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PLEASE NOTE THAT BLACK INDICATES NOTES FROM THE READINGS, AND RED INDICATES SUPPLEMANTARY NOTES FROM LECTURE

# Part 1: Introduction

1. Public finance economics talk about 3 economic functions of the state to justify taxation
	* Allocation of resources
		+ Public goods or services
		+ Based on demand
	* Distribution
		+ Even out the market forces
	* Stabilization
2. Most income taxes were introduced in times of war
	* The original income tax act in Canada was the Income War Tax Act
3. In order to have a tax we must have:
	* Tax rates
		+ See s 117
		+ For individuals 117(2)
			- We have 4 brackets
	* Tax base
		+ Taxable income
	* Tax unit
		+ Every person resident in Canada at any time in the year (an individual)
	* Accounting period
		+ Taxation year
	* Tax credits
		+ Personal credits exempt some money from tax
		+ Disability
		+ Medical expenses
		+ Tuition and education
			- Incentive credits, mostly for busines
4. A deduction is worth more to a higher income earner than a lower income earner
	* Credits are a fairer system
	* A deduction is an upside down equity
	* We use credits now rather than deductions
5. Taxable income = income +/- deductions in division C; see s 2(2)
6. Section 3 defines income
	* Income from source includes
		+ Wages of labour
		+ Profits of stock
		+ Income from property (interest rent)
	* Capital gains not included in income
		+ If owner of building, apartment building is source, rent is income
		+ If property increases in value, this is a capital gain upon disposition
	* Gifts and inheritances not included in income
		+ Looks like income, but not income from a source
			- Not taxable under an income tax act
			- But taxable under other statutes
* Act has special provisions for stamps and coins
* Para 3c
	+ We already know that income = income from sources, plus net taxable capital gains
	+ This para adds another provision
		- Add (a) + (b) and subtract the other stuff listed in subdivision (e) (60-66)
		- This gives us a net amount
		- Examples of subdivision e deductions considered in course are deductions for moving expenses in s 62, and deduction for child care expenses in s 63
* Para 3d
	+ Circumstances where expenses you are deducting exceed revenue (losses)
		- Act allows you to offset the losses
	+ Paragraph (d) provides for the deduction of losses from each of the four sources identified in paragraph (a) as well as allowable business investment losses
* In general, section 3 requires taxpayers to add together income from all sources [paragraph (a)] as well as what can be called net taxable capital gains [paragraph (b)], from which they may then subtract subdivision e deductions [paragraph (c)] and specified losses [paragraph (d)]. A more detailed explanation of each paragraph follows.
* For present purposes, the most important feature of paragraph (b): allowable capital losses generally deductible only against taxable capital gains, rather than other kinds of income.



# Introduction to Statutory Interpretation

## III. INTERPRETIVE DOCTRINES

* Canadian courts traditionally adopted a strict approach: statutory language was construed literally and ambiguities in taxing provision were resolved in the TP’s favour

### A. Strict Construction

* Strict construction required the courts to adhere to the letter of the law reflected in the words of the statute, notwithstanding spirit of law nor consequences of the court’s interpretation

#### MNR v McInnes (1954: Ex Ct)

* Parliament should express its intention in clear terms
* Since s 32(2) did not expressly extent liability, the TP is not liable
* Courts apply strict construction, interpret act narrowly
	+ Ambiguity in favour of TP

##### Notes

* Implications of strict construction rule:
	+ The stricter the construction of the statutory language, the more need for detailed specific provisions, the greater the likelihood of creating a hopefully complex unmanageable labyrinth
* Strict approach formally rejected in *Stubart Investments Ltd v Canada* in favour of modern rule

### B. Modern Rule

* *Stubart* affirmed Driedger’s modern rule:
	+ Words of the 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
* Subsequent SCC judgments initially failed to settle on preferred approach to interpretation of tax legislation
	+ Favouring in some cases a purposive or teleological approach
		- Courts first determine purpose of legislation; read words in light of purpose
	+ On other occasions favoured plain meaning rule: provisions of tax statute must be applied together regardless of their object or purpose
* More recent SCC judgments have returned to the modern rule, combining textual emphasis on the plain meaning rule with the purposive consideration relied on in the teleological approach

#### Will-Kare Paving and Contracting Ltd v Canada

* Will-Kare claimed plant was property used primarily in manufacturing/processing goods for sale
	+ Claimed accelerated capital cost allowance under s 20(1)(a)
	+ Also claimed investment tax credit within s 127(9)
* MNA reassessed Will-Kare reclassifying plant for CCA purposes, denying investment tax credit
	+ Plant not being used primarily for manufacturing or processing of goods for sale
* Issue: which of the asset pools Will-Kare’s plant was to be placed
* Major J (majority)
	+ Will-Kare’s claiming s 127(5) investment tax credit is contingent upon the plant being characterized as “qualified property” within the meaning of s 127(9) of the Act
		- Will-Kare must establish that it acquired the asphalt plant primarily for the purpose of manufacturing or processing goods for sale or lease
	+ Parliament’s objective in enacting legislation: encouragement of production of manufactured and processed goods, competition with foreign manufacturers
	+ Application of plain meaning interpretation to concept of sale in this case: assume Act operates in vacuum, oblivious to broader commercial relationships
	+ The plant was used primarily in the manufacturing or processing of goods supplied through contracts for work and materials, not through sale
	+ Contextual approach is necessary
		- Need to read in concert with property law, commercial law, legal document
		- Look at words in Benjamin’s Sale of Goods
* Binnie J (dissent)
	+ Millions of TPs who are not lawyers cannot be expected to research difference between contract for sale of goods and contract for work and materials in *Benjamin’s Sale of Goods* and apply these distinctions in assessment of their own income tax liability
	+ Allow the appeal
	+ Prof Duff says that by over-simplifying the interpretive task, the plain meaning rule in its pure form obscures the process of statutory interpretation, artificially limits its scope, produces decisions contrary to legislative intentions and statutory purposes, permits substantial judicial discretion and places an unreasonable burden on legislative drafters

# Introduction to Tax Avoidance

## I. Introduction

* Courts have task of characterizing amounts and transactions for purposes of assessing tax
* Legal efforts to organize one’s affairs to minimize tax labeled tax avoidance

## II. JUDICIAL ANTI-AVOIDANCE DOCTRINES

### A. US APPROACH

* In *Gregory v Helvering, Commissioner of Internal Revenue*, TP entered a series of tax-motivated transactions to obtain the benefit of a statutory provision governing corporate reorganizations

#### Gregory v Helvering, Commissioner of Internal Revenue (1935, US Supreme Court)

* For sole purpose of procuring transfer of shares to herself to sell them for individual profit, and diminish the amount of income tax, TP did a reorganization
* Not disputed that if reorganization was ineffective, petitioner liable for much larger tax for transaction
* Issue: whether what was done, apart from tax motive, was thing which the statute intended
* The whole undertaking was in fact an elaborate and devious form of conveyance masquerading as a corporate reorganization, and nothing else
* Then this goes to the Supreme Court
	+ This court looks at what the words really mean, and look at what is really happening
	+ Statute intended that the plan of reorganization must be related to business purpose
		- There was no business purpose
* The approach above is still used in the US

##### Notes

* Despite court’s insistence that TP’s motive was not pertinent to situation, absence of genuine business or non-tax purpose essential in court’s conclusion that the TP had not effected plan of reorganization, but merely a preconceived plan, to transfer parcel of corporate shares
* While transactions may have taken the *form* of a reorganization, in *substance* they amounted to a dividend and should be taxed as such
* The doctrine of economic or commercial “substance over form” appears to have functioned as a remedial adjunct to the “business purpose test”

### B. Anglo-Canadian Approach

* 3 judicial anti-avoidance doctrines:
	+ Substance over form
	+ Sham
	+ Business purpose test

### 1. Form and Substance

#### Commissioners of Inland Revenue v Duke of Westminster (1936, UK House of Lords)

* Duke (R) drew up a deed promising to pay Allman weekly payments for a period of time
* Duke claimed that in computing the amount of his total income liable to surtax, he was entitled to exclude the payments made under the deeds during the three years
* Lord Tomlin:
	+ In order to ascertain substance, court must look to legal effect of bargain entered into
* Lord Russell of Kollowen:
	+ Dismiss the appeal
	+ Payments are not payments of salary or wages
* Lord Atkin (dissenting)
	+ The Duke has the legal right to dispose of his capital and income as to attract upon himself the least amount of tax
	+ Facts and terms indicate that transaction intended to have, and had, more substantial results than interchange of unnecessary assurances between master and servant
	+ The document must be understood as a representation that he was being asked to make a contract in the terms of the document
	+ He looks at legal correctness of relationship

##### Notes

* Lords Tomlin and Russell rejected the doctrine of economic or commercial substance over form
	+ But they affirmed the statements in earlier cases that the courts may disregard the nomenclature used by parties to a contract in favour of the substance which results from the legal rights and obligations of the parties ascertained upon ordinary legal principles
* Canadian courts have generally accepted the doctrine that the legal substance of a contract or transaction is to prevail over the nomenclature employed by the parties
	+ But not more expansive doctrine of economic or commercial substance over form adopted in US

### 2. Sham Doctrine

* Cases where documents are not bona fide, nor intended to be acted upon, but are only used as a cloak to conceal a different transaction

### 3. Ineffective Transactions Doctrine

* Courts must scrutinize the conduct and documents by which rights and obligations are established
* Like the sham doctrine, the doctrine of legally ineffective or incomplete transactions reflects the more general rule expressed in *Duke of Westminster* that tax consequences are to depend on the legal substance actually created by the parties rather than the form on nomenclature that they employ
* This doctrine has generally been invoked to challenge tax-motivated transactions involving partnerships, trusts and corporations

### 4. Business Purpose Test

* By the mid-1970s Canadian courts began to adopt a more activist approach to tax avoidance
	+ Akin more to *Gregory*
* In *Stubart Investments Ltd v Canada* the SCC considered the adoption of a judicial “business purpose test” like in the US (*Gregory)*
	+ Although *Stubart* was effectively overruled by enactment of GAAR in 1988, it remains the most authoritative statement of judicial anti-avoidance doctrines in Canadian tax law

## VI. GENERAL ANTI-AVOIDANCE RULE

* This rule will introduce a “business purpose test” and a “step transaction” concept into *Income Tax Act*
	+ New GAAR intended to prevent artificial tax avoidance arrangements
	+ Strike a balance between TPs’ need for certainty in planning their affairs and the government’s responsibility to protect the tax base and the fairness of the tax system

### A. Avoidance Transaction

* GAAR applies where a transaction is an avoidance transaction
* Subsection 245(1) defines “transaction” to include an arrangement or event
* Subsection 245(3) defines “avoidance transaction”
	+ Would result in a tax benefit unless undertaken for bona fide purpose
	+ Series of transactions resulting in tax benefit, unless undertaken for bona fide purposes
* Tax benefit is defined is subsection 245(1) as:
	+ Reduction avoidance or deferral of tax
	+ Otherwise payable
	+ But for a tax treaty or an increase in a refund of tax or other amount under this Act as a result of the tax treaty
* Language of the GAAR is intended to encompass all types of abusive and artificial tax avoidance schemes including the types to which existing subsection 245(1) already applies
* The non tax purpose test in subsection 245(3) has been described as an expanded version of the business purpose test
	+ Under this test, a transaction will not be characterized as an avoidance transaction if it may *reasonably* be considered to have been undertaken or arranged *primarily* for *bone fide* purposes other than to obtain the tax benefit
	+ This test is intended to be objective rather than subjective
		- Not with what was in the particular TP’s mind, but with what a reasonable TP would have considered to be the purpose of the transaction
	+ It is not sufficient that a transaction was in fact undertaken or arranged primarily for bone fide purposes other than to obtain the tax benefit
		- The bona fide non-tax purpose must provide a rational basis for the particular transaction under consideration
	+ Transaction not considered avoidance transaction if it results in a tax benefit, or because tax considerations were significant, if not primary purpose for carrying out transaction
* A transaction may be characterized as an avoidance transaction if it is part of a series of transactions that collectively results in a tax benefit
	+ Even though the individual transaction alone does not result in a tax benefit

### B. Misuse or Abuse

* According to subsection 254(4) the charging provision in subsection 245(2) applies to an avoidance transaction only if it may reasonably be considered that the transaction
	+ Results directly or indirectly in a misuse of
		- The Act
		- The *Income Tax Regulations*
		- The *Income Tax Application Rules*
		- A tax treaty
		- Or any other enactment that is relevant in computing tax
	+ Would result directly or indirectly in an abuse
* Determining whether or not there has been a misuse or abuse is a 2 stage process
	+ Identifying relevant policy of the provisions of the Act as a whole
	+ Assessment of the facts
* In *Canada Trustco,* the SCC endorsed the 2 stage analytical process, as well as the view that the GAAR should apply only when the abusive nature of the transaction is clear
	+ Rejected any distinction between misuse and abuse
* The burden is on the Minister to prove, on the BoP, that the avoidance transaction results in an abuse and misuse within the meaning of s 245(4)

### C. Tax Consequences

* Tax consequences to person determined as is reasonable in circumstances in order to deny tax benefit that would otherwise result from transaction/series
* The scope of these remedial powers in subsection 245(5) is broad
* GAAR may be used to adjust
	+ Deductions in computing TP’s income from a source
	+ Deductions in computing TP’s net income from all sources for year: 2(2)
	+ Tax credits available to reduce the amount of basic federal tax otherwise payable
* Para 245(5)(c) authorizes CRA and courts to recharacterize nature of amount
* Para 245(5)(d) provides that tax effects that would otherwise result from the application of any other provisions of the Act may be ignored
* Under 245(2)
	+ The tax consequences must be reasonable in the circumstances
	+ They must be determined in order to deny the tax benefit

##### Notes

* Arnold and Wilson:
	+ If a transaction results in a misuse or abuse of the provisions of the Act, those provisions will not apply and the issue of the application of the GAAR rule will not apply
	+ If a transaction is within other statutory provisions, the transaction is exempt from the GAAR rule by virtue of subsection 245(4)
	+ In the absence of a penalty, some TPs may be willing to take the risk that a transaction may ultimately be determined to be subject to the GAAR, since the only costs would be the transaction costs and the interest on any unpaid taxes
		- There is also some risk that a penalty might discourage Revenue Canada and the courts from applying the rule and/or that it might discourage legitimate commercial transactions

# Part 2: Income or Loss from an Office or Employment and Other Income and Deductions

# Introduction and Characterization

* The calculation of each TP’s tax payable in a taxation year begins with the computation of the TP’s aggregate income for the taxation year
	+ Computed by adding all amounts, each of which is the TP’s income for the year from all sources
		- Subtracting total of all deductions permitted by subdivision e of Division B
			* To extent they have not been taken into account in computing TP’s income from specific sources under para 3(a)

## I. INTRODUCTION

* Para 3(a): TP’s income for year includes TP’ income from each office and each employment
	+ Para 3d permits TPs to deduct losses from each office and employment in computing net income for the year
* Subsection 5(1) defines a TP’s income for the taxation year from an office or employment as:
	+ Salary, wages, and other remuneration including gratuities, received by the TP in a year
* Distinction between office and employment is irrelevant for tax purposes
	+ References to income from employment should be read to include income from office
* 2 serious tax consequences from distinction between income from employment and income from business
	+ Deductions permitted under s 8 in computing a TP’s income from employment are less generous than those available in computing a TP’s income from a business under subdivision b
	+ Employers are required to withhold and remit income and payroll taxes in respect of amounts paid to employees
		- Both workers and persons hiring them will usually prefer that the source of an amount be characterized as business rather than employment
			* Administrative and financial obligation for employers
		- For revenue authorities, characterization as income from employment will be more advantageous
* The distinction between employee and contractor: focus is on control
	+ An employer can control what you do and how you do it

## II. CHARACTERIZATION

* “Office” and “Employment” are defined in subsection 248(1) of the Act
* Employment: position of an individual in service of some other person
	+ A person holding an employment position is referred to as a servant or employee
		- The term employee is deemed to include officers
	+ Term employer includes the person from whom an officer receives remuneration
* Office: subsisting permanent, substantive position which has an existence independent of the person who fills it, and which goes on and is filled in succession

### A. Employees v Independent Contractors

* In private law, existence of employment relationship traditionally based on legal rights of one party to control and direct the manner in which employee performs contractual obligations
* Courts have traditionally distinguished between a “contract for service” between an employee and an employer and a “contract for services” involving independent contractors

#### Wiebe Door Services Ltd v MNR (1986, FCA)

* Applicant is in the business of installing doors and repairing overhead doors in the Calgary area
* Case law has determined series of tests to determine whether contract is for service or provision of services
* Tax court:
	+ Degree or absence of control, exercised by alleged employer
		- The evidence is indecisive
	+ Ownership of tools
		- Each worker owned his own truck and tools: independent contractors
	+ Chance of profit and risk of loss
		- Independent contractors
	+ Integration of the alleged employees work into the alleged employers business
		- Without the installers, the A would be out of business
		- This test tips scales in favour of contract of service; not contract for services
		- How essential to the business is the work?
		- This test comes from copyright law
		- Without these workers, there is no business, so must be employees
		- From the worker's perspective, are they deeply integrated?
* Question is whether a contract is one for service (master servant or employment relationship), or for services (between independent contractors)
* Traditional CL criteria:
	+ Principal has the right to direct what the agent has to do
	+ Master has that right, and the right to say how it is done
* AN Khan said: the integration, or organization test if applied in isolation can lead to as impractical and absurd results as the control test
* What must always remain in the essence is the search for the total relationship of the parties
* Federal Court of Appeal
	+ Looks at the total relationship
		- Whose business is it?
		- Is the person who has engaged himself to perform these services performing them as a person in business on his own account?
	+ Relevant considerations
		- Control
		- Ownership of tools
		- Hiring of helpers
		- Degree of financial risk taken
		- Degree of responsibility for investment and management
		- Opportunity of profit
		- Principal workplace
		- Specific results
		- Exclusivity of employment
		- Whether business already established
		- Intentions of the parties
* Cooke J in *Market Investigations Ltd v Minister of Social Security*
	+ No exhaustive list has been compiled and perhaps no exhaustive list can be compiled of considerations relevant to determining the question
	+ Control will always have to be considered, though it can no longer be regarded as the sole determining factors
* Refer the matter back to the Tax Court judge for a determination consistent with these reasons

##### Notes

* Tax cases in Quebec have applied the general test adopted in *Wiebe Door,* considering each of the subordinate tests by the Federal Court of Appeal in order to evaluate the total relationship of the parties

### B. Incorporated Employees

* Strategy to avoid being characterized as employment: interposition of corporation between individual performing services and person contracting for performance of services
* Payments to a corporation for services performed by an individual on its behalf must be characterized as income from a business rather than income from an office or employment
* Although the cases and statutory provisions considered precede introduction of General Anti-Avoidance Rule (GAAR) in 1988, it is useful to consider how GAAR might have applied

### 1. Judicial Anti-Avoidance Doctrines

#### Engel v MNR (1982)

* A was, before 1975 a tv journalist employed by Global Communications
* Late in 1975 A incorporated a company (Reasoned Communications Ltd), entered into an employment agreement with Reasoned and resigned from Global
	+ Reasoned entered into a contract with Global
	+ Reasoned undertook to lend the A’s services to Global for a period of 9 months
* Principal assumption of fact made on assessment:
	+ The interposition of Reasoned between the A and Global were arrangements for a fiscal purpose, lacked a bona fide business purpose, were shams and a fiscal scheme
		- Amounts which were in fact and substance salary, wages or other remuneration earned by the A from Global were transferred or assigned to Reasoned
* Issue: whether the Minister was correct in so assessing
* A’s reasons for changing the structure
	+ A expanded his free lance journalist activities
		- As an employee, A was required to spend time each day at Global premises
			* Inhibited A’s efforts to promote and perform free lance work
	+ A desired to charge mother for financial and economic advice pertaining to investments
* A made it clear that his free lance services were provided by Reasoned
* No basis for any suggestion that the relationship which the contract purported to create was not intended to be created or was not adhered to
	+ There is no sham here in agreement between Global and Reasoned
* Appeals will be allowed
	+ Amounts paid by Global to Reasoned were revenues of Reasoned; not income of A

##### Notes

* In *MNR v Leon*, for the Rs to be successful they must establish a bona fide business purpose for the transaction, which they have failed to do so
	+ If the agreement or transaction lacks a bona fide business purpose, it is a sham
* In *Canada v Parsons*, although TPs acknowledged having no business purpose apart from minimizing tax, court held transactions of interposition of management companies between TPs and former employer valid and complete
* *Engel, Leon* and *Parsons* were decided before the introduction of the GAAR in 1988
	+ How might the GAAR have applied to each of these cases?

### 2. Statutory Anti-Avoidance Rules: Personal Services Business

* Statutory anti-avoidance rules to eliminate tax advantages available to incorporated employees
* Key statutory provision is the definition of a “personal services business” 18(1)(p) and 125(7)
	+ A business of providing services where
		- An individual who performs services on behalf of the corporation or
		- Any person related to the incorporated employee 251(2)
			* Connected by blood, relationship, marriage, CL partnership, adoption
	+ Is a specified shareholder of the corporate and the incorporated employee would reasonably be regarded as an officer or employee of the person or partnership to whom or to which the services were provided but for the existence of the corporation unless
		- The corporation employs in the business more than 5 full time employees or
		- The amount paid to the corporation in the year for services is received by it from a corporation with which it was associated in the year
* 18(1)(p) isallows the deduction of most expenses other than remunerations and benefits paid to incorporated employees in computing the income of a personal services business
* 127(5) excludes income from personal services businesses from the low corporate tax rate otherwise available to Canadian-controlled private corporations (CCPCs)

#### Dynamic Industries Ltd v Canada

* Dynamic has carried on the business of providing steel work services in Alberta and BC
	+ Shares owned by Steven Martindale or his spouse Ms. Shkwarok
* As a contractor signatory, Dynamic able to provide steel work services to both union and non-union employees, as long as those employed by Dynamic were union members
	+ Mr. Martindale was thus able to obtain work in 2 ways
		- Through Local 97 (union)
		- Through Dynamic
* Dynamic more lucrative for Mr. Martindale: flexibility in choosing work and ability to negotiate
* Dynamic later provided services to SIIL Maintenance Ltd
	+ 1995-1999 SIIL only source of income for Dynamic, except for small amount of invested money
* Applying the law to the facts
	+ SIIL provided Martindale with office space, parking facilities, administrative facilities, technical and maintenance services
		- Favours position of Crown
	+ Chance of profit, risk of loss favoured Crown
		- Martindale did not stand to share in profits or losses of SIIL
			* This missed the point
		- This factor is intended to reveal whether activities of Martindale entailed kind of risks more typical of those borne by a business enterprise than an employee
		- The business enterprise is not that of SIIL but of Martindale himself
		- This factor actually favours Martindale
	+ Integration
		- Monopolization of Martindale during period did not arise because SIIL and Martindale were forging relationship resembling employer and employee
			* Rather it arose because SIIL was particularly successful during the period
		- You can't view this period of time in isolation
			* Had been working for other contacts before and after this time period
			* Exclusivity should not be viewed in the moment, but rather over time
	+ Control
		- This was a significant factor which was overlooked
		- Favours Martindale
* The Judge failed to correctly apply all of the *Sagaz* factors to the facts of the case
* Allow this appeal

##### Notes

* According to the CRA, the following lists of factors, although not exhaustive, are indications of employee status
	+ Entity to which services are provided controls amount, nature and direction of work and manner of doing it
	+ Payment for work is by the hour, week or month
	+ Payment of worker’s travelling and other expenses incidental to payor’s business
	+ Requirement that a worker must work specificed hours
	+ Workers provides services only for payor
	+ Entity to which the services are provided furnishes the tools, materials and facilities to the worker
* 533702 Ontario Ltd (TCC, 1991)
	+ She had a showroom, the shares of which were owned entirely by her husband
	+ Issues: but for the existence of this numbered company, is she an employee of Brouwer Plumbing and Heating Ltd?
		- Corporation had no commercial purpose other than plumbing business of BPH
		- Showroom services carried on by A had no commercial independence of BPH
			* The exclusivity dimension is significant here
		- Independent commercial purpose
			* This language is similar to business purpose test
				+ The courts are trying to rely on other anti-avoidance principles in order to figure out how this rule should apply

## III. Inclusions (Part 1: Remuneration)

* Subsection 5(1): TP’s income for a taxation year from an office or employment is:
	+ Salary, wages, other remuneration, including gratuities, received by TP in the year
* For s 5, subsection 6(3) deems certain amounts to be remuneration for payee’s services
* Para 6(1)(c) includes director’s or other fees
* Para 6(1)(a) adds the value of board, lodging and other benefits of any kind, by virtue of an office or employment
* 6(1)(b) includes allowance for personal or living expenses
* Other inclusions:
	+ Amounts allocated under employee profit sharing plan
	+ Benefits in respect of an employer provided automobile
	+ Amounts received under various kinds of employee benefit plan
	+ Employee trust
	+ Prescribed benefits under a group term life insurance policy
	+ Salary deferral arrangement
	+ Forgiveness of employee debt
	+ Employee’s housing loss
	+ Employer provided housing subsidies
	+ Stock options

A. Remuneration

* Para 6(1)(c) and subsection 5(1) of the Act include in income from office or employment, fees, salary, wages, gratuities and other remuneration
* Subsection 6(3): specific anti-avoidance rule designed to expand scope of TP’s income from office or employment by including amounts connected to employment relationship but not otherwise characterized as taxable remuneration
	+ (a) or (b) deems certain amounts not otherwise remuneration, to be remuneration
	+ These things would not be included in 5(1) already
		- You can ignore the legal rule and look at economic substance
		- Unless the taxpayer establishes that it can't reasonably be one of these things
	+ (c) Inducement payment
	+ (d) Remuneration
	+ (e) Generally refers to a restrictive covenant
	+ Another category deals with termination pay
		- Doesn't qualify as employment pay because you no longer have employment
* In general:
	+ Fees refer to fixed payments in respect of an office
	+ Salaries and wages describe regular payments to employees
* In the context of subsection 5(1) gratuities may be understood as amounts paid to an officer or employee on account of legally non-enforceable claims
* Unlike fees, salary, wages, gratuities, remuneration is a more general concept comprising these specific kinds of payments

### 1. Inducement Payments

* Where TP is paid amount as inducement to accept office or enter into employment contract
	+ Arguable that payment is not remuneration for services rendered; not taxable under subsection 5(1)
	+ Subsection 6(3) deems most such inducement payments to be taxable remuneration
		- Only applies where inducement payment is received by one person from another, according to certain conditions
			* While payee was officer of, or in employment of payer
			* On account, in lieu or in satisfaction of obligation from agreement between payer and payee prior to period when payee was in employment of payer
* Inducement provision does not apply where payment made by someone other than recipient’s current or future employer
* In *Curran v MNR* the TP received a payment before entering into a contract of employment not with the person making the payment but with a company controlled by the payer

#### Curran v MNR

* A, geologist, employed as manager of producing department of Imperial Oil Ltd
* Brown induced A to resign from Imperial Oil to work for one of Brown’s companies
* Brown paid A $250,000, but Calta Assets Ltd actually furnished the funds
* On the same day, A entered into agreement with Federated Petroleums to act as general manager at a fixed salary
* A resigned from Imperial Oil and became employed with Home Oil
* True nature of payment found in terms of 2 agreements and surrounding circumstances
* Cannot agree with A that it establishes non-taxability under s 6(3)
	+ But it was taxable under s 3 as an un-enumerated source (see concurring)
* Martland (concurring)
	+ A contended that the payment represented capital receipt and not income
	+ The payment was income to A within the meaning of s 3 of Income Tax Act

### 4. Tort Damages for Personal Injury or Death

* Where TP receives tort damages for personal injury or death, this compensation typically includes special damages in respect of lost earnings

#### Cirella v Canada

* Issue: whether P is liable for income tax in respect of $14,500, part of damages awarded by a SCC judgment for damages for personal injuries sustained in a motor vehicle accident
* D argued that the amount was not damages for loss of capital, but for loss of income
* In this case there was no loss or shortfall of revenue of his business attributable to the tort, since the injuries were incurred long before the business was commenced
* The amount in question is not assessable in whole or in part as income of the P’s business
* Nor is the amount income from employment
* In personal injury cases court awards damages to compensate injured person for wrong done
* These damages are not of an income character
	+ The description as damages for loss of income do not re-characterize them
	+ The damages were of a capital nature (earning capacity is essentially capital)

### 5. Gratuitous Payments

* 5(1) requires TPs to include gratuities in computing income from office or employment
	+ Nevertheless, TPs often argue that gratuitous payments ought not to be included in computing income from office or employment, arguing that payment gift or windfall, not remuneration for services provided within scope of TP’s office or employment

#### Goldman v MNR

* A was active with 2 others in the formation of a committee of shareholders of a company then in receivership, and became its chairman
* A nominated Black to be counsel for the shareholders committee
* A intended to be paid for his services on the committee
	+ The scheme excluded direct payment; intended to characterize payment as gift
* Payment made in connection with the A’s office as chairman and as remuneration therefor
	+ That the services were completed before payment, or that there was no assurance from beginning that services would be remunerated does not prevent amount being taxable income
* Rand J (concurring)
	+ That both parties intended the money to be paid and received as remuneration for services rendered by Goldman as committee chairman is not open to doubt

### 6. Strike Pay

* Strike pay provided by union typically paid for non-performance of services by the employee
* Pre-Fries
	+ Loeb: TP entered into employment contract with union and received taxable employment income
	+ Ferris: TP carried on business with other union members operating a newspaper and received taxable employment income
* In *Canada v Fries* Federal Court of Appeal concluded that strike pay is taxable under para 3(a) as income from an unspecified source
	+ On appeal, SCC reversed the decision in a remarkably brief judgment stating only:
		- Not satisfied that payments by way of strike pay in this case come within definition of income from source, within meaning of s 3 of ITA.
			* In these circumstances benefit of the doubt must go to TP.
* Revenue authorities released an informational bulletin
	+ Money paid during a strike is not necessarily income
	+ Taxable if money is received as a result of the individual being employee of union
* Statutory context:
	+ Deduction for union dues: paragraph 8(1)(i)(iv)
	+ Exemption for unions: paragraph 149(1)(k)

#### Canada v Fries (1989, FCA)

* The issue involves payment, by union, to D. employee of Saskatchewan Liquor Board
	+ Money equivalent to D’s normal net take home pay during period he was on strike
* D was paid out of strike fund, which came from union dues paid by the members, including D
* There is nothing in the act which exempts strike pay from taxability
* While administrative policy is entitled to weight, it cannot be determinative
* Funds derived from such dues completely lost identity
	+ Members have all lost control over funds; disposition is solely determined by union
* Since, under the Act, such payments are income, they become subject to tax

## Inclusions (Part 2: Payments on Termination)

### C. Retiring Allowances

* 56(1)(a)(ii) requires TPs to include in computing their income for a taxation year:
	+ Amount received by TP in the year on account or in lieu of payment of, or in satisfaction of … a retiring allowance
	+ Other than amounts received out of or under various deferred income plans, which are taxable as income from an office or employment
* Subsection 248(1) defines retiring allowance
	+ An amount received
		- On or after retirement in recognition of TP’s long service
		- In respect of loss of an office or employment
	+ By the TP, or after death, by dependent or legal representative

### 2. Payments in Respect of Loss of an Office or Employment

#### Mendes-Roux v Canada (Tax Court)

* A was employed with Translation Bureau of NB for 7 years
* During maternity leave, informed that her office was to be closed, relocated to a further office, or lose employment
* She alleged that her boss feared she would blow the whistle on his illicit activities
* A was wrongfully dismissed
* The settlement was kept confidential
	+ A claims she does not know precisely how amount of settlement was calculated
* Court finds 50% of the sum received by the A as a retirement allowance and is taxable
* Special damages for pain and suffering not taxable

##### Notes

* CRA’s views on amounts received in respect of a loss of an office or employment
	+ Where an individual receives compensation on account of damages as a result of a loss of employment, the amount received will be taxed as a retiring allowance
		- This applies both to special damages, as well as general damages received for loss of self-respect, humiliation, mental anguish, hurt feelings etc
	+ Where personal injuries have been sustained before or after the loss of employment, the general damages received may be viewed as unrelated to the loss of employment and non-taxable
		- It must be clearly demonstrated that the damages relate to events or actions separate from the loss of employment
	+ General damages relating to human rights violations can be considered unrelated to the loss of employment, despite the fact that the loss of employment is often a direct result of a human rights violations complaint

#### Schwartz v Canada (1996)

* Issue: compensation received by employee from employer pursuant to a termination settlement before employee under obligation to provide services
	+ Taxable as income, or retiring allowance
* Dynacare offered A $75,000 in exchange for full and final release from the contract
	+ A refused the offer
* A settlement was reached
* Crown assessed damages as constituting retiring allowance taxable under subpara 56(1)(a)(ii)
* Appeal should be allowed
* Para 3(a) of the Act does contemplate taxability of income arising from sources other than those specifically provided for in para 3(a) and in subdivision d of Division B of Part I of the Act
* The damages received by Schwartz do not constitute a retiring allowance
* Section 3 identifies the five principal sources from which income can be generated:
	+ Office, employment, business, property and capital gains
* By end of 1970s,settled that damages received by employee, from ex-employer, as a result of latter’s cancellation of employment contact, did not constitute income from office or employment taxable under 5(1) or retiring allowance taxable under 56(1)(a)(ii)
	+ This constitutes the mischief Parliament intended to remedy in 1979 when it amended the Act and introduced the concept of termination payments
		- These were rendered taxable through subpara 56(1)(a)(viii) and defined in subsection 248(1)
			* Portion of payment exceeding amount considered termination payment, under subsection 248(1), considered non-taxable benefit
* Parliament again addressed the issue in 1983, making termination payments of this kind taxable as retiring allowances
* Crown argued the Surrogatum principle, developed in *London & Thames,* that $342,000 of the $360,000 received by Schwartz must be characterized as income from a source
	+ Source: employment contract
		- Moneys, that if received, would have constituted income from a source
* To find that damages received by Schwartz are taxable under the general provision of para 3(a) would disregard that Parliament has dealt with taxability of such payments in provisions relating to retiring allowances
* Loss of employment cannot occur before Schwartz became under obligation to provide services to Dynacare, because he could not have been in the service of his future employer
* Allow the appeal, restore the decision of the Tax Court of Canada

## Inclusions (Part 3: General Benefits)

### B. Benefits

* Para 6(1)(a) includes value of board, lodging and other benefits received by TP in respect of office or employment

1. General Rule

* Application of 6(1)(a) involves 3 steps
	+ Characterization of benefit
	+ Determination of relationship between benefit and TP’s employment
	+ Valuation of the benefit to be included in computing the TP’s income

#### Lowe v Canada (1996, FCA)

* Appeal arises from assessment of A’s income, which included portion of cost of expense-paid trip taken by A and wife on basis that A received taxable benefit under para 6(1)(a)
* A’s job: promote employer’s insurance to independent brokers through smooth relationships
* Tax Court Judge:
	+ Trip not holiday, not considered perk; spouse expected to entertain other spouses
* Purpose of 6(1)(a): equalize tax payable by employees who receive compensation in cash with the amount payable by those who receive compensation in cash and kind
	+ In the absence of this rule, tax system would provide incentive for employees to barter for non-cash benefits
* Starting point to determine a benefit is to determine whether the item under review provides the employee with an economic advantage that is measurable in monetary terms
	+ Something of value test
* Tax Court judge held 20% of trip taxable
* CRA Bulletin:
	+ Where a business trip is extended to provide for a paid holiday or vacation, employee in receipt of taxable benefit equal to costs borne by employer with respect to extension
	+ Trip viewed as a business trip provided employee is engaged directly in business activities during a substantial part of each day
	+ Where a spouse accompanies employee on business trip, payment or reimbursement by employer of spouse’s travelling expense is a taxable benefit to employee
		- Unless spouse engaged primarily in business activities on behalf of employer during trip

Notes

* *Hoffman* $500 allowance to get new clothes/repair and clean clothes b/c police officer
	+ Not a taxable benefit, really just a reimbursement
* Guerinhard tax them!
* Pallazari and Clemes TPs defraud their companies and then their companies pay their legal expenses; court asks were your actions that brought about the charges part of the course of employment; if not, then taxable benefit
* Cutmore required to use company accountant specifically; however court held that even though the employer required this action, still a benefit (pre-Lowe, unclear if it has been overruled)
* Christmas party obligated to go, taxable benefit—not trivial benefit, didn’t matter that he didn’t want to, still taxable benefit
* \*\*\*Note 15; 302 golf club membership—didn’t like golf, accepted membership only to avoid appearing as a rebel, used to meet clients, employer requires for BUSINESS PURPOSES!!! Not a taxable benefit
* In *Dunlop v Canada*:
	+ Employer provided party or social event, available to all employees, accepted as a non-taxable privilege if cost per employee is reasonable in the circumstances
		- Those events costing up to $100 per person will be considered non-taxable
		- Parties costing more considered beyond privilege, may result in taxable benefit
* CRA’s views on tuition reimbursements
	+ 3 broad categories of training
		- Specific employer related training courses
			* Maintenance or upgrading employer related skills
			* Generally considered to primarily benefit employer
				+ Non taxable
		- General employment related training
			* Business courses, though not related to employer’s business, generally considered non-taxable
			* Could include stress management, employment equity, first aid, language skills
		- Personal interest training
			* Employer paid courses for personal interest or technical skills unrelated to employer’s business are considered of primary benefit to employee
			* Taxable
* CRA lists various non taxable benefits
	+ Employee benefiting from discounted merchandise
	+ Provision of vehicles to get to employment
	+ Employees using recreational facilities
	+ Employer pays fees to join social or athletic club
	+ Airlines passes available to airline employees
		- Only taxable if employee travels on a space confirmed basis and is paying less than 50% of the economy fare available
	+ Employees of bus and rail companies using passes
	+ Retired employees of transportation companies receiving pass benefits

### B. Relationship to Office or Employment

* For an amount to be included as a taxable benefit under para 6(1)(a) the benefit must have been received or enjoyed by the TP in respect of, in the course of or by virtue of office or employment

#### R v Savage (1982, SCC)

* Savage was employed as RA and voluntarily took 3 courses in accordance with company policy that encouraged self-upgrading
* Appropriate test in *Phaneuf:* whether benefit conferred on Phaneuf as employee or as a person
	+ Phaneuf received, as a person, the right to acquire the shares
* Employee took the course to improve his or her knowledge and efficiency in the company business and for better opportunity of promotion
* The payments were in respect of employment

##### Notes

* In 2002 the CRA announced the following liberalization
	+ Employers will be able to give 2 non cash gifts per year on a tax free basis
		- Where the aggregate cost of the gifts is less than $500/year
	+ Employers will be able to give employees 2 non cash awards per year, on a tax free basis
		- In recognition of special achievements such as reaching a set number of years of service, meeting or exceeding safety standards
			* Where the total cost of awards to employer is less than $500/year
* If the cost exceeds the $500 threshold, then the full fair market value of the gifts or awards will be included in the employee’s employment income

### C. Valuation

* After determining benefit was received, necessary to place value on benefit to determine amount included in para 6(1)(a)

#### Detchon v Canada (1995, TCC)

* As appeal assessments; neither of them received a benefit in respect of employment pursuant to para 6(1)(a) as a result of their children attending their employer’s school
	+ Alternatively, if benefit was conferred, value was less than Minister determined
* Teachers had to live on campus, be available 24 hours a day, participate in the school, and send their children to the school
* The treasurer and director of finance of the school suggested that teachers would be reprimanded for not sending their children to the school
* School never achieved full capacity; the cost of having staff’s children attend is virtually nothing
* Court does not agree with A’s submission that the value of the benefit is the additional or incremental cost to the school of having A’s children attend
* Valuing the benefit at the average cost per student is an appropriate method of valuation
* Not just to other Canadian TPs, that employees, solely because of occupations and low level salaries, obtain a tax free benefit from an employer who does not pay a higher wage

##### Notes

* In *Richmond v Canada*, whether the A used the property is of little consequence
	+ It was available to him and was accordingly a benefit to him

## Inclusions (Part 4: Allowances and Other Benefits)

### B. Insurance Benefits

* 6(1)(a)(i) excludes benefits derived from contributions of TP’s employer to or under group sickness or accident insurance plan, private health services plan or group term life insurance policy
	+ Benefits derived from employer’s contributions under a group sickness or accidence insurance plan are taxable under para 6(1)(f)
	+ Benefits derived from employer’s contributions under a group life insurance policy are taxable under subsection 6(4)
	+ In contrast, benefits derived from employer’s contribution to or under a private health services plan are fully exempt from income tax
		- Applies to dental, medical and hospital care plans
		- Is it fair to exempt these kinds of employer-provided benefits
* CRA: an insured plan can include both formal arrangements and informal arrangements
	+ 6(1)(f) does not apply to uninsured employee benefits such as continuing wage or salary payments based on sick leave debits, which payments are included in income under 6(1)(a)
* Employees are exempt from tax on the insurance coverage provided by a wage loss replacement plan to which their employer has made a contribution
	+ For example, by paying all or any portion of insurance premiums
	+ However, employees are taxed on period payments actually received under these plans
	+ In contrast, under employee-pay-all plans, employees are taxable on the value of the premiums paid into the plan, but exempt from tax on payments received under the plan

#### Tsiaprailis v the Queen (2005, SCC)

* As a result of failure by insurance company to pay disability benefits, Tsiaprailis sued for declaration that she was entitled to those benefits
* Issue: whether a portion of the lump sum settlement is taxable
* Tsiaprailis was entitled to long-term disability benefits through insurance policy carried and paid for by employer
	+ Manulife terminated benefits, claiming Tsiaprailis was no longer totally disabled
* A settlement was negotiated
* Abella J (dissent):
	+ Section 6(1)(f) sets out 2 relevant requirements
		- Amount must be payable to TP on a periodic basis
		- Amount must be paid pursuant to a disability insurance plan
	+ Amount was not so payable; unnecessary to determine whether lump sum payment was payable on periodic basis
	+ Damage and settlement payments are inherently neutral for tax purposes and must therefore be classified in order to determine whether they are taxable
	+ In applying the surrogatum principle to this case
		- Settlement payment was to release insurance company from claim that it was liable and extinguish Tsiaprailis’ claim for entitlement under disability insurance policy
		- 3 aspects of liability
			* Amount to extinguish claim for accumulated arrears
			* Amount to extinguish claim for future benefits
			* Amount to extinguish claim for costs
	+ Parties never came to agreement about value of arrears or future benefits
		- Lump sum is amount paid to extinguish any liability for claims that might be asserted because of disability policy
	+ Not payment made in accordance with policy, and not payment made pursuant to it
	+ Allow the appeal, with costs
* Charron J (majority)
	+ Reach a different result and would dismiss the appeal
	+ Surrogatum principle: tax treatment of item depends on what amount is intended to replace
	+ Tsiaprailis cannot assert the insurer’s liability under the policy in her action, recover an amount from the insurer in that action, then argue that the payment does not flow from the obligations of the insurer under the policy
	+ Determinative questions
		- What was the payment intended to replace?
		- Would the replaced amount have been taxable in the recipient’s hands?
	+ Part of settlement monies were intended to replace past disability payments
	+ Portion of lump sum allocated to accumulated arrears is taxable
	+ Dismiss the appeal

### C. Interest-free and low-interest loans

* Subsection 6(9) includes amount in respect of loan or debt deemed by subsection 80.4(1) to be benefit received by individual
	+ 80.4(1): where a person received loan or incurs debt because of intended or current office/employment, individual is deemed to have received benefit in taxation year, equal to difference between
		- Total of all interest on loan/debt computed at prescribed rate for period it was outstanding, and all interest paid or payable in respect of loan or debt by employer or person related to employer
		- Total of all interest paid on loan/debt within 30 days after end of taxation year and any portion of interest paid or payable by employer or person related to employer that is reimbursed by debtor in year or within 30 days after end of taxation year
* Effect of rule: require individual to whom provision applies to include as a benefit amount equal to difference between this prescribed rate and amounts paid by debtor either as interest or by way of reimbursement of interest paid by employer or a person related to employer
* 80.4(i): [(a)+(b)] - [(c) + (d)]
	+ (a): interest at prescribed rate for year
	+ (b): interest paid or payable on income in year
	+ ©: interest paid on loan within 30 days of the year
	+ (d) employer interest payments reimbursed by debtor
* This rule is designed to compute the benefit from an interest free or low interest loan

#### Canada v Hoefele (1995, FCA)

* Issue: whether mortgage interest subsidy received by TP, after relocation to more expensive housing area, is taxable under para 6(1)(a) or section 80.4 of Income Tax Act
* 5 TPs were required to move from Calgary to Toronto
	+ Relocation incentive: employer offered to pay increase in interest charges on mortgages on costlier Toronto homes to a maximum set by differential
		- Owner of house eligible for interest subsidy paid by employer to extent of interest payable on increase in principle
		- Subsidy would cease upon termination of employment
		- Subsidy directed solely at defraying increased interest charges; not be applicable to principal
* 2nd issue: whether interest subsidy qualifies as taxable benefit under subsection 80.4(1)
	+ Such a loan or debt must have been incurred by virtue of employment
* Whether those portions of mortgage loans taken out by TPs for Toronto homes was because of, as a consequence of, or by virtue of employment
* Subsection 80.4(1) requires a close connection between the loan or debt and employment
	+ Closer than what is required by para 6(1)(a) between benefit and employment
* No strong causal relationship here; not taxable
* Court fails to see loan or debt incurred because of, as consequence of, or by virtue of employment
	+ No employee jumped from rental to mortgage situation, and none traded principal residence for non-principal residence
* The loan wasn't a consequence of employment -- it was a consequence of buying a house
* This decision precedes the new provision 80.4(1.1)
	+ Instead of correcting original provision, we now have a deeming rule

### D. Forgiveness of Debt

#### McArdle v MNR

* A left employment with Integration Building Corp Ltd
* While employed he owed employer money; repayment waived
* A testified that the forgiveness of loan not part of arrangement under which employment ended
	+ Rather Integrated decided to write off the loan as a bad debt
* Court is satisfied that forgiveness of balance of loan was integral part of arrangements under which A’s employment with Integrated ended
	+ The thing which motivated forgiveness of loan was existence of employment contract
* The amount of the loan was taxable under 6(15)(a)

Notes

* *Norris v Canada:* pursuant to case law, amount forgiven should be included in A’s income regardless of source of benefit

E. Benefits in Respect of a Housing Loss

* Subsection 6(19) deems amount paid in respect of housing loss to or on behalf of TP or person not dealing at arm’s length with TP in respect of, or in the course of, or because of office or employment to be benefit received by TP because of the office or employment
* Subsection 6(21) defines a housing loss at any time as:
	+ Amount by which the greater of cost of residence and its highest FMV during previous six months exceeds lesser of proceeds of disposition or FMV if it is disposed of before end of next taxation year, or FMV
* Subsection 6(20) deems amount paid in taxation year in respect of eligible housing loss to or on behalf of TP, or person not dealing at arm’s length with TP in respect of, in course of, or because of office or employment to be a benefit received by TP because of office/employment
	+ But only to the extent of
		- The amount by which
			* ½ of the amount by which the total of all amounts each of which is so paid in the year or in a preceding taxation year exceeds $15,000
		- Exceeds
			* The total of all amounts each of which is an amount included in computing the TP’s income because of this subsection for a preceding taxation year in respect of the loss
* Subsection 6(22) defines an eligible housing loss
	+ In respect of residence designated by TP as housing loss in respect of eligible relocation
	+ Stipulates for this purpose that no more than 1 residence may be so designated in respect of an eligible relocation
* If you have an eligible housing loss (required to move for work reasons, and have moved more than 40 km closer to work location), then the first 15,000 of that compensation will be tax free, and anything above that will be half taxable (20)
* Subsection 248(1) defines an eligible relocation
	+ Relocation that enables TP to be employed at new work location; if TP ordinarily resided at old residence before relocation and at new residence after relocation
		- New residence not less than 40km closer to new work location than old residence
* Where employee is subject to being moved, his financial position is adversely affected by that facet of employment relationship
	+ When his employer reimburses him for such loss it cannot be regarded as remuneration
* Thomas v the Queen (TCC – affirmed by FCA in 2007)
	+ Federal public servant with contract to build ships for the Canadian navy
* He moved from Ottawa to St John in 1997 and was employed for about a year
* Employment terminated and moved back to Ottawa
	+ Purchased lot in St John and built new house there, which company bought from him
* He argues that the house is not a taxable employment benefit; not part of his contract
	+ This argument won't work; he did receive a benefit (see Savage)
* Can it be an employment benefit if you aren't employed anymore?
	+ He is still employed because he receives salary after his employment ends
* There is a benefit
	+ To determine amount of benefit:
		- (850K -- what the company bought it for) - (758K -- FMV) = housing loss
		- $92K housing income, unless he can establish eligible relocation
		- Exemption is $15K = $77K,half of that is taxable = $38.5K
* Must establish eligible relocation
	+ Must enable him to carry on a business or be employed in the new work location
	+ Both residences must be Canada
* Move enabled him to carry on a business within Canada and both residences are in Canada
* It seems like he should get exemption, but court finds instead that the move was a result of losing employment, not because of searching for new employment
* Eligible relocation must be an attraction; to start new job -- not to run from old job
* Appealed to Federal Court of Appeal who refused to overturn the decision of the Tax Court
* The housing loss here is not an eligible housing loss under 6(22)

### F. Relocation Assistance

* 6(23) designed to overturn previous decisions which allowed TPs to move to a different location and get a housing subsidy that was not considered a non taxable benefit
* In *Splane v MNR* TP transferred from Ottawa to Edmonton, compensated for increased mortgage interest payments on new residence, attributable to higher interest rates prevailing at time of transfer
	+ No economic benefit of any significant value was conferred upon P
		- P moved at request of employer, incurred expenses in move; suffered loss
		- Reimbursement of these expenses cannot be considered as conferring a benefit within terms of Act
* 6(23) does not address reimbursement of ordinary moving expenses by TP’s employer
	+ In *Pollesel v Canada* the Court held that TP had not received economic benefit from a reimbursement of moving expenses
* CRA’s views on reimbursement of moving expenses
	+ Where an employer reimburses an employee for the expenses incurred because the employee has been transferred, this reimbursement is not considered a taxable benefit
	+ Where employer pays the expense of moving an employee and employee’s family and household at the termination of employment, no taxable benefit
* Where moving expenses are neither paid by the TP’s employer nor reimbursed in a non-taxable form, the TP may deduct those expenses under s 62

### C. Allowances

* Para 6(1)(b) requires TPs to include all amounts received in the year as an allowance for personal or living expenses or as an allowance for any other purpose
	+ The act does not define “allowance”

### 1. Characterization

* According to Oxford Dictionary, allowance means “money paid to cover special expenses”

#### MacDonald v Canada (AG) (1994, FCA)

* R moved from Regina to Toronto and was paid $700 each month as a housing subsidy
* MNR determined that the money should be included in R’s income
* Purpose of paras 6(1)(a) and 6(1)(b): include in TP’s income from employment gains/advantages arising from TP’s employment that increase TP’s income from that employment
* The subsidy is a taxable allowance
* Reimbursement of expense actually incurred in course of employment or of a loss actually incurred in course of employment not allowance within meaning of word in para 6(1)()
	+ An allowance is an arbitrary amount usually paid in lieu of reimbursement
	+ Employee can use as he wishes without being required to account for its expenditure
	+ Allowances are taxed as though they were remuneration
* The amount of an allowance is predetermined without regard to the exact amount of a particular actual expense or cost
	+ The scope for abuse is greater
		- Employee does not have to account for an allowance
* General principle of defining allowance for 6(1)(b)
	+ Allowance is arbitrary amount, predetermined sum set without special reference to any actual cost or expense
	+ Para 6(1)(b) encompasses allowances for personal or living expenses, so that an allowance will usually be for a specific purpose
	+ An allowance is in discretion of recipient; recipient need not account for expenditure of funds towards an actual expense or cost

##### Notes

* For the purpose of para 6(1)(b) the CRA distinguishes among
	+ An allowance
		- Any periodic or other payment that an employee receives from an employer, in addition to salary and wages without having to account for its use
	+ A reimbursement
		- Payment by an employer to an employee to repay the employee for amount spent by employee on employer’s business
	+ Accountable advance
		- Amount given by an employer to an employee for expenses to be incurred by the employee on the employer’s business and to be accounted for by the production of vouchers and the return of any amount not so spent
* An allowance is generally taxable, unless subject to a statutory exception
* A reimbursement or accountable advantage is generally not taxable

## 2. Exceptions

* There are numerous exceptions to para 6(1)(b)
	+ See 6(1)(b)(v), (vii) and (vii.1)
	+ Reasonable allowances for travel expenses in connection with selling property or negotiating contracts for employee’s employer
	+ Reasonable allowances for travel expenses for travelling away from
		- Municipality where employee ordinarily works
		- Metropolitan area where establishment is located
	+ Reasonable allowances for use of motor vehicle while in performance of duties
* Allowance for use of car not reasonable where measurement of use is not based solely on number of km (for employment purposes), or where TP receives allowance and reimbursement for same use

#### Blackman v MNR (1967, TAB)

* As were employees of firm engaged in transporting passengers and goods
* Employer used to pay As allowances for living away from main establishment of employer
* Sum of money was not of a travelling expense nature
	+ Rather they were personal and living expenses
* Appeals must be dismissed
* Tax Appeal Board says this is taxable, not exempt travel allowance
	+ Money wasn't for travelling, it was for the enjoyment of journey
		- Distinction between sojourning and travel

### D. Statutory Exclusions

* 2 rules excluding certain benefits and allowances
	+ Subsection 6(6) exempts certain benefits and allowances for TP employed at special work site or remote location
	+ Subsection 6(16) exempts certain disability-related benefits or allowances

### 1. Employment at Special Work Site or Remote Location

* Subsection 6(6) applies where an employee’s duties at a special work site or remote location require employee to be away from his or her principal place of residence for at least 36 hours
	+ Para 6(6)(a) exempts value or expenses that TP has incurred for board and lodging while at work site
	+ Para 6(6)(b) exempt benefits or allowances for transportation between special work site and TP’s principal place of residence
1. Special Work Site
* Subpara 6(6)(a)(i) defines a special work site as
	+ Location at which duties performed by TP were of temporary nature, if TP maintained at another location, self-contained domestic establishment as TP’s principal residence
		- That was available for TP’s occupancy
		- To which, by reason of distance, TP could not reasonably be expected to have returned daily from special work site
* In Bouchard v MNR (1980, TRB), TP was employed by Quebec government, lived in Quebec city
	+ Received allowance for living and travel expenses for travelling to Sherbrooke
	+ Court said that going from Quebec to Sherbrooke was not travel in performance of duties, but travel to get to work
		- Not exempt
* This was legislatively reversed by enactment of subsection 81(3.1)
	+ Exempts amount paid by TP from arm’s length employer as allowance or reimbursement for travel expenses for part time work, if TP had other employment 80 km away

#### Guilbert v MNR (1991, TTC)

* A accepted position of editor-in-chief of newspaper Le Soleil only temporarily on basis he would be appointed chairman of Le Droit in Ottawa within relatively short period of time
* A states that his stay in Quebec City had initially been seen as of a temporary nature
	+ Newspaper would provide him with an apartment in Quebec City free of charge
* A always maintained a principal residence in Domaine Cheribourg
	+ Returned on the weekend, where his wife lived
	+ His kids lived in Quebec City with him
* A did not occupy apartment more than 50% of time
* Apartment was used as housing for other journalists from Le Soleil
* Newspaper’s premises are not work site, or special work site within meaning intended by Parliament
* The exception in subsection 6(6) does not apply in this case
* Duff: if court did its job properly and actually read act, would they have decided this differently?
	+ At the end of the day, the duties lasted 3 years, and weren't really a temporary nature
	+ But he did keep the other house

##### Notes

* *Jaffer v R:* Oxford English Dictionary defines “special work site”:
	+ A “special” place is an unusual or exceptional place
		- English version of paragraph refers to unusual place where employee does task
	+ In this day, a special work site may be any place in the world, including large metropolitan areas, remote countries etc
		- Expertise today is contractual commodity; contract not for a lifetime
* In *Rozumiak v the Queen* (Chicago): court held that new office in new city was special work site
	+ Amounts paid by employer to cover TP’s rent and expenses covered by 6(6)
* CRA’s views on requirement that TP’s duties be of a temporary nature:
	+ Temporary is not defined
		- Duties considered to be of temporary nature if it can reasonably be expected that they will not provide continuous employment beyond a period of 2 years
* CRA’s views on meaning of a TP’s principal place of residence
	+ Where employee maintains a self-contained domestic establishment
		- Dwelling house, apartment or other similar place of residence where a person generally eats and sleeps
		- Restricted access, including kitchen bathroom, and sleeping facilities
		- Does not necessarily have to be in Canada
* In *Charun v MNR* (1983, TCC) TP maintained principal residence in Vancouver, 60 km from temporary work site, where he had temporary accommodation
	+ Court should consider distance and kind of work
* CRA’s views on distance
	+ Employee not expected to return to principal place of residence if work site is more than 80 km from employee’s residence by most direct route normally travelled
		- Cases not meeting this general rule must consider other factors:
			* Number of hours that employee is at special work site
			* Amount of time to travel and time of day
			* Means of transportation available and condition of route
			* Length of rest period if employee returned home
			* General physical and mental health of employee

## IV. Deductions

* 8(2) limits amounts that may be deducted in computing TP’s income from office/employment

### A. Travelling Expenses

* Travel expenses include costs of transportation, accommodation, meals that are consumed during period of travel
* Amount of reimbursement generally not regarded as taxable benefit within 6(1)(a) nor allowance under 6(1)(b)
* Where employee incurs travel expenses that are not reimbursed, or employer does not provide reasonable travel allowance, these are regarded as cost of earning TP’s income
	+ Deductible in computing income from this source
* In order to qualify for the deductions in para 8(1)(h) and (h.1):
	+ Employee must have been ordinarily required to carry on duties of office or employment away from employer’s place of business or in different places
	+ Employee must have been required under contract of employment to pay travel expenses incurred
	+ Employee must not have received travel allowance already exempt from tax 6(1)(b)

### 1. Ordinarily Required to Carry on Duties Away from Employer’s Place of Business or in Different Places

#### Nelson v MNR (1981, TRB)

* A, architect and lawyer employed with firms engaged in management of construction contracts
* Difficulties in appeal center of what is meant by
	+ Employer’s place of business
	+ Duties of TP’s employment
	+ Ordinarily required to carry out duties of employment away from employer’s place of business
* A alleges he was hired as senior management officer in Toronto
	+ Required to work away from head office in Toronto in Markham and Aylmer
* A was in fact assigned to Aylmer
	+ His duties were carried out at employer’s place of business

##### Notes

* *Lowe v MNR* (1959, TAB): court concluded TP worked on ship and not any land establishment
	+ Disallowed deduction
* *Ronchka v MNR* court held that TP was not ordinarily required to carry on duties in Rolphton
* *Shangraw v MNR* (1976, TRB): interpreting words as being related to actual duties and responsibilities of A’s employment rather than to time factor is legal and valid interpretation
	+ Ordinarily, as part of employment, went to homes of customers
* *Imray v Canada* (1988, FCTD) court accepted TPs’ argument that they were required to attend annual Teachers’ Conventions
	+ Attended normally, and as a matter of regular occurrence
	+ Allow deduction
* *Tremblay v Canada* (1997, FCA) TP required to attend English language course in Montreal
	+ Home stay deductible; ordinarily required as part of training; ordinarily interpreted as what they have to do, not what they generally do
* *Klue v MNR* court concluded that attendance at court was an essential and important part of TP’s duties as police officer
* *Charlton v MNR* (1984, TCC) court concluded that TP had voluntarily chosen to teach in Milton
	+ Disallowed deduction on basis that TP was not required to carry on duties of employment away from original place of business in Guelph
* *MNR v Jeromel* court noted that TP’s contract permitted, but did not require him to apply for sabbatical leave; disallowed deduction
* CRA’s views
	+ “Ordinarily” means customarily, or habitually, rather than continually
		- But there should be some degree of regularity
	+ “Required” means travelling is necessary for satisfactory performance of duties
	+ “Place of business” is permanent establishment of employer
		- Office, factory, warehouse, branch or store
	+ “In different places” refers to situation where employer does not have a single or fixed placed of business

### 2. Required Under Contract of Employment to Pay Travel Expenses

#### Canada v Cival (1983, FCA)

* Cival used his own car to carry out duties of his employment
	+ Department of National Revenue reimbursed him at a mileage rate
* Issue: can he deduct these expenses?
	+ Was he required by contract of employment to pay expenses incurred in using car
* The arrangement, if a contract at all, might be a unilateral contract
* He was not contractually bound to use his car in doing his job and to pay the expenses involved
* Appeal allowed

##### Notes

* *Cival* was distinguished in *Rozen v Canada* (1985, FCTD)
	+ If auditor did not have car, firm would probably dismiss him
	+ P was indeed required to use his car; did not have option if he was to do job properly
* In *Ain v MNR* (1986, TCC) court disallowed deduction: TP was required to use car, but no verifiable obligation that he was required to pay expenses above government allowance

### 3. Receipt of Travel Allowance

####  Yurkovich v MNR (1986, TCC)

* Yukovich was and is an auditor with Province of Alberta
* First 2 conditions under para 8(1)(h) are fulfilled
	+ Required to carry on duties of employment away from his employer’s place of business
	+ Under contract of employment was required to pay travelling expenses incurred
* Does he qualify for the third condition, that he was no in receipt of an allowance for travelling
* There was no evidence that the mileage rates were calculated and paid in advance
	+ Rather they were paid as result of claims made by A subsequent to and dependent on such travel
		- Outside allowance category
* No reason to deny Yurkovitch claim; met first 2 conditions and third is inapplicable

##### Notes

* In *Gauvin v MNR* he sought to deduct car expenses in excess of allowance on grounds that allowance not reasonable
	+ Board disallowed deduction
	+ To be unreasonably low would require mileage allowance set below standard or reasonable amount for functions it was intended to reimburse, not merely lower than total operating costs incurred

### 4. Travel in the Course of an Office or Employment

#### Luks v MNR (1958, Ex Ct)

* A is electrician employed by Eastern Electrical Construction Ltd
* List of tools required is lengthy, but could not be left at worksite, and he carried them in his car
* Travelling between A’s home and several places of employment not part of duties of employment, nor part of duties of employment to take his tools to and from home
	+ The fact that it was the practical thing to do does not make it part of his duties

##### Notes

* *Chrapko v Canada* (1988, FCA)TP sought to deduct expenses travelling to 3 racetracks
	+ Court disallowed expenses to 2 sites in Toronto where he worked 75% of the time
	+ Court allowed deductions to third site in Fort Erie
* *MNR v Merten* court recognized that TP can deduct expenses for travelling from his home to a place of work as long as that place of work is other than the place at which he usually works
* *Evans v Canada* (1999, TCC) a school psychologist required to travel to various schools; sought to deduct automobile expenses
	+ Implied term of contract to have a car available, and to have materials on hand
	+ The cost of transport by automobile of materials back and forth at the start and close of each day was a necessary expense incurred in performance of her duties
* This is completely inconsistent with Luks

### B. Meals

* Subsection 8(4): TPs who seek to deduct cost of meals as traveling expenses under para 8(1)(h) or 8(1)(f) must satisfy
	+ Meal consumed while TP was required by duties to be away, for a period of not less than 12 hours, from municipality where employer’s establishment which TP ordinarily reported, and away from the metropolitan area

#### Healy v Canada (1979, FCA)

* A employed by Ontario Jockey Club, head office in Rexdale; required to work at 3 race tracks
	+ Received no allowance or reimbursement for travelling expenses to and from Fort Erie, nor for cost of accommodation in Fort Erie
* Trial judge: D’s situation (performing duties at 2 or 3 places) fell within meaning of 8(1)(h)
	+ Entitled to deduction for travel expenses in court of employment
	+ Neither of the workplaces were where the D ordinarily reported for work
* Agree with trial judge
	+ A falls within 8(1)(h) and was entitled to deduct travel expenses
* Disagree with trial judge that he was not entitled to deduct travelling expenses under 8(4)
* A normally worked in Toronto
* A can deduct meal expenses while in Fort Erie

## Other Deductions (Moving Expenses)

* Canadian courts have traditionally regarded the cost of moving from one residence to another to be closer to a new or already existing place of business as non-deductible personal expenses incurred in order to be available to the TP’s employment or business
	+ But not in the course of carrying on the duties of the TP’s employment or business
	+ *Stanley Karp v MNR*
		- The whereabouts of a person’s furniture at given moment can have no bearing on that person’s ability to earn income
* Act was amended in 1972 to allow a limited deduction for moving expenses (s 62)
	+ Incurred in respect of an eligible relocation
* 62(1) you can deduct moving expenses if it is an eligible location (limitations)
* 62(3): eligible expenses
* 248(1): eligible relocation

### 1. Eligible Expenses

* Subsection 62(3) defines moving expenses to include any expense incurred as or on account of
	+ Travel costs (meals and lodging) while moving
	+ Cost of transporting or storing household effects while moving
	+ Cost of meals and lodging not exceeding 15 days
	+ Cost of cancelling lease
	+ Selling costs in respect of selling old residence
	+ Cost of legal services is respect of purchase of new residence, and registration of title
	+ Interest, property taxes, insurances premiums and cost of heating and utilities in respect of old residence
		- Extent of lesser of $5000
		- Total of such expenses of the TP for the period
			* While old residence not occupied by TP or other person who ordinarily resided there
				+ Nor rented to any other person
			* In which reasonable efforts are made to sell the old residence
	+ Cost of revising legal documents to reflect address of TP’s new residence, or replacing drivers licenses, and non-commercial vehicle permits, connecting or disconnecting utilities

#### Storrow v Canada (1978, FCTD)

* P moved from Ottawa to Vancouver and claimed part of his deductible moving expenses:
	+ Cost of new residence in excess of the amount he received on sale of former residence
	+ Mortgage interest attributable to $22,750
	+ Land registry fees for new residence
	+ Installation costs of dishwasher and new door locks
* Moving expenses, as permitted in 62(3) do not mean outlays or costs incurred in connection with the acquisition of a new residence
	+ Only outlays incurred to effect the physical transfer of the TP, his household, and their belongings to a new residence are deductible
* Since this case the statute has been expanded

##### Notes

* *Ball v Canada:* Tax Court disallowed the expenses of moving on the basis that section 62 does not allow the deduction of expenses for house hunting and job hunting
* *Critchley v MNR*: court allowed veterinarian charges for tranquilizers and rabies shots incurred in moving the family dog; dog is a member of the household
* *Yaeger v MNR*:court rejected costs of moving a horse and trailer, stating that these were not costs of transporting and storing household effects
* *Hasan v Canada*: amount must have been paid when TP physically moves or changes residence
* *Pollard v MNR:* amount incurred to complete a sale properly deductible under s 62 as selling cost (62(3)(e))
	+ Agreement to pay higher rate of interest on new mortgage on new residence to discharge mortgage on old residence
* *Lowe v Canada*: court found TP was not making reasonable efforts to sell his old residence
* *Rose v Canada*: court disallowed deduction of mortgage interest, utility payments and insurance in respect of the old residence because TP’s son continued to live in the old residence
	+ Reasonable efforts had not been made to sell the residence
* *Johnston v Canada*: interest on money borrowed to purchase a home in new work location is not within the definition of moving expenses
* *Cusson v Canada*: cost of purchasing better tv is not a deduction, even though the original connection was unavailable
	+ Equipment and installation charges are not provided for in the para, since it refers to connection and disconnection costs

### 2. Eligible Relocation

* Subsection 248(1) defines an eligible relocation where
	+ Relocation occurs to enable TP to
		- Carry on a business or be employed in Canada
		- Be a student full time at post-secondary
	+ Both residences are in Canada
	+ Distance between old residence and new work location is not less than 40 km greater than the distance between new residence and new work location
* In applying this section, courts must consider
	+ The purpose of the relocation
	+ The residences at which the TP ordinarily resided before and after the relocation
	+ Distance of the relocation (40 km test)

### a. Purpose of Relocation

* Must enable TP to carry on business, be employed or be a full time student at new work location

#### Beyette v MNR (1990, TCC)

* Issue: was TP entitled to deduction claimed for moving to new employment site in 1986 from old employment site, after already working at new site (commuting daily) for 5 years
* Good reasons for delay: illness, lack of housing at new site, inactive real estate selling market
	+ All of this is irrelevant
* It is up to the TP to determine the timing of the move, the costs associated
* No time limit is expressed by the Act
* He is entitled to costs of moving
* Purpose of relocation
	+ Old language: in order to get the deduction, the employee must have commenced work at a new location, and must have moved for the reason
	+ New language: the move must enable work at a new work location

##### Notes

* *Beyette* was followed in *Beaudoin v Canada*
	+ TP was relocated in 1996, but delayed moving until 2003
* *Howlett v Canada:* promotion required TP to spend more time at employer’s work location in Mississauga
	+ Court disallowed deduction: not employed at a new work location
* *Broydell v Canada*: disallowed deduction of moving expenses; no new work location
* *Crampton v MNR:* deduction of expenses of moving from one suburb to another was disallowed
	+ No real different in nature of employment or work sites

### b. Residences Before and After Relocation

* It is essential to determine not only the purpose of the move, but also where the TP ordinarily resided before and after the relocation
	+ Moving expenses are deductible only where new residence is at least 40 km closer to new work location than old residence

#### Rennie v MNR (1989, TCC)

* When TP left Montreal in 1981 he was uncertain of length of employment in Edmonton
	+ He took only a minimum of household effects
	+ They lived in a rented apartment, and formed no intention to reside there permanently
* They moved to Victoria in 1983 and took up residence in rented premises
* TP decided to stay in Victoria and purchased a home
* A person is not capable of having more than one residence under s 62
	+ It is not the word “residence” that governs, but rather the phrase “ordinarily resided”
	+ Ordinarily resided:
		- *Thomson v MNR*: place where in the settled routine he regularly, normally or customarily lives
* In 1984 TP ordinarily resided in Victoria
	+ Cannot claim cost of moving from Montreal to Victoria, nor costs associated with Montreal home

##### Notes

* *Neville v MNR:* Tax Review Board allowed deduction of expenses from Peterborough to Winnipeg, despite TP having lived in rented accommodation
	+ A’s rented accommodation was temporary in nature, and old residence continued to be in Peterborough
* *Pitchford v Canada*: TP moved from Victoria to Moose Jaw to Saskatoon
	+ TP had no settled routine until Saskatoon; allowed deductions of moving from Victoria to Saskatoon
* *Simard v Canada:* TP occupied temporary lodgings near new work location in Mont-Joli, Quebec for five years before selling old residence and purchasing new residence
	+ Court allowed TP to deduct moving expenses associated with sale of old residence and transportation of household effects to new residence
* *Dalisay v Canada*: TP moved from St John’s to Regina, then to Edmonton 7 weeks later
	+ Allowed deduction of move from St John’s to Regina against employment income earned after moving to Regina
	+ Court held that the TP was never ordinarily resident in Regina, but had relocated from St John’s to Edmonton
* *Ringham v Canada*: TP sold home in Kanata in 1995 and rented condo in the same city, while travelling weekly to Thornhill, staying at the Holiday Inn
	+ TP then moved to Richmond Hill
	+ Court allowed TP’s appeal on the basis that there was really only a move from Kanata home to Richmond Hill
* *Ringham* was distinguished in *Calvano v Canada*: TP moved from Brampton to Coquitlam, but delayed selling house in Brampton for 16 months, renting to a tenant
	+ Court rejected TP’s argument that he resided in Coquitlam only temporarily until selling house
	+ Disallowed deduction of selling costs of Brampton house on the basis that the TP ordinarily resided in Coquitlam in 1996
* *Turnbull v Canada*: court disallowed deduction of moving expenses to and from BC on the basis that the TP was at all times ordinarily resident in Newfoundland
* *Cavalier v Canada*: court allowed deduction of moving expenses to and from Fort McMurray
	+ Even though his wife remained in Delta and his mail wasn’t forwarded
* *Klein v Canada:* TP owned 2 homes in Montreal
	+ When he moved to Vancouver and sold both homes, the court claimed that a person cannot have two ordinary residences, and disallowed expenses for Lachute residence
* *Templeton v Canada*: he worked from his own home and sought to deduct expenses incurred moving from two residences (one owned and one rented) to a rented house in Don Mills
	+ Court allowed deduction on the basis that the TP needed to be closer to business contacts in Toronto

### c. Distance of Relocation

* New residence must be at least 40 km closer to the new work location than the old residence

#### Giannakopoulos v MNR (1995, FCA)

* TP accepted new position which required her to work at a different location
* Applicant calculated that her new residence was 44 km closer than prior one
	+ Reassessment calculated the move at 36 km closer using the “straight line method”
* It only makes sense to measure the distance of a move using real routes of travel
	+ the straight line method bears no relation to how an employee travels to work
* The shortest normal route is a preferable test to the straight line method
	+ it is more realistic and precise
	+ it further the purpose of the provision
	+ it would also leave room to consider travel on roads, ferries, and rail lines
* Application allowed
* The straight line method is easier to enforce and understand; but it is not practical

##### Notes

* *Higgins v Canada:* application of *Giannakopoulos*
	+ Court disallowed deductions for moving expenses incurred by TP: shortest normal route from old residence to new work location was by ferry, even though inconvenient due to freezing conditions and ferry lines
* *Nagy v Canada*: also applied *Giannakopoulos*
	+ Disallowed deduction of moving expenses claimed by TP: moved only 34.6 km closer
	+ The idea of shortest route should be coupled with notion of normal route

### 3. Limitations on Deductibility

* Subsection 62(1) limits deduction of moving expenses in several ways

#### Hippola v The Queen (2002, TCC)

* Appellant started new employment and resided in rental accommodation in Waterloo
	+ His wife and kids continued to reside at old location in Navan
* A planned to start a consulting business in Ottawa
* After he moved back to Ottawa area (Navan) he started a job with Mitel Corporation
* In A’s settled life he normally lived in Waterloo
* It is only after A moved back to Navan that Mitel approached him and offered employment
	+ A did not move to Navan to enable him to be employed by Mitel
* The conclusion would be different if Mitel hired A before he moved
	+ Then A would have moved for the purposes of employment and could deduct moving expenses to the extent that they do not exceed income from employment
* This case was decided under the old language (moving before commencing a job)

##### Notes

* *James v Canada* (2001, TCC): on advice of accountant, TP received no salary from his company, withdrawing funds solely in form of dividends; sought to deduct moving expenses
	+ Court noted that TP could have deducted expenses had he withdrawn sufficient funds from company in form of salary rather than dividends

# Part 3: Income or Loss from a Business or Property and Other Income

## I. INTRODUCTION

* Para 3(a) identifies “business” and “property” as sources of income to include in computing net income
* Subsection 9(1) defines income from business or property as “profit”
	+ Implies deduction of reasonable expenses incurred in order to obtain the income
* Subsection 9(2) defines a TP’s loss from business or property
	+ Applying provisions of Act respecting computation of income from source in circumstances
* Subsection 9(3) stipulates that “income from a property” and “loss from a property” do not include capital gains or losses from the disposition of that property
* Where the source of a profit or loss is characterized as a “business” or “property”, income is fully taxable under subsection 9(1) and para 3(a) of the Act
	+ Losses are fully deductible under para 3(d)
* Where a gain or loss is of a capital nature, only ½ of the gain is taxable
* Where a TP realizes a gain, generally to his/her advantage to argue that gain not contemplated by act, or that gain originated from disposition of capital rather than business or property
	+ Where TP suffers economic loss, more advantageous to characterize loss as from business or property

## II. CHARACTERIZATION

* Business is defined as a “habitual occupation, profession, trade” in Oxford Dictionary
* Property is defined as “the right to the possession, use or disposal of anything” in Oxford
* For the purpose of the ITA:
	+ Business includes profession, calling, trade, manufacture or undertaking of any kind whatever and … adventure or concern in nature of trade; does not include office or employment
	+ Property: property of any kind whether real or personal or corporeal or incorporeal
* Business extends ordinary dictionary meaning by including other activities that might not be characterized as a business
	+ Adventure or concern in the nature of trade
* ITA definition also restricts the ordinary definition by specifically excluding office or employment

### A. Business

### 1. Ordinary Meaning

#### MNR v Morden (1961, Ex Ct)

* 1935 R acquired Morden Hotel in Sarnia and operated it until it was sold in 1957
* From 1942 to 1948 he was the owner of a racing stable
	+ A substantial portion of his time was devoted to training and racing horses
	+ He was betting on his own horses and others
		- No records of his gains or losses was kept
* From 1949 to 1955, the period in question, his gambling activities were occasional
* Persons who make gains by organizing efforts in the way that a bookmaker does are deriving income that is taxable
* In *Graham v Green* Rowlatt J said that each time he puts on his money, I do not think he could be said to organize his effort in the same way a bookmaker organizes his
	+ A winning bet is substantially in the same position as a gift or finding
* To be taxable, a gambling gain must be derived from carrying on a business as defined in s 127(1)(e) – now subsection 248(1)
	+ Casual winnings from bets are not subject to tax
* No evidence that his operations amounted to a calling or carrying on a business

##### Notes

* Most Canadian cases dealing with taxation of gambling gains have held that gains not income from business
* In 1994 House of Commons Standing Committee on Finance recommended that lottery and casino winnings over $500 be included in computing income of TP for with losses deductible against winnings
* In *MacEachern v MNR* (1977, TRB)*:* search and recovery of treasure from a sunken ship
	+ Found to be income from a business: TP and his partners intended to sell for profit anything of value that was recovered; hobby with potential for profit
* In *Tobias v Canada* (1978, FCTD)*:* unsuccessful search for treasure
	+ Court found operation to be of commercial nature; allowed the costs of search to be deducted as losses from a business
* In *Cameron v MNR* (1971, TAB): court concluded TP was professional salmon fisherman and not a whaler
	+ 2 occasions fortuitous and not business venture; 3rd catch would change things
	+ Both events should be considered as favourable to TP; gain not taxable under ITA

### 2. Extended Meaning

#### MNR v Taylor (1956, Ex Ct)

* Canadian company permitted by its parent to have on hand only a 30 day supply of raw metals
* TP asked parent company to purchase supply of lead himself; granted this permission
	+ He bought the lead, sold it to the company and assumed the risk personally
	+ TP made a profit
* Issue: whether R’s purchase and sale of the lead was an adventure or concern in the nature of trade under para 127(1)(e) – now 248(1)
* Test in *Californian Copper Syndicate Limited v Harris (1904)* by Lord Justice Clerk
	+ Line separating two classes of cases may be difficult to define
	+ Each case must be considered according to its facts
	+ Is the sum of gain made a mere enhancement of value by realizing a security, or is it a gain made in operation of business carrying out a scheme for profitmaking?
* Lord Justice Clerk in the test above stressed the element of speculation as a determining factor
	+ Whether transaction was gaining profit by sale of property rather than realization of investment
	+ Sale of property can be trade in property rather than realization of investment
* Lord Clyde in *CIR v Livingston et al (1926)*
	+ Test: whether or not the operations involved in it are of the same kind, and carried on in the same way, as those which are characteristic of ordinary trading in the line of business in which the venture was made
		- If they are, no reason why venture should not be regarded as “in the nature of trade” merely because it was single venture which took only 3 months to complete
* In *Rutledge v CIR* (1929) Lord President Clyde
	+ Is the adventure one in the nature of trade
		- Profits of isolated venture may be taxable provided venture is in nature of trade
* *Rutledge* was followed in *CIR v Fraser*
	+ R bought large quantity of whisky, no special knowledge of whisky trade; sold it at profit
	+ Lord President Normand
		- Purchaser of large quantity of whisky, greatly in excess of that could be used by himself, his family and friends, a commodity which yields no pride in possession, which cannot be turned to account except by a process of realization
			* Must be adventure in a transaction in the nature of trade
		- The fact that the transaction was not in the way of the business of R in no way alters the character which necessarily belongs to a transaction like this
		- Actual dealings were exactly the kind that take place in ordinary trade
* Negative propositions
	+ Singleness or isolation of transaction cannot be test of whether it was adventure in nature of trade
		- Word adventure implies single or isolated transaction; erroneous to set up its singleness or isolation as indication that it was not adventure in nature of trade
		- It is nature of transaction, not its singleness or isolation that is to be determined
	+ Not essential for organization to be set up to carry the adventure into effect
	+ That a transaction is totally different in nature from any of the other activities of TP and that he has never entered upon a transaction of that kind before does not take it out of category of being an adventure in nature of trade
* R cannot escape liability by showing that
	+ His transaction was a single or isolated one
	+ That it was not necessary to set up any organization
	+ That it was different from and unconnected with his ordinary activities
	+ He had never entered into such a transaction before or since
	+ That he purchased the lead without any intention of making a profit on its sale the company
* Positive guides
	+ Whether a particular transaction is an adventure in the nature of trade depends on its character and surrounding circumstances
		- No single criterion can be formulated
	+ If a transaction is of the same kind and carried on in the same way as a transaction of an ordinary trader or dealer in property of the same kind as the subject matter of the transaction it may be called an adventure in the nature of trade
	+ Nature and quantity of the subject matter of the transaction may be such as to exclude the possibility that its sale was the realization of an investment or otherwise of a capital nature or that it could have been disposed of otherwise than as a trade transaction
* These positive guides indicate that R entered into transaction for a variety of purposes, all of a business nature; many of them were similar to those that would have motivated a trader
	+ His transaction was in dealing with lead and nothing else

##### Notes

* CRA Interpretation Bulletin IT-459:
	+ Courts have emphasized that all the circumstances of the transaction must be considered and that no single criterion can be formulated
	+ Principal tests:
		- Whether TP dealt with the property acquired by him in the same way as a dealer in such properly ordinarily would
			* Compare what other dealers are doing
			* Whether efforts were soon made to find or attract purchasers
			* Whether steps were taken with intended result of improving marketability
			* Improve profit potential
			* Whether TP has commercial background in similar areas
		- Whether nature and quantity of property excludes possibility that its sale was realization of investment
			* Or was otherwise of a capital nature
			* Or that it could have been disposed of other than in trading transaction
			* Whether it could produce income or personal enjoyment to its owner by virtue of ownership
			* Some kinds of property are prima facie of an investment nature
				+ Manner in which it is dealt with and intention when acquired must be governing factors
		- Whether TP’s intention consistent with other evidence of trading motivation
			* TP’s intention to sell at a profit is not sufficient, by itself, to establish that he was involved in an adventure or concern in the nature of trade
			* TP may have more than one intention when a property is acquired

### B. Reasonable Expectation of Profit

* Where activity such as gambling is not carried on for purpose of making a profit, courts have generally held that the activity is not a business within meaning of Act
* Gambling winnings nor losses included/deducted in computing a TP’s net income
* Canadian courts have frequently supplemented subjective profit-making purpose test for existence of business or property source with objective “reasonable expectation of profit” test

#### Stewart v Canada (2002, SCC)

* Issue: appropriate use of “reasonable expectation of profit test”
	+ In order to have source of income, TP must have profit or REOP
* Minister disallowed losses from rental income: TP had no reasonable expectation of profit
* The REOP analysis cannot be maintained as an independent source test
	+ This test is imprecise, causing uncertainty for TPs
* There was no personal element in the TP’s endeavor; commercial nature never questioned
* A’s rental activities constitute source of income; entitled to deduct his rental loss
* In *Tonn v Canada* (1996, FCA)
	+ Tax system does not tax on basis of TP’s business acumen, with deductions to wise and withheld from foolish
* REOP test has transcended use as mere interpretive tool and has taken on a life of its own
* To summarize, in recent years the *Moldowan* REOP test has become a broad based tool used by Minister and courts in any manner of situation where the view is taken that the TP does not have a reasonable expectation of profiting from the activity in question
	+ From this it is inferred that the TP has no source of income
		- No basis from which to deduct losses and expenses relating to activity
	+ REOP has been applied to second guess bona fide commercial decisions, and runs afoul of the principle that courts should avoid judicial rule making in tax law
	+ REOP is problematic due to its vagueness and uncertainty of application
		- Results in unfair and arbitrary treatment of TPs
* Whether TP has source of income must be grounded in words and scheme of act
	+ To apply s 9, TP must determine if he/she has source of business or property income
		- A commercial activity which falls short of being a business may nevertheless be a source of property income
		- 2 stage approach to this question
			* Is activity of TP undertaken in pursuit of profit, or personal endeavor
			* If not personal endeavor, is source of income a business or property?
		- Purpose of this stage: distinguish between personal and commercial activities
* The issue of whether or not a TP has a source of income is to be determined by looking at the commerciality of the activity in question
	+ Where activity contains no personal element, is clearly commercial, no further inquiry necessary
	+ Where activity could be classified as personal pursuit, must be determined whether activity is carried on in a sufficiently commercial manner to constitute source of income
		- TP’s REOP is factor to be examined to determine commercial intent
* Application of source test
	+ Property rental activity lacks any element of personal use or benefit to TP; clearly commercial activity
		- As a result, A satisfies test for source of income
	+ Had A made use of one or more properties for personal benefit, he would have opportunity to establish that predominant intention was to make profit, and activity was carried out in accordance with objective standards of businesslike behavior
* A’s rental activities constituted a source of income

##### Notes

* In *Quebec v Lipson* (1979, SCC) TP admitted that sole purpose of transactions was to enable members of syndicate to deduct the rental losses in computing their net income
	+ On appeal, SCC upheld assessment under Quebec *ITA;* disallowed TP’s share of syndicate’s losses as a deduction in computing his income for purposes of provincial income tax
		- Purpose of transaction was not genuine business purpose to make profit, but purely tax motivated purpose, to create deductible loss by means of disadvantageous contract
* In *Mason v MNR* (1984, TRB)
	+ TP incurred losses from renting out house during period required to live at school
		- House had been maintained for TP’s own benefit
		- Board disallowed deduction of rental losses on the basis that the rental operation was not carried on with a reasonable expectation of profit
* In *Dallos v MNR* (1985, TCC) rental losses were disallowed: TP had built property to use during retirement, not for investment purposes
* In *Moldowan v Canada* (1977, SCC) SCC suggested following criteria to be considered in determining whether a TP has carried on an activity with a reasonable expectation of profit:
	+ Profit and loss experience in past years
	+ TP’s training
	+ TP’s intended course of action
	+ Capability of venture as capitalized to show a profit after capital cost allowance
* *Landry v Canada* (1994, FCA) : further tests :
	+ Time required to make an activity of this nature profitable
	+ Presence of necessary ingredients for profits ultimately to be earned
	+ Profit and loss situation for the years subsequent to the years in issue
	+ Number of consecutive years during which losses were incurred
	+ Increase in expenses and decrease in expenses in the course of the relevant periods
	+ Persistence of factors causing the losses
	+ Absence of planning
	+ Failure to adjust

## III. INCLUSIONS

* TP’s income from a business or property is TP’s “profit” 9(1)
	+ This is a net concept implying the deduction of reasonable expenses incurred for the purpose of gaining or producing the TP’s income from the business or property from the gross revenues obtained by the business or property

### A. Gains from Illegal Activities

#### No 275 v MNR

* A’s only grounds of appeal:
	+ Income derived from earnings as prostitute not taxable since not derived from business
		- And not taxable because derived from sordid and contemptible way of living
* A’s earnings are derived from a business within meaning under s 127(1)(e) – now 248(1)
* No reason for holding that the words were intended to exclude these people
	+ To do so would increase the burden on lawful businesses
* Once the courts are satisfied that the income is liable to tax, it is immaterial that it comes from a legal or an illegal business, or a business which is malum in se or malum prohibitum

##### Notes

* In *Smith v Minister of Finance* (1925, SCC)
	+ Difficult to conceive Minister requiring criminals to furnish information on profits from crimes, or demanding keeping of books or records of illicit or criminal operations
* This decision above was reversed by the JCPC which found:
	+ No valid reasons for holding that the words used by Dominion Parliament were intended to exclude these people
		- Particