), but not the full amount (¾)

4. Resource Depletion

- Resource property depletes – access to ore body, can be deducted over time as you deplete the resource

***Canada v Johns-Manville Corp (1985) SCC:* Tests capital expense vs. income expenditure**

Facts	T operated asbestos mine – necessary purchase land on regular basis so mine perimeter could extend to maintain gradual slope. T deducted cost of land acquired as ordinary business expense. Minister disallowed deductions on basis that the cost of the land was a capital expenditure. T purchased annually for 40 years – cost each year was 3% total cost/yr.
Issue	Can T, when purchasing additional land needed for pit, charge purchase price of land as a production expense or must T capitalize the land cost?
History	**TJ** - land expenditures were not capital outlays –expenses incurred in mining operations and should be taken into account in determining net income **Court of Appeal** – reversed TJ – found expenditures were capital in nature
Analysis	Weren't buying land with ore body in it – just buying land so could have wider access to mine pit • No depletion allowance Not depreciable – if have underground mine and build tunnel to get ore body then ITA calls this depreciable property that can depreciate over time **<u>Different Tests to determine if it is capital expense or business expense:</u>** *Sun Newspaper:* 3 matters to consider: • **1. Character of advantage sought** - Lasting qualities may play a part • 2. Manner which it is to be **used, relied upon or enjoyed** - Recurrence may play part • 3. **Means adopted to obtain it -**

	Hallstroms - Diff b/w capital & income expenditures lay b/w: • Acquisition of the means of production and use of them; • Establishing/extending a business organization and carrying on the business; • Implements employed in work and regular performance of work • Enterprise itself and sustained effort of those engaged in it *BP Australia –* **Were sums expended on structure within which profits were to be earned or were they part of the money-earning process?** • Depends what expenditure is calculated to effect from practical or business pov, rather than on juristic classification of legal rights, if any, secured, employed or exhausted in the process *Helsby Cables v Atherton* – "once and for all test" • **Capital expenditure is spent once and for all; income expenditure is recur every year**
Apply	T has been doing this every year for 40 years If T knew how much land going to need and bought all land yr 1 then probably capital expense – part of structure – Revenue says this is structure, shouldn't get diff result buying little land at a time Don't distort income by doing it in pieces over time – if done upfront then would distort income If apply 3 steps from *Sun Newspaper*- expenditure would qualify as expense, not capital • Character of advantage was for current operations; practice reoccurring; means adopted was period outlay of funds
Holding	Appropriate tax treatment is to allocate expenditures to revenue account and **not capital**
Ratio	***2 test: (1) expense incurred once and for all with view bringing into existence asset/advantage for enduring benefit of trade; (2) was amount expended on establishing structure within which profits are earned or in the process of earning income?***

***MNR Haddonn Hall Realty Inc (1961) SCC:* Tenant apartment – capital**

Facts: T runs apartment building – buying drapes and appliances. Sought in computing income to deduct money spent to replace stoves, fridges, window blinds.

Holding: Disallowed deduction - replacing capital assets – significant thing that give give rise to enduring benefit

- Expenditure to replace capital assets which have become worn out or obsolete is different than ordinary expenditures for repairs which are income reimbursements

If payment made once and for all w view to bringing into existence asset or advantage for enduring benefit of T's business then capital expenditure

***Damon Developments v MNR (1988) TCC:* Hotel – business expense**

Facts: T owned a hotel. Deducted expenses to replace items (drapes, TVs, washing machines) in hotel.

Holding: Found were **not** capital expenditures – expenditures for the hotel occur regularly at relatively short intervals and are made to meet a continuous demand for expenditures

- Distinguished *Haddon* b/c items had shorter useful life span in hotel business then when used by tenants in an apartment

Look at lifetime of the product – in hotel more wear and tear then in tenant apartment – expenditures are not capital b/c no enduring benefit

***Central Amusement Co:* no enduring benefit – not capital expenditure**

Facts: T deducted $175,026 in computing business income – spent to replace circuit boards in video and arcade games, to create new games that satisfied the market for few months.

Holding: Rejected that payments were on account of capital – no enduring benefit

- Expenditure was required on reoccurring and regular basis
- Advantage obtained by T by purchase was temporary in nature

Court found **tuition expenses generally capital expense** (unless carrying along business while in school)

- T takes courses to establish self in career – court finds capital expense that isn't depreciable

***Oxford Shopping Centres:* speculative benefit – not capital expenditure**

Facts: T deducted money in computing business income that was paid to City for city agreeing to construct a road interchange to make it easier to access T's mall parking lot

Holding: Expense not properly characterize as a capital expenditure

- Complete speculative about what benefit, if any, T will get

***Algoma Central Railway:* Speculative benefit – not capital expenditure**

Facts: T operated railway through sparsely populated areas northern Ontario. Commissioned 5-year geological survey of properties in hope that this would lead to resource development and increased traffic on their lines.

Holding: Rejected Minister's argument that payments for survey were non-deductible capital expenditures

- Anticipated benefit of increased traffic too remote and speculative to constituted "advantage" of enduring benefit within means of test in *Helsby v Atherton*

Expenses are like advertising expenses- designed benefit business in enduring way, but generally deductible expenses in year which they are incurred

***Cormack v MNR (1965) TAB:* Investigation cost for business – capital expense, non-deductible**

Facts: T, doc who devoted time to educational projects and opened private school in Edmonton, sought to deduct costs to Europe to observe their schools and education system.

Holding: Disallowed deduction – capital expense

- Setting up school – school is capital expense, investigation cost to establish **structure** of business

***DM Firestone v Canada (1987) FCA:* investigation to set up business - capital**

Facts: T wanted to create "venture capital" business by acquiring financially distressed manufacturing businesses and making them profitable. Sought to deduct expense to investigate potential businesses for acquisition.

Holding: capital expenditure – disallowed deduction

- Expense was incurred in putting together new business structure

Setting up business that doesn't happen – creating business structure – capital expense

Bancroft – acquired land w intention opening resort, then abounded project – capital expense (business structure)

Park Royal Shopping Center **Facts**: paid to draw up pans for building next to mall – non-deductible capital expense

Expanding a Business – Deductible Business Expense

Bowater Power – expenses for engineering studies to assess opportunities of increased business – incurred while business operating

MP Drilling - Expenses in first 3 years incurred in unsuccessful attempt to get into business of marketing gas abroad – not a start-up expense

Wacky Wheatley's - traveling expenses T family to travel to Australia to assess business opportunities to expand

RENOVATION & REPAIR EXPENSES

***Canada Steamship Lines Limited v MNR (1966) Ex Ct:* capital vs. repair expense**

Facts	T deducted amounts paid to repair several ships by replacing floors and walls of carrying holds and boilers which powered the ships – sought to deduct it all as repair expenses, but MNR Said so substantial they were capital expenses.
Analysis	**Boilers of Ship** – can be taken out and put in another boat (suggests separate capital expense) *Thompson Construction (1957) Ex Ct* – T sought to deduct expense to install new engine used on power shovel. Court rejected that expense was in the nature of repair – found **capital expense** • (1) engine had substantial commercial value; (2) cot of engine significant relative to value of power shovel; (3) special scheme for the engines *Vancouver Tugboat (1957) Ex Ct* – T operated tugboat service and sought to deduct expense to replace engine in tugboat. Court found expense was **capital** • Expense cover accumulation wear & tear and prevent necessity future repairs – large expenditure

	Look at: how substantial cost of separate item is compared to value of entire thing; is it a severable asset (can be sold on own) and is there a statutory scheme that allows for deduction **Replace Hold Lining of Ship –** lining is integral to ship and isn't severable (can't sell on its own) • Even though is significance expense it is repair
Holding	Replacing boilers of ship was capital expense; holding in ship is repair expense
Ratio	***Repairs are deductible, separate asset is capital and non-deductible expense. Quantum of expense isn't determinative***
Note	Contemplated that significant upgrade might be beyond mere repair and becomes capital expense Likely for minor expense (replacing screw) isn't going to be capital, even though separate

Donohue Normick v Canada (1995) FCA: **spare parts = capital expense**
Facts: T buys spare parts in case something breaks so he can operate continuously - Spends $500K on spare parts. Cost of mill is $2 million and cost of machine is $30 million. Spare parts **meant to last 10 yrs**
Holding: Spare parts are separate and should be treated as separate capital expense

Canadian Reynolds Metal v Canada (1996) FCA: **upgrade becomes capital expense**
Facts: T deducted expenditures made replace lining in pots used produce aluminium – upped life of the pots.
Holding: Characterized cost of new linings as capital expenditure – used to acquire capital cost of enduring nature

Canaport v Canada (1993) TCC:
Facts: T had offshore crude tanker unloading and receiving facility. Had underwater pipeline to get oil into tankers. Spent a lot of money to put fiber glass into pipe – extend life time of pipeline
Holding: Same as cost of repairing cargo holds in *Canada Steamship* – deductible (not capital)

If technology changes don't have use old technology – **use new technology, but not considered upgrade**

Shabro Investment v MNR (1979) FCA: **Repairs to buildings: repairs vs. upgrades**

Facts	T sought deduct as operation expense incurred for: removing bottom floor, installing steel piles to support new floor; constructing new concrete floor; and repair and replace waterlines, drains etc.
Issue	Is this a capital expense or a currently deductible expense? • T – just repairing building, got building back up • MNR – bought crap building and now have to replace – capital expenses
Analysis	Generally, replacement of worn or damaged parts, even though substantial are repairs (different then change designed to create enduring addition or improvement to the structure **Examples repairs and capital additions/improvements:** • If building built w thatched roof then filing in holes in roof would be repairs, but replacing roof with a more modern room would be capital improvement in structure of building • If building built leaving one side w/o wall but protected by metal awning that was essential part of structure, remedying damage awning "repair" but replacing it by wall capital improvement • If building built w floors on lowering story consisting dry fill spread on ground, remedying losses to fill and smooth would be repair, but replacing dry fill w concrete floor - capital improvement Replacing operation = sub some part of building with something essential different in kind to what was there before → improvement, not repair
Holding	Disallowed deduction on everything except repairing and replacing waterlines, drains etc • Now have building on steel piles which didn't exist before – capital • Concrete floors integrated with steel piles – part and parcel with them • Waterlines – deductible, had these before – ordinary to repair these
Ratio	***Objective Test: Are you getting something different in kind or are you repairing what you had before? If something new replacing what was there before then capital expense*** ***Repairs don't need to be caused by normal wear and tear – can be brought about by damage***
Note	If expense is large the more likely court consider it an upgrade and capital

Goldbar Developments v MNR (1987) FCTD: **Purpose Test – don't look at effect, look at purpose**
Facts: T owned a building worth $8 million – side of building falling apart. Spent $250: to repair brick wall – replaced brick wall w metal. Revenue authority said upgrade – diff kind of wall
Holding: Characterized as deductible expense - Sum of money wasn't substantial – 3% of cost of building itself

- Repairing wall in light new technology – not really an upgrade
- Had to do this – Bricks falling down and city told you that you had to – so purpose was not to upgrade the building, but was to just use the building

Marklib Investments v Canada (2000) TCC:
Facts: T had building and had to spend $3.5 million to comply w work orders from authorities
Holding: Based on purpose test – fully deductible expense

- Purpose was to comply with authorities

Note: *Goldbar* and *Marklib* that use purpose test are lower court decisions, and *Shabro* is FCA

Bowland (1999) TCC aff'd FCA & ***Speek (1994) TCC***
Facts: T had building damages b/c of fire – spend lots of money to restoring building
Holding: both cases court found capital expense – provides permanent advantage to T who will not have to incur expense every year – one time occurrence

- Building virtually rebuilt – resulted in new capital asset

STATUTORY RULES – Capitalization Rules – ON EXAM!!!

S. 18(2): Limit Extent T Deduct Interest and Property Expenses Vacant Land

Interest and property taxes not deductible unless using it for business

- (a) interest on debt relating to acquisition of the land (borrowed money to get the land)
- (b) property taxes paid or payable by T in respect of land to province
- (c) T using it themselves
- (d) renting property out
- (e) Can't deduct property tax and interest expense to generate a loss – can deduct down to 0 but any amount beyond that becomes part of cost of property

Where land not subject to exceptions in (c) or (d), amount T may deduct in respect of carrying charges in (a) and (b) cannot exceed net income from land

S. 18(3): Land in s. 18(2) = Vacant Land

Land does not include:

- (a) property that is a building or other structure affixed to land
- (b) land sub adjacent to property described in (a) and (c)
- (c) land immediately contiguous to land described in (b) that is parking area, driveway, yard, garden or similar land necessary for use of any property in (a)

S. 18(3.1): T Renovating/Construction Building

(a) When computing T's income no deduction for outlay/expense made/incurred by T that can reasonably be regarded as a ***cost attributable to period of construction, renovation, or alteration of a building*** *by T*
(b) Amount of such outlay/expense included in computing cost or capital cost of the building to T

- All of that is not deductible – it is capitalized

"Soft Costs" – costs not directly related construction building but related ownership building during construction 18(3.1) – capitalized construction soft costs

S. 18(3.2): Included Costs for (3.1)

(a) Interest paid or payable by T in respect of borrowed money that cannot be identified with particular building or particular land, but can be reasonably considered as interest on borrowed money used by T in respect of construction, renovation, or alteration of a building or ownership of land

S. 18(3.3): Completion

For purpose of (3.1), construction, renovation, or alteration of building is completed at earlier of day on which the construction, renovation or alteration is actually completed and day on which all or substantially all of building is used for purpose for which it was constructed, renovated or altered

S. 20(29): deduction where s. 18(3.1) applies – read this with (3.1)

Can't deduct but then this says can deduct but not to generate a loss so need income

Where b/c of 18(3.1), deduction would, but for this section, be allowed to T in respect outlay/expense in respect of building, and outlay/expense would, but for this section, be deductible in computing T's income for tax year, there may be deducted in respect of such outlays and expenses in computing T's income an amount equal to lesser of:

- *Total of all such outlays and expenses; and*
- *T's income for year for renting building*

CAPITAL COST ALLOWANCE – s. 20(1)(a)

2 Ways to Calculate Depreciation:

Straight Line – Cost of property is deducted in equal annual increments over the course of its useful life until unrecovered or undepreciated cost (or book value) = 0

Declining Balance – don't take equal amount every year, percentage of undepreciated cost deducted each year, causes book value to approach but never reach 0

- Gives more deduction upfront but never becomes 0 – always taking percent of something
- Makes sense for most assets b/c always have some residual value

Ex. Buy equipment – costs $1000 and going to last 10 years

- Straight line – deduct 1/10 each year
- Declining balance - 40%/yr so yr 1 deduct $400, leaves capital $600 –always 40% off remaining amount

3 Ways Tax Depreciation differs Accounting Depreciation:

1. Generally done on ***declining balance basis***
2. Accounting depreciation is done on an asset by asset basis, whereas ***tax pools assets*** and does on class basis
    - Implications when dispose property, & makes calculation easier b/c calculate on aggregate basis for class
3. Accounting depreciation automatically done – depreciates over time and you deduct it, for tax purposes it is ***permissive***, don't have to deduct CCA
    - Wouldn't want to deduct amount if don't have a lot of income in current year – want to carry over losses
    - Optional deduction under s. 20(1)(A) – "**may** be deducted"

S. 18(1)(b) says no deduction for depreciation **EXCEPT** as allowed - s. 20(1)(a) allows it

S. 20(1): Permitted deductions Computing Income B/P

Notwithstanding ss. 18(1)(a),(b), and (h), in computing T's income for tax year from B/P, there may be deducted such following amounts as wholly applicable or such part reasonably regarded as applicable:

(a): Capital Cost of Property

Such part capital cost to T of property, or such amount respect capital cost to T property, if any, as allowed by reg

Deducting capital cost of depreciable, and it is the amount that is **allowed by regulation**

Reg 1100(1): Capital Cost Allowance

Gives rates allowed for each class for deductions

- Rates are supposed to match the useful life of assets – often used for inventive purposes
- Higher rate the better – get to deduct more money faster –

Schedule II: What is included in each Class

- Ex. Class 1 - Building of structure = 4%; Class 6 - building of frame = 10%
    - Building of structure expected to last longer than building of frame

S. 1102(1): Property not included

- (a) prevents CCA deduction of amounts already deductible in computing T's income
- (b) prohibits CCA deduction for depreciable property described as T's **inventory**
- **(c)** property not acquired by T for the **purpose of gaining or producing income**
  - Income producing purpose test – essentially same purpose in 18(1)(a) and 20(1)(c)

1102(2) – **land is not depreciable property**

Excludes all land from the categories of depreciable property in respect of which CCA may be claimed

Ben's Limited v MNR (1955): **Reg 1102(1)(c)**

Facts	T runs bakery in Halifax – purchases 3 buildings near the bakery so can expand – want to tear down buildings. Bought buildings and land. Land is non-depreciable capital property, buildings are depreciable capital property (when buy building start depreciating at right in regulations). In purchaser price allocate \$3K for land and \$39K for buildings. Hold buildings 8-9 months while T gets zoning and then sells buildings for \$12K. Tenant in one of the buildings for that 8 months – had lease that wasn't up. T wants to argue depreciable property.
Issue	Under s. 1102(1)(c), has T used property for purpose of gaining or producing income?
Analysis	T says got it for purpose earning income – purpose was extend bakery so can make more money • Court says no – not depreciating land, depreciating buildings and **Q is whether building acquired for purpose of gaining or producing income** (not unrelated to test in s. 18(1)(a) and 20(1)(c)) T loses big argument that bought building + land for purpose producing income – subsidiary arguments → Tenant in building – earned income from rent; used for storage; primary purpose was to tear down building but had **secondary purposes** Sole intent was to tear down the buildings – not trying to earn income
Holding	T doesn't get CCA deduction – didn't get buildings for purpose of earning income
Ratio	***Need to acquire property trying to claim CCA on for the purpose of gaining income***
Note	What if bought completely empty building that you want to tear down – tax lawyer says not going to get CCA deduction so get tenant to come in for a bit to pay rent → GAAR might apply • Principle getting deduction that vastly exceeds income – similar to *Ludco* • Same type of test – did T acquire property for purpose of gaining income 1102(1)(c) – says "the" purpose – but in *Ludco* court changed "the" purpose to "a" purpose 1102(1)(c) just says income so strong argument means gross income and not net income

Hickman Motors (1997) SCC: **Gross income, not net income: okay CCA >>> Income**

Facts: Hick had sub carrying on leasing business –owned assets so claiming CCA on assets – gets rental income. But business wasn't doing well – had losses. B/c lots of losses couldn't use CCA. B/c Hick and sub separate companies, can't use losses in Hick. Wanted to wind up leading company – so transferred all property to Hick (profitable company). Hick had property for 5 days and then sold it – during the 5 days deductible CCA - \$2 million of CCA deducted. Got rental income for 5 days. But \$2 million vastly exceeded the rental income.

Holding: No problem here – used for purpose of earning income b/c got rental income for 5 days

- "Purpose of producing income" means gross income and not net income

DD: Okay with this here b/c doesn't say "purpose of producing income from business or property"

S. 13(21): "Depreciable Property"

*Property **acquired** by in respect of which T has been allowed, or would, if T owned property at end of year and this Act were read w/o reference to (26), but entitled to, a deduction under s. 20(1)(a) in computing income for that year or proceeding tax year*

Property "**acquired** by T" to qualify depreciable property – relevant for when to include under (A) of UCC Formula

- T purchased property but under delayed payment system – seller retained legal title until payments are made – has T acquired the property?

Wardean Drilling – purchaser acquired assets when purchaser as all incidents of title (**possession, use, and risk**) although legal title remains with vendor

CCA's permitted in respect of diff classes of depreciable property based on "undepreciated capital cost" (UCC) to T as of end of taxation year

S. 13(21): "Undepreciated Capital Cost"

UCC = [A + B] – [E + F] = A – E – F + B

- A = capital cost of all property (total amount paid)
  - Full cost to T for acquiring the property
  - Only include once it is available for use – s. **13(26)**
- E = total depreciation allowed T for property in class (includes CCA (s. 20(1)(a) and terminal loss (**20(16)**)
  - Terminal loss – deducted only where positive balance to UCC and no property left in class
- F = total proceeds of disposition (up to original capital cost)
- B = amount from proceeds of sale above UCC (amount of any "recaptured" income)

At any moment can find UCC – generally relevant at end of year so can kind CCA deductible under s. 20(1)(a)

- Balance is constantly changing
- Gives incentive to acquire property at end of year – so enacted 1100(2)

If subtracting F causes UCC to become negative, it means T claimed deductions in respect property of class more than it has actually decreased in value – negative balance in "recapture" by including it in computing T's income under s. 13(1) → amount added in computing UCC of class under B (making UCC 0)

If depreciable property disposed of for proceeds less than UCC, and no depreciable property remaining in class, T has deducted less of cost than actual depreciation value of property, and positive balance may be deducted as terminal loss – s. 20(16) → amount deducted under s. 20(16) subtracted in computing UCC under E as part of "total depreciation" claimed by T

One Asset in class:
If UCC < 0 after F is subtracted → then include negative balance in T's income under 13(1) under B
If UCC > 0 after F subtracted → positive balance deducted as terminal loss (s. 20(16)) , under E

S. 13(26): Available to use

In applying UCC for s.20(1)(a) in computing T's income for year from B/P, can't include amount in calculating UCC to T of depreciable property in respect of capital cost to t of property before the time the property is considered to have become available for use by T

- Can't claim CCA until have possession (don't add it to A in UCC formula until available for use)
- Generally property available to T's use when delivered to T or when it is first used by T

Reg 1100(2): Doesn't matter when you acquired property in the year

In year you acquire property, if net addition to balance, can only deduct ½ of capital cost of property in that year

Example: One Asset

Buy car (depreciable property) costs $30K – running taxi business so using car purpose earning income (class 10 property, rate = 30%) (Ignore half year rule) - A = $30K

- At end of year 1 can deduct 30% of $30K = $9,000 (=E)
- UCC immediately after year: A - E = $30,000 - $9,000 = $21,000 (ITA recognized after 1 yr car is worth $21)

Now T disposes of the car for $15,000 → $15,000 < $21,000 - car depreciated more than ITA recognized

- F = $15 ➔ UCC = A – E – F = 30 – 9 – 15 = $6
- T has not deducted enough CCA for the car – allowed T to deduct terminal loss of $6 under s. 20(16)
- Amount is added to E as part of "total depreciable property" – so UCC = 30 – (9+6) – 15 = 0

T disposes of car for $24,000 → $24 > $21 – car depreciated less than ITA recognized

- F = 24 ➔ UCC = 30 – 9 – 24 = $-3
- T deducted too much CCA, so ITA requires T to include the $3 as "recaptured depreciation" under 13(1)
- Added in computing UCC under B: UCC = 30 – 9 – 24 – (-3) = 0

T disposes of car for $40,000 → $40> $21 – car increased in value

- F = 30 ➔ 30 – 9 – 30 = $-9
- T deducted CCA when it wasn't justified but had a realized gain of 10
- Taxes CCA as recaptured depreciation (B = -9) and taxes gain as taxable capital gain (1/2 x 10 = 5)
- UCC = 30 – 9 – 30 + 9 = 0

Example: Have 2 cars – each $30,000, sells one but keeps the other (ignore half year rule in 1100(2))

After acquiring each car, T may add capital cost of each car to UCC of class (A) → UCC = 2 x 30 = 60

- Under s. 20(1)(a) and 1100(1) of Reg, deduct 30% of UCC of class at end of year which it was acquire:
  - 30% of $60 = $18,000 = E (amount T can deduct)
  - UCC = A – E = 60 – 18 = $42

Assume T disposes **one** car (but keeps the other one)

Sells car $15,000 (F = $15) → UCC = A – E – F = 60 – 18 – 15 = $27

- Since T still owns the other car there is no terminal loss – the $6 that would have been terminal loss is deferred and deductible as CCA or terminal loss in later years

Sells car $24,000 (F = $24) → UCC = A – E – F = 60 – 18 – 24 = 18

- UCC of class positive, disposition doesn't result in recaptured depreciation under 13(1)
- The $3 recaptured depreciation that would have resulted if T only had one car is deferred in form of lower depreciation in subsequent years

Sells car for $40,000 (F = $30) UCC = A – E – F = 60 – 18 – 30 = 12

- UCC positive so recpatured depreciation under s. 13(1) deferred
- Dispositions that are capital gain ($10) are taxed as capital gain

Now sell other car

Sell other car for $15,000: proceeds subtracted in computing UCC under F

- UCC = A – E – F = $27 - 15 = $12 → since UCC positive and T owns no more assets of class, $12,000 deducted as terminal loss under s. 20(16) – amount deducted under E when computing UCC as total depreciation
- UCC = 0

Sell other car for $24,000: subtracted under F

- UCC = 18 – 24 = -6 → UCC negative, T include 6 as recapture depreciation under s. 13(1) so B = -6
- UCC = 0

Sell car for $40,000:

- UCC = 12 – 30 = -18 → negative balance is recapture depreciation under s. 13(1) → (B)
- UCC = 10
- Tax the capital gain of ½ x 10 = 5

Terminal loss and recaptured gain turns on disposition of the property

S. 248(1): "Disposition of Property"

Includes any transaction or event entitling T to proceeds of disposition of the property

Disposed of property when given up all incidents of ownership (**user, possession, and risk**) even if retain legal title (***Olympia & York Development***)

S. 13(21): "Proceeds of Disposition"

- (a) **sale price** of property that has been sold,
- **(b) compensation** for property unlawfully taken,
- (c) compensation for property destroyed and any amount payable under a policy of insurance in respect of loss or destruction of property,
- (d) compensation for property taken under statutory authority or the sale price of property sold to a person by whom notice of an intention to take it under statutory authority was given,
- (e) compensation property injuriously affected, whether lawfully or unlawfully or under statutory authority
- (f) compensation for property damaged and any amount payable under a policy of insurance in respect of damage to property, except to the extent that the compensation or amount, as the case may be, has within a reasonable time after the damage been expended on repairing the damage,
- (g) an amount by which the liability of a taxpayer to a mortgagee or hypothecary creditor is reduced as a result of the sale of mortgaged or hypothecated property under a provision of the mortgage or hypothec, plus any amount received by the taxpayer out of the proceeds of the sale, and
- (h) any amount included b/c of section 79 in computing a T's proceeds of disposition of the property;

S. 13(4):

Where T gets compensation under (b), (c), (d) that used to acquire "**replacement property**" within a specified period of time, s. 13(4) reduces amount proceeds must be subtracted in computing the UCC of class by the less of proceeds otherwise determine and amount used acquire replacement property

- Eliminates tax consequences that would otherwise result from the disposition

S. 13(4.1) – property is "**replacement of the former property**" where:

- (a) reasonable to conclude that the property was acquired by the taxpayer to replace the former property
- (a.1) and it was acquired by T and used by T for a use that is the same as or similar to the use to which T put the former property

Hewlett Packard (Canada) v Canada (2004) FCA: **Point in time made disposition**

Facts: H provided new cars to employees. To maximize CCA deductions, H acquired new Ford vehicles before end of financial year and disposed of previous year's models shortly after financial year end. H claimed entitled to 2 years of CCA with respect to the vehicles, despite just having them over a year. Minister reassessed and refused CCA deduction for previous year's cars on basis been change of use of vehicles before end of year

Court: Parl ensured time disposition corresponds w time acquisition – essential proper operation of Act. Problem with allowing Minister's assessment is that there would be a period of time that no one would own the car

S. 13(7)(g): Specific Rule – Luxury Vehicles
Where cost T of passenger vehicle exceeds prescribed amount, capital cost to T is deemed to be prescribed amount (prescribed amount is in **Reg 7307(1)** = $30,000)

- Spend any amount more than $30,000 on a passenger vehicle then limited to $30,000

Rental Properties – owned by T principally for purpose gaining or producing revenue by rent
1100(11) – prevents T's CCA deductions to create or increase rental losses to shelter income

- **1100(14)** – defines **rental property** as: (a) building owned by T or (b) leasehold interest in real property
- When determining if negative CCA look pool of the rental properties – don't look at individual properties
- Compute income from all your rental properties and then deduct CCA up to the amount by which your income from rental properties (without CCA) exceeds lost from rental properties (not including CCA)

1100(15) – prevent T using CCA deductions to create or increase losses from rental of leasing property

- **1100(17)** defines **leasing property** as depreciable property other than rental property or certified film feature or production that is owned by T and used by T principally for the purpose of gaining or producing gross revenue that is rent, royalty, or leasing revenue

Depreciable Property Categorized Separate Classes

If say each property is separate class for purpose of CCA then get recapture and terminal loss when sell asset

- Triggers recapture and terminal loss for certain assets

Reg 1101(1ac) – separate class prescribed each rental property (defined 1100(14)) w a capital cost $50K or more

- Impossible avoid recognition recaptured depreciation on disposition proceeds exceeding UCC of property

Reg 1101(5p) & (5q) – allow T who acquired rapidly depreciating electronic equipment as specified to elect treat each such depreciable property as separate class

- Making T eligible for terminal loss on disposition

Reg 1103(2g) – where property held 5 years, property required to be transferred back to class in which it would have been included but for the election

Reg 1101(1)(ag): Luxury Vehicles
Dispose luxury vehicle, cost of which capped at $30K then that will also be treated as a separate class

CAPITAL GAINS AND ALLOWABLE CAPITAL LOSSES: INTRO

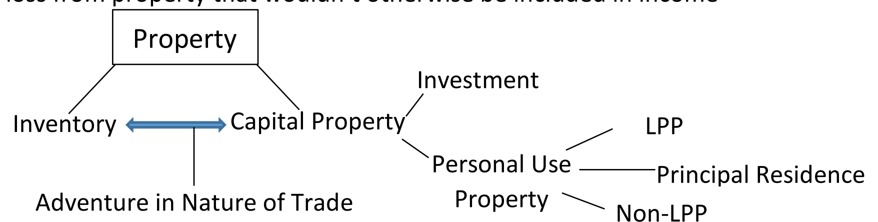
S. 3(b): **Net taxable capital gains** included in income (= capital gains – capital losses)
(i) T's "taxable capital gains" for tax yr (other gains disposition LPP) + T's taxable net gain from dispositions of LPP
(ii) – subtract T's allowable capital losses for the year
Capital losses generally deductible only against capital gains under 3(b)

Capital Gains = Proceeds received from disposition – (cost property + expenses selling property)
Capital Loss: Sum of cost + expense of selling > proceeds

S. 38: "**taxable**" portion capital gain & "**allowable**" portion capital or business investment loss
= ½ amount of gain or loss

S. 41: "**taxable**" net gain from disposition of LPP **= ½ taxpayers net gain** from dispositions of LPP

S. 39: Definition "Capital Gain" & "Capital Loss":
Capital gain & loss are **residual** – gain or loss from property that wouldn't otherwise be included in income



Characterization Capital Gain & Loss

Inventory vs. Capital Property

Characterization based primarily on the type of income property produces (*Friesen (1995) SCC*)

Capital Property – property if gain/loss from disposition of property is characterized capital gain/loss

- Capital property used for investment or personal purposes (investment depreciable or non-depreciable)
- Personal use property is subset of capital property – no losses recognized but recognizes gains
  - LPP is type personal use property – get tax recognition losses LPP
- Any **depreciable property**
  - Taxable capital gain for depreciable property = ½ (s. 38)
  - No such thing as taxable loss on disposition depreciable property – cost depreciated over time when computing income from business (CCA), don't get capital loss but get terminal loss
- Any property where gain or loss from disposition of which would be a capital gain or capital loss
  - Non-depreciable property can have capital gain or loss

Inventory – property if gain/loss characterized as income from a business
Characterize gain/loss from business where property disposed of in course of business or pursuant to adventure or concern in nature of trade

- If dispose of property for adventure in nature of trade then inventory or if carrying on business of trading then inventory → fully taxable business income

Taylor: **2 positive test:**

- 1. **Nature/quantity** of the subject matter
- 2. **Manner of dealing** – Does T deal with property in the same way a trader would?

Subsequent cases say **intention** is relevant factor – subjective evidence of intent

- Adventure – T is buying property primarily to sell it
- Capital Investment – T is buying the property primarily to hold on to it?

Real or Immovable Property

Real Property – land and anything growing on, attached to, or erected on it, excluding anything that may be severed without injury to the land

Regal Heights v MNR (1960) SCC: **Secondary Intent Doctrine**

Facts	T company acquired property large shopping center - $70K for 40 acres. Bought land across road ($14.5K), bought property for advertising ($4K) – total cost $88.7K. Have sketches what mall look like, list prospective tenants, favourable opinions rezoning, talk bank about financing. Found out couldn't establish mall b/c department store going to open 20 blocks way. Sold all land for a huge gain – got about $251.7K (gain = 251.7 – 88.7 = $135K). Revenue Authority argues fully taxable – business buying & selling land. T says non-depreciable capital property purpose of running the mall.
Issue	Was T's profit from sale of property derived from adventure in nature of trade?
Analysis	T knew land was going to increase in value – had intent to profit from land but wasn't their primary intent - primary intent was to establish the mall – secondary intent if negotiations with department store didn't work out to sell land for profit
Dissent	T always have a secondary intent to sell land and make on it • Sale of land was realization of capital assets
Holding	Adventure in nature of trade – profit fully taxable as business income
Ratio	***Even if not T primary intent to buy and sell land at profit, if that is secondary intention then adventure in nature of trade***

Secondary intent doctrine is really a motivating doctrine → "but for" test

Would T have bought the property, but for, the possibility of re-selling it at a profit?

- If sale of property for profit motivating intent then that is secondary intent - enough to suggest inventory
- "secondary intent" doctrine" – possibility of resale at profit as motivating reason for T's decision to acquire the property (*Morev Investments*, *DeSalaberry Realties*)
- Fact person buying property with aim using it as capital could be induced to sell if sufficiently high price were offered, not sufficient to change acquisition of capital into adventure in the nature of trade - *Raccine*

Hiwako Investments - Where subject purchase and resale active profit producing property, more difficult to conceive it having acquired both as an investment and speculation in sense of an adventure in nature of trade

Factors to look at to determine if dealing with real property same as trader:

- **Buy low sell high**
- **Holding period** – trader's don't hold period for long
- **Frequency Transactions** – might suggest have ordinary trading business or might sell a few times that not frequent enough to be "in the business" but acting like ordinary trader
- **Borrowing a lot of money** - suggest buying land for the purpose of re-sell
- **Looking purchasers** – when buy property, does T immediately find ppl to sell it to, or does T get an unsolicited offer? (unsolicited offer – capital property; finding purchasers – inventory)

Happy Valley Farms v MNR (1986) FCTD: **Looked at T's history of similar transactions**

Court didn't accept that T acquired land for use as hobby farmer b/c it had subdivided and sold lots of 17 previous occasions – presumption dealing in respect of property

H Fine & Sons v Canada (1984) FCTD: **considered length of time T held property**

Gain on vacant land characterized as capital gain – T acquired property for purpose of eventual business expansion and held the property for 10 years

- Vacant land rule isn't absolute rule, can be rebutted by other factors

Gratl v Canada (1993) TCC aff'd FCA: **short holding period = inventory**

Facts: T acquired property and sold it 2 months later

Holding: Inventory - court says this is speculative adventure in land – short holding period

Courts distinguish b/w **sale vacant land** and **sales of land w building** – goes to nature of subject matter

- **Generally – sell vacant land then it is inventory – adventure in nature of trade**
  - ***Lawee*** – gain on farmland acquired b T and sold 9 years later to development was characterized as capital – T invested in land to restore his wealth
  - ***Montford Lake*** – gain on sale of land originally acquired by principal shareholders to build summer cottage and held benefit of their children was characterized as capital gains – property acquired for personal use, not resale, and was sold in response to unsolicited offer
- Sell land w building on it then buy property so earn profit b/c can rent it out – capital property

Corporate Shares

Corporate Shares – fractional interests in ownership of issuing corporation

- Held for purpose of receiving regular flow of income or for purpose resale at a profit or both

Irrigational Industries v MNR (1962) SCC: **presumption corporate shares are capital**

Facts	T bought shares in company "Brunswick" – purchased 4,000 shares for $10/share. T sold 2,400 of shares for $38,513 and remaining 1,600 for $28,000. T realized total profit of $26,897 from purchase and sale of these shares. T had no dealings with securities other than purchase and sale of 4,000 shares of Brunswick. Brunswick held mining claims in NB – exploration indicated some good deposits (speculative). MNR said buying and selling shares was adventure in nature of trade
Issue	Does the profit constitute taxable income or non-taxable capital gain?
Dissent	**Factors to decide inventory**: • Short holding period – sold within 4 months, suggest adventure; • Borrowed funds to finance purchase of shares; • No immediate likelihood dividends since speculative shares, reflect possibility mineral deposits T not in business trading securities, isolated speculative purchase, no intention retaining as investment would later yield income – intention disposing shares near future at increased price
Majority	Nature of subject matter becomes deciding factor • If buy corporate shares there is **presumption of capital property** • Nature of corporate share is investment Quantity of shares purchased doesn't indicate adventure in nature of trade (4,000/500,000)
Holding	T acquired capital interest in new corporate business venture in manner which has characteristics of making investment – capital property
Ratio	***Presumption with corporate shares that it is an investment – nature of subject matter***
Note	Recognized right away as a bad decision! Major decision that led to taxation of capital gains

Lots of cases after say **intention** matters – can buy & sell shares and have it be adventure in nature trade

Foreign power securities (1967) SCC:

T acquired shares for investment purposes, gains or losses on sale of shares prompted by market conditions or to take advantage of other investment opportunities are characterized as being **capital**

Bossin v Canada (1976) FCTD: **intention test emphasized**

Distinguished from *Irrigation Industries* b/c in Irrigation T acquired sales directly from issuing corporation, rather than secondary market

Canadian Securities s. 39(4)-(6)

T, when they sell Canadian Securities, can file election that says want gain recognized as a capital gain – consequence election is that disposition **all** Canadian securities of T have be characterized capital gain

S. 39(4): Election Disposition CA Securities

*Except as provided in (5), where CA security has been disposed of by a T in a tax year and the T so **elects** in prescribed form in the T's return of income for that year,*

- *(a) every CA security owned by T in that year or any subsequent taxation year shall be **deemed** to have been a **capital property** owned by T in those years; and*
- *(b) every disposition by T of any such CA security shall be deemed to be disposition by T of capital property.*

Allows T to elect to have gains or losses treated as inventory or capital property, once make election it is forever – all Canadian securities treated that way when disposed of (subject to s. 29(5))

Effect ➔ allow adventurer's to get capital gains treatment

S. 39(5): Exception to (4)

(5) Election under 39(4) does not apply to disposition of CA security by T who at time of disposition is:

- *(a) a **trader or dealer** in securities,*
- *(b) a **financial institution***
- *(f) a **corporation** whose principal business is lending of money or purchasing of debt obligations or a combo, or*
- *(g) a non-resident,*

or any combination thereof.

S. 39(6): Definition "Canadian Security" = share

means a security (other than prescribed security) that is share of capital stock of a corp resident in CA, a unit of a mutual fund trust or a bond, debenture, bill, note, mortgage, hypothecary claim or similar obligation issued by person resident in CA.

- Trying to encourage investment in CA enterprises

Reg 6200: "Prescribed Security"

Real property and non-arm's length transactions

Private companies, value of which derives primarily from real property is not CA security

- **Reason**: don't want ppl incorporating real estate, sale would have been taxable as business income

***Vancouver Art Metal Works v Canada (1993) FCA:* Leading cases – meaning "trader or dealer" in 39(5)**

Facts	Q of law put to FCA: does Trader or dealer mean: someone who trades on their own account, in ordering trading business OR someone who is in regulated industry – registered/licensed?
Van Art arguments	"Trader or dealer" meaning someone registered/licensed: • Parl intended clear line – if means anyone who trades and deals on own account then not a clear line and will get lots of litigation about whether someone is trader/dealer or adventure • Association of words – financial institution in 39(5) has definition that suggests trader or dealer would need to be regulated
Analysis	Nothing says trader/dealer has to be read in same way as other things listed in s. 39(5) Just says "trader or dealer" – doesn't say registered or licensed, if wanted licensed then would have put it (put licensed in (c)) – since put licensed in (c), then suggest didn't want it in (a)
Ratio	***Words "trader or dealer" in securities in s. 39(5)(a) are broad enough to include anyone other than a person engaged in an adventure or concern in the nature of trade***
Note	Going think **frequency** – trader buys & sells a lot, but adventurer doesn't buy and sell that much • If trader means frequency effect of rule is to say that if you are adventurer then can elect capital gains treatment, but if do it a lot then can't elect and it has to be inventory

Recent case law w ppl trading shares on internet – are day traders in business buying and selling shares?

Leng v Canada (2007) TCC: **17 times in 3 year – not trader**
Facts: T, a prof, bought & sold shares on internet, incurred losses which he sought to deduct as business loses.
Holding: Capital losses - since T only had 17 transactions from 2000-2002 and had no specialized knowledge of shares he was acquiring – characterized losses as capital losses

- Found T was not a trader in securities – was not carrying on a business

Note: T wouldn't want to claim election in s. 39(4) b/c he had losses

Zsebok v Canada (2012) TCC: **Adventurer but not trader**
Facts: T claimed business losses from online share trading activities – minister characterized losses as capital.
Holding: T was an adventurer – not enough to be a trader (imply trader is every day)

- T was not a trader – no special knowledge of market in which he trades
- Adventure in nature of trade, reasons:
  - Type of shares T acquired (generally not "blue-chip" dividend shares)
  - Frequency of transactions he engaged – 20 to 50 trades/yr
  - Short period of time he held the shares – averaged 60 days

Note: Since adventurer, and not trader, if he had gains he could file election and get capital gains

Not clear line b/w adventurer & trader – Q of fact whether T's activities amount to carrying on business

For trader - **frequency** is key and length of holding is something to consider, time spent on the activity (***Vancouver Art metal works***)

Gains from isolated transactions in shares are income from business within ordinary meaning of the word (*Robertson*)

Kane v Canada (1994) FCTD: **dealers have special knowledge of market**
Facts: T was shareholder, director & president of company and bought and sold shares of other companies like his
Holding: T had special knowledge which made him a dealer, even though infrequent

COMPUTATION CAPITAL GAINS & CAPITAL LOSSES

Typically gains are **realized** from capital property when **dispose** of the property

S. 40(1): General Computation Rule

(a): Gain = proceeds – [adjusted cost based + transaction cost]

- Reserve allows T to spread a gain over # of years when don't get all proceeds in 1 year, subject to limit
- (i) deals with if property disposed of in the year; and (ii) is if property was disposed of before the year
- (iii) allows for **reserves**: Gains can be spread out over period of time
    - Reserve is lesser of:
        - (C) reasonable amount = $\frac{capital\ gain\ x\ amount\ payable\ after\ end\ of\ year}{total\ proceeds\ disposition}$ and
        - (D) 1/5 included over 5 years (year 1 80%, year 2, 60% ….)

(b): Loss = [Adjusted cost based + transaction cost] – proceeds

- No reserve for loss – just take full loss for year

Dispositions Capital Property

S. 248(1): "**Disposition**" of any property **includes** any transaction, or event entitling a T to proceeds of disposition of the property

S. 54: "Proceeds of Disposition" includes: (a) Sale price of property that has been sold

S. 54: "**Adjusted Cost Base**"

Means, except as otherwise provided,

- *(a) where property is depreciable property of T, the **capital cost to T** of the property as of that time, and*
    - *If you dispose of depreciable property for greater than capital cost then taxable capital gain*
- *(b) in any other case, cost to T of the property adjusted, as of that time, in accordance with section 53*

Start with ordinary cost of property – buy parcel of land and that is the adjusted cost base, then look to see if it has to be adjusted in some way

- From T perspective an increased cost base is good, decreased ACB bad for T
- **For the most part, adjusted cost base is the cost of the property**

Reserves

Allow for proceeds to be spread out where not receiving all the money in year 1

Example Reserve Calculation:

Have sale of property, proceeds = \$500 and ACB = \$100, under s. 40(1)(a)(i) **Gain = 500 – 100 = 400**. Assume don't get \$500 in year 1, get spread out over 10 years – get 50/year for 10 years

- 40(1)(iii) – allows you to spread gain out over time – won't be taxed for all \$400 upfront
- (C): Reasonable reserve = proceeds payable after end of year = 450
    - Reserve $=\frac{capital\ gain\ x\ amount\ payable\ after\ end\ of\ year}{total\ proceeds\ disposition}$
    - 450/500 x 400 = 360 ➔ Net inclusion in year 1 is 40: 400-360
    - 400 – 360 = 40 →Include 40 in each year

(ii) If property was disposed of before the year – in year 2 but disposed in year 1

- Again deduct reasonable portion in respect of the proceeds payable at the end of the year
- Reserve = $\frac{400\ x\ 400}{500}$ = 320
    - 360 – 230 = 40 → spread gain out over entire period, \$40 a year
    - 320 – include in year 2 360 but subtract 320 = 40
    - Spreads out gain over the entire period

Limit on this is **40(1)(a)(iii)(D)** – can only do this over 5 years and at least have to take 1/5 of the gain

Year 1 – reserve 360, so include 40 b/c spread over 10 years but subject to **D**

- 1/5 of 400 gain = 80
- In year dispose of property, the number of years preceding the years of disposition is 0 so it's multiplication of 80 x 4 = 320 ➔ So limit in D is 320
- And had 400-320 = 80 → higher than 40 that otherwise would have been included

PERSONAL USE PROPERTY (PUP)

S. 54: “**Personal-use Property**” includes
(a) property owned by T that is used primarily for personal use or enjoyment of T

Where T uses property mainly for personal use/enjoyment and subsequently disposes of property for proceeds less than original cost – **loss is generally attributable to T’s personal use of the property**

S. 40(2)(g)(iii): Loss from Disposition PUP = 0
T’s loss from disposition of property to extent it is a loss from disposition of any person-use property of T is nil

Capital gains from disposition PUP are recognized but generally capital losses from PUP are 0

S. 46: Personal Use Property
(1) Deems ACB and proceeds of disposition of PUP to be greater of **$1,000** or amount otherwise determined

- Simplify tax administration - If you buy anything for less than $1,000 then don’t have to keep record, if it goes up in value then just say cost was $1000
- Exempts capital gains of most kinds of PUP less than $1,000
- Eliminates need for recordkeeping on cost of personal-use property acquired for less than $1000

(3) Property ordinarily disposed of in “set”
Where T disposes of number of personal-use properties that would ordina**rily be disposed of in a single disposition** as a set to one person or to group of persons who don’t deal at arm’s length, and fmv of set exceeds $1,000, then the set is **deemed to be a single personal-use property**

Listed Personal Property

LPP can go down in value b/c of the market and not b/c T used the property

- Deductions only allowed against gains

S. 54: “Listed Personal Property” of a T means
the T’s personal-use property that is all or any portion of, or any interest in or right to any

- (a) print, etching, drawing, painting, sculpture, or other similar work of art; (b) jewellery; (c) rare folio, rare manuscript, or rare book; (d) stamp, or (e) coin;

S. 3(b): segregates LPP from capital gains

S 41: Taxable Net Gain Disposition LPP
(1) T’s taxable net gain for tax year from dispositions of LPP is **½ of amount** under (2) to be T’s net gain for year from disposition of such property
(2) T’s net gain for tax year from disposition of LPP is amount by which total of T’s gains for year from disposition exceeds total T’s losses for year from disposition LPP
   - **(a) Net = gains – losses**

(3) If **losses > gains** then have LPP loss → carried over to other years

S. 41(2)(b): Carryovers Losses
In yr in, can carry forward losses from 7 tax years immediately preceding and 3 tax years immediately following

- 10 year period where you have LPP losses that can carryover

** PRINCIPAL RESIDENCE

Has to be capital property in order to get this – personal use property

S. 40(2)(g)(iii): loss deemed to be 0 for PUP

S. 40(2)(b): Principal Residence Exemption

All gains on sale of principle residence are exempt from tax

- Only individuals can own a principal residence

Gain Principal Residence = A – (A x B/C)

A = Taxpayer Gain

B/C = choose over # years own principal residence to call it your principal residence

B = 1 + yrs property is T's principal residence

- In yrs buy property and sell another – so in that 1 year you have 2 principal residences → still allows you exempt whole gain

C = # of years property owned by T

S. 54: "Principal Residence"

Housing unit owned by the T, if:

(a) T is an individual then housing unit ordinarily inhabited in year by the T, the T's spouse or common-law partner, or former spouse or common law partner, or child of T

(c) where T individual, unless particular property designated by T in prescribed form and manner to be T's principle residence for yr and no other property has been **designated** for purpose of this definition for yr

- After 1981 if under 18 then can't have designation principal residence if mother or father does (1 per fam)

(e): Principle residence **deemed** include land subjacent housing unit and such portion any immediately contiguous land can reasonably regarded contributing use and enjoyment housing unit as residence **EXCEPT** where total area subjacent land exceeds ½ hectare, excess shall be deemed not have contributed use and enjoyment housing unit as residence unless T established was necessary to such use and enjoyment

- Up to ½ hectare say part of principal residence – **reasonably contributing** use and enjoyment
- If have more than ½ hectare then have to establish not just reasonably regarded as contributing to use and enjoyment, has to be **necessary** to use and enjoy residence

If have gain T will say capital property and principal residence (exempt from tax); if loss T will say this was business/adventure and trying to sell at profit so can deduct whole amount

- If loss then trying to avoid personal use property b/c s. 40(2)(g)(iii) deems the loss to be 0

Has to be (1) capital, (2) T ordinarily inhabit; (3) use & enjoy/necessary surrounding land

CAPITAL

Burnett v Canada (1995) TCC: **T's speculative intent**

Facts	T lived house West Van then moved North Van. 1979 - T wanted benefit real estate boom – tore down house West Van and built bigger house to sell at profit. Things go wrong – real estate prices decline significantly. T lists for sale, and offer 715K, but builder says wait. House declines in value, so T and fam move back for period of time. 1985 – rent/sell house, listed $439K – rented property for year. Then fam moves back in - Sell property for $385K. T claims business loss tax return $520K – cost land, building, selling expenses, ect (wants deduct full amount). Minister says T lived there for long time – designed house to specifications - Says PUP, loss disallowed completely
Issue	Was this an adventure in the nature of trade?
Analysis	Initial intent of T was speculative to make money – profit from house • T lived here just from circumstance – doesn't make it principal residence Basically just judgment call of court on whether principal residence or adventure in nature of trade
Holding	T wins – adventure in nature of trade- fully deductible
Ratio	***Look at speculative intent of T to determine if adventure in nature of trade or principal residence***

Down v MNR (1993) TCC:

Facts: T bought and sold b/w 80-100 properties in previous years – sought to deduct loss of $112,818 incurred on sale of house. Acquired house Feb 1982 and lived in it until December 1982.

Holding: Rejected property is PUP

- Court accepted T acquires house for purpose of renovating and reselling as soon as possible

Jason v Canada (1995) TCC: **Secondary Intention**

Facts: T sought to deduct loss incurred on sale of residence acquired by T April 1989 and sold residence Jan 1990.

Holding: Purchase & sale constituted adventure in nature of trade – loss fully deductible in T's net income

- T lived residence 8 months and property acquired with intention of using it as principal residence
- Purchase was 96.5% debt-financed – T had secondary intention not sell for profit at first opportunity

Cayer v Canada (2007) TCC:

Facts	T single mother, not been employed for 23 years. T and former spouse owned construction company that bought and sold homes. After splitting with husband, sold her house, only lived there for 1.5 years. Bought and sold number of houses. Revenue authority says this isn't principal residence – carrying on business buying houses and renovating them – inventory for business.
Analysis	Test from *Happy Valley Farms* – various considerations • 1. **Nature of property** sold (*Taylor)* • 2. **Length of time** property was owned o Deal w property like trader – don't hold on to property for a long time (*Taylor*) • 3. **Frequency** or number of other similar transactions o More transactions do looks like carrying on series adventures – becomes ordinary business • 4. **Amount work or effort** expended on property • 5. **Reason** why property was sold; • 6. **Taxpayer's intention** at time property acquired
Apply	**Nature of property -** Newly developed area • Built or refurbished houses in newly developed area • Did the type of stuff to make the houses look great and then sell the property **Length of time held -** Most part, she didn't hold it that long • Some cases, buy it and list it after a month – suggest not planning on staying there **Number/frequency** transactions - Revenue authority only go after most recent 3 – earlier ones were held longer (one bought sep 27 and listed march 30) • Look at these 3 in light of what she was doing before **Work/effort expended -** in a construction business – essentially she is continuing **Reasons sold property** - assess her credibility – throughout she has a variety of reasons • Ultimately property was sold b/c in a business • Lived in houses period of time b/c allowed her to get out of builders warranty program **Intentions at time property acquired** • Objectives factors suggest wasn't going live in these places for a lengthy period of time • Financed with line of credit - If going to live in home for long time then get mortgage
Holding	T engaged in business of selling residential properties
Ratio	***6 factors to look at to determine if ordinary business/adventure in nature of trade***

Isaaks v Canada (2001) FCA: **selling lots related to existing business**

Facts: T carried on business as home finishing contractor and carpenter, purchased 3 residential lots and constructed home on each lot. Resided in for period ranging 4-13 months before selling residence.

Holding: speed with which T acquired land and build houses and resold them + flimsy excuses given by T for sale, supports inference that transactions in issue were extensions of T's ordinary carpentry business

Relationship b/w sale and T's other activities is factor to look at

Giusti v Canada (2011) TCC: **short duration holding property – intention T**

Facts: T, professional real estate agent and experienced condo owner, argued Van condo he purchased and inhabited for 4 months was his principal residence

Holding: characterized condo as inventory in business

- T held property for short duration and engaged in number other similar real estate transactions
- Convinced on BOP that T purchased the property with view to immediately resale

Vogan v Canada (2004) TCC: **Unsolicited offer – principal residence**

Facts: T purchased residential lot and constructed new house which he moved in in Dec 1995 and sold March 1996. T owned 6 homes b/w 1992 and 1998 and gains from subsequent 2 sales were reported as business income following audit T's activities

Holding: gain exempt from tax – house built to T's personal specifications w/o any thought to what buyer would want – sale prompted by unsolicited offer

ORDINARILY INHABIT HOUSING UNIT

Flanagan v MNR (1989) TCC: **Ordinarily Inhabited Property**

Facts	T bought vacant lot on Shuswap– wanted build on property but denied building permit. Land too low and could flood so couldn't build septic system. Purchased lot across - connected by pipe. Never built on land, lived in rented apartment in Van. Purchased 14ft trailer w sink stove, bed and toilet - Kept it at parents in surrey but took it to lake on weekend. Lived there about 30 days a year. Sold property, and then sold other property. T claims principal residence exemption DD: Doesn't have housing unit on land, Didn't ordinarily inhabit property. If trailer/van is housing unit then that is what you get principal residence on, not on the land
Analysis	Finds trailer is a housing unit – includes land and he ordinarily inhabited it • Housing unit doesn't need to be a building – key word court focuses on is "shelter" • Van and trailer qualify as shelter – has necessities – roof, kitchen, bathroom, etc • CRA says trailer qualifies as housing unit – housing unit is supposed to be connected with land Judge takes pity on T – gives exemption for land (even though trailer and land aren't connected) **Did T ordinarily inhabit the property?** • *Thomson v MNR* – can ordinarily inhabit more than one place at a time • Ordinary for him to go to property whenever he can – not main residence but he ordinarily goes and resides there each year for whatever period of time he can • Broader view of ordinarily **Principal residence available for place that doesn't have to be main residence**
Holding	T is able to claim principal residence for lot
Ratio	***Ordinarily inhabited broad, and housing unit broad, and link b/w housing unit and land is broad***

CRA: following can qualify as housing unit: house, apartment, cottage, mobile home, trailer, or houseboat

Rebus v Canada (2002) TCC: **Garden shed doesn't qualify as shelter**

Facts: T buys property in North Van – puts garden shed on property, not house – says he sleeps in garden shed every night- No electrical supply, no stove

Holding: Under concept shelter court develops in *Flanagan* → not a housing unit

Ennist v MNR (1985) TCC: **1 night a week is not ordinarily inhabit**

Facts: T buys condo in Van, and moves to Ottawa – moves to Ottawa before condo in Van is built. He was going to live in Van condo but now wants to sell it – gain. He sleeps there 1 night so that he can say he ordinarily inhabit it

Holding: No – ordinarily means more than 1 night

Qualification Surrounding Land

Principal residence deemed include land subjacent to housing unit, and such portion immediately contiguous to land as can be reasonable regarded as contributing to use an enjoyment of the housing unit as a residence, if more ½ hectare then has to be necessary to use and enjoyment

Flanagan (1989) TCC: **Pipe connection is not contiguous**

Facts: T has second property with pipe connected to first property – never parks van on second property, wants to claim principal residence exemption for both

Holding: Property not immediately contiguous property 1 – pipe doesn't make properties immediately contiguous

Canada v Yates (1983) FCA: **Assess use and enjoyment immediately before disposition**

Facts	T bought 10 acres of land and built house on it – at time bought the zoning bylaws said that for this area have to have minimum of 10 acres. Subsequently was increased to 25 acres but got exemption. City wanted to expropriate some property so T sells 9.3 acres to City and keeps 0.7 acres – wants to claim principal residence exemption, part disposition of the property.
Issue	Was disposition of 9.3 acres disposition of principal residence?
Analysis	In order get principal residence exemption on 9.3 acres, have to establish land **necessary** to use and enjoy principal residence as principal residence – only have 0.7 acres left and clearly still enjoying house so didn't need 9.3 acres - responding argument is that they had to have 10 acres Time to assess use and enjoyment is **immediately before disposition**
Holding	Disposition was disposition of principal residence
Ratio	***Time to assess use and enjoyment is immediately before disposition*** ***Rezoning can show necessity for land surrounding house***
Note	Formula in 40(2)(b): A – (A x B/C) • DD: more reasonable to say necessary for use and enjoyment in some years but not others (B/C) – number of years with 10 acre requirement

Cassidy v Canada (2010) FCA: **determine reasonable/necessary year by year**

Facts: T acquired house on 2.43 acres of land which was minimum property size under applicable zoning regulations. Then T was able to have property rezoned and subdivided. /t sold property to developer.

TCC: relying on Yates that relevant time for determining whether land in excess of ½ acre was necessary for use and enjoyment of principal residence is moment of disposition – dismissed argument that exemption should apply to entire 2.43 acres

FCA: assess reasonable or necessary use of land to residence on annual basis

- Allocated based on formula in 40(2)(b) – some years gains could be principal residence and some years not

Rode v MNR (1985) TCC: **objective use/enjoyment test**

Facts: T had 9 acres, but said the like seclusion and like grow own food – so for our purposes that is necessary.

Holding: can't make subjective arguments, has to be objective arguments (like zoning arguments)

Augart v MNR (1993) FCA: **Subdivision Restrictions**

Facts: T acquired home on 8.99 acre land at time when local bylaws required minimum area of 3 acres residence and prohibited subdivision land parcels of less than 10 acres in size. Then minimum area for residence increased to 80 acres, with exemption for existing properties. T sold whole 8.99 acres to City and got substantial capital gain in respect which he claimed principal residence exemption.

Holding: Local restrictions on subdivision of property are as relevant as zoning restrictions on residential lot sizes for determining "use and enjoyment" of housing unit as principal residence

Carlile (1995) FCA:

Facts: T owned 33-acre land – 3 acres around house for personal use and 25 rented to a farmer. Land was rezoned for agricultural purposes – 25 acre minimum

Holding: entire parcel of land eligible for principal residence exemption

Stuart Estate v Canada (2004) FCA: **T's ability to seek amendment and qualify**

Facts: Elderly widow lived in 3.3 acres of land in surrey. Sells it to developer before her death for 1.8 million. Developer wants it rezoned as multifamily residential. Estate makes argument all land was necessary for use and enjoyment of it b/c she didn't have resources to get it rezoned

Holding: T could have sought the change, so not all of it was necessary for use and enjoyment

Use and enjoyment must be linked to physical characteristics of property and not personal abilities of tax payer

RECOGNITION & NON-RECOGNITION RULES

Personal Use ➔ Income producing (s. 45(1)(a)(i) & 13(7)(b)) → election under s. 45(2)

Income Producing ➔ Personal Use (s. 45(1)(a)(ii) & 13(7)(a)) → election s. 45(3) for principle residence

Act has rules contemplate changes in use – **deem T have disposed property at fmv and reacquired property at fmv**

- Deemed dispositions – change timing of the recognition of a gain or loss by **artificial transaction**

Income producing could be inventory or income producing capital

S: 45(1): Property more one use - *Where T*

- *(i) acquired property for some other purpose, has commenced later time to use it for purpose gaining or producing income, or (*Other purpose → income gaining purpose)
- *(ii) acquired property purpose of gaining or producing income, commenced at a later time to use for some other purpose (*Income gaining purpose → other purpose)

T deemed to have

- *(iii) disposed of it at later time for proceeds equal to fmv at later time, and*
- *(iv) immediately thereafter reacquired it at cost equal to that fmv*

S. 13(7) contains similar provision to s. 45(1) but for **depreciable property**

(a) Acquire property for purpose producing income and then start using for personal use then deemed to dispose of it at equal to fmv and immediately acquire it at fmv

- Producing income → other purpose

(b) T acquired property for some other purpose (non-income producing purpose) has begun to use it for purpose of producing income, T deemed to acquire it at later time to acquire it at fmv

- Other purpose → producing income purpose

Just need to know capital cost of property is the **fmv** and **time the change of use** has happened

S. 45(2) & (3): Exception Changes in Use → Elections

(2) Used property personal use, started use it for non-personal use, elect not have disposition occur

- **Personal Use → non-personal use**
- Elect to say not using property for income producing purposes, no deemed dispositions
- Consequence – if subsequent loss, then still regarded as PUP (s. 40(2)(g)(iii) losses PUP = 0)

(3) Acquired property for purpose of gaining or producing income and then becomes principal residence

- **Income Producing Purpose → Principal Residence**
- T can elect to not have deemed disposition property and immediately acquiring it after
- Ex. Have house go up in value – if deemed disposition then will cost lots of money, don't want to discourage ppl moving into houses they own so elect to not have rules apply
- **Consequence**: becomes principle residence so if you dispose then you designate some years and principal residence and some years not – deduct some gains
- BUT under **45(4),** election is not allowed if T has claimed CCA on residence in any year after 1984

S. 54(b) & (d): Election Principal Residence

(b) *Where T is individual, T*

- *(i) elected under s. 45(2) relates to the change in use of particular property in year or preceding tax year, other than election rescinded under s. 45(2) in T's return of income for year or preceding tax year, or*
- *(ii) elected under s. 45(3) that relates to a change in use of particular property in subsequent tax year*

Except that a particular property shall be considered not to be a T's principal residence for tax year.

Where T is individual, and T elected under 45(2) then can **still call principle residence** (i); or elected under 45(3) – elected in subsequent tax year (ii)
(d) Elected subsequent call it principle residence for **4 years**

Inventory ↔ Capital Property
Rules don't contemplate change property from inventory to capital property or vice versa

- Revenue Authority have said **notional disposition** – when change inventory to income producing capital (or vice versa) then wait till dispose property an some portion treat inventory until changes use to capital property (or vice versa)
- Once ultimately sell allocate gain or loss b/c inventory portion and capital portion

Example:
Acquire apartment for $100 (capital), convert to condo's (worth $500) and sell $1000 → CRA says not going to tax

- When tax some part are capital and some part business
- $400 capital gain – ½ tax so $200 and $500 business gain so get taxed on $700

Duthie Estate v Canada (1995) FCTD: **Personal Use → income producing**

Facts	T owned property – principle residence. Early 1980's decides he should develop property and put condos on it. Hires projects manager, gets drawings drawn up. Decides go ahead –gets letter from manager that market is turning and should put project on hold. T keeps project alive by making sure zoning doesn't change. Deduct project expenses relating to project. T dies in plane crash in 1984 → when die property deemed disposed of. Estate says that there was a change of use in the property in 1981 – no longer personal. Value property decreased, and claim business loss $446K
Analysis	Arguments form Minister for why wasn't change of use in 1981 – • Estoppel – didn't report change of use → fails b/c Minister was informed • T doing preliminary phrase – T hasn't started business so hasn't changed use of property ○ Court says there has been enough activity – spent $40K
Holding	There was change of use property from personal residence to business – get deduction
Ratio	***If T takes actions in advance that might be sufficient to constitute change in use***

Menzies v MNR (1990) TCC: **Personal → renting → personal**
Facts: T owned house which intended sell when moved new residence, but decided to rent it out when real estate market declined. The T moved back to property – sought to deduct allowable capital loss on land and terminal loss on building on grounds that property was subject to deemed disposition under 45(1)(a)(i) and 13(7)(b) when rented property and deemed disposition under s. 45(1)(a)(ii) and 13(7)(a) when returned property year later.
Holding: T not commenced use property for purpose gaining or producing income when decided to rent it out – disallowed deduction
Short period of income producing didn't change the use of the property

Can look at when subdivision applied for to determine when change use happened
Dawd (1981) TRB:
Facts: T, purchased 6 acres land in 1967 with intention of building home for himself, obtained engineering study of the property in 1972 for purpose of developing land. Approval of draft plan of subdivision in 1973, sold land in 1976
Holding: T commenced series operations indistinguishable those of a person carrying on business of land developer Conduct by T long in advance of actual registration of subdivision plan may be sufficient to establish a date/time at which commitment to change use can be determined for property (*Jones*)

GENERAL COMPUTATION RULES

S. 67: Reasonable
Can't deduct amount except to extent it is reasonable in the circumstances

S. 68: Specific Anti-Avoidance Rule
Regardless of form or legal effect

S. 69(1): Non-arm Length Transfers
Designed to deal with income splitting b/w related persons

Section 68

Ben's Limited v MNR (1955):
Bakery bought buildings beside them and tore down the buildings and deducted CCA on the buildings. Paid $42K for land and buildings, tore down buildings and allocated $39K to buildings and deducted $3500 CCA

When buy business you get:

- Land
- Buildings (low CCA) – 5-10%
- Vehicles (higher CCA) – 30%
- Inventory – fully deductible when sell

Purchaser wants to get most tax deduction possible- put most of purchase price in inventory and least in land
Vendor do opposite – want to land, or claim CCA on building and vehicles

Typically purchase assets (buying business), incentives reversed → purchaser wants inventory, vendor wants land

- Not always - claimed no CCA on buildings or vehicles – if allocate vehicles then amount above originally capital cost will be capital gain (same as land), but purchaser still wants it in vehicles over land

S. 68 puts limits T's abilities allocate b/w property – can't just put whatever you want as part of the purchase price

S. 68(a): "**Reasonably be regarded**" as amount received
Allows revenue authority, to reallocate consideration from global proceeds among diff elements property

- If not reasonable to allocate amount to vehicles, then can deem the amount to be something else
- Effects proceeds of disposition for person who sold property, and person who gets property

Golden v Canada (1983) FCA aff'd SCC: **Lots of deference to the K**

Facts	T owned apartment building in Edmonton. Approached by S - wants to buy it all from T (land, building, vehicles) → Agreement negotiate for 5.85 million → change allocation (5.1 for land, Remainder 750K to building and vehicles). Vendor avoided lots of recaptured depreciation. Revenue authority says s. 68 applies.
Issue	Is it reasonable to regard part of consideration as being for some other property irrespective form or legal effect of agreement?

TCC	Factors court will look at to determine if reasonable to allocate some of consideration:
	• Fair market value – class definition fmv highest amount vendor willing purchaser
	    ○ Non-arm's length transaction but they are clearly operating together
	    ○ 5.1 for land is not fmv – fmv for land closer to 2.3 million, unreasonable to allocate 5.1 for land, move extra to building

FCA	Fmv is not the sole guide, Act doesn't say "fmv" it says "consideration" → lots of deference to K • S wanted to develop land so reasonable to pay that much for the land – S is going to tear down buildings and not unreasonable for S to pay 5.1 for the land
Ratio	***2 primary considerations: deference to contract, but look at fmv***

Fmv plays role, but deference to K, but if turns out that didn't negotiate over allocation then courts less willing to defer to K, also less willing to defer to K if amounts very far off from fmv

Transalta Corp (2012) FCA:
Facts: T sold regulated electricity transmission business in AB for negotiated price 1.31x net regulated book value of tangible assets -$190 million extra - allocated for goodwill. Minister reallocated the $190 million to tangible assets.
Holding: allowed T's appeal – efficient management by T & potential new business opportunities viewed as goodwill

- Fact parties agreed to allocation doesn't trump reasonableness test under s. 68
- Test: would a reasonable business person, w business considerations in mind, would have made the allocation

Peterson v MNR (1988) TCC: **Goodwill of Business – appraisal reports**
Facts: T sold daycare centre – allocated $45K to goodwill of the business
Holding: Appraisal reports say there is no goodwill in business – $45K was unreasonable

- No basis to allocate anything to the goodwill of the business

H Baur Investments v MNR (1987) FCTD: **T invoking s. 68 – less sympathetic**
Facts: T sold land and building for 3 million, T is vendor and wants less towards building
Holding: Court is less sympathetic – T agreed to K, and if they change it then it effects the vendor also

Leonard v Canada (1990) TCC: **T successfully relies s. 68 to change K**
Facts: T are farmers and buy a farm with livestock and milk quota – milk quota is depreciable and can depreciate over time. T's want to depreciate at something closer to fmv
Holding: Allow T re-write K on basis **significant diff b/w fmv & contractual value** AND there was no real discussion about apportionment - T kind of signed under pressure

T selling land and buildings, and purchaser is going to tear down the building
MNR v Steen Realty (1964) SCC:
Facts: Agreed amount, but T says nothing should be allocated to building b/c purchaser going to tear it down
Holding: Court agrees – no value to building
Stanely v MNR (1972) SCC **Have to look at vendor and purchaser**
Facts: Building expropriated by Van school board, and then tore it down, T says that clearly building had no value
SCC: have to look at it from both sides
Canada v Malloney Studio (1979) SCC:
Facts: T owned and operated restaurant next to hospital.
Holding: Able to say getting terminal loss of building when tear it down and then get the gain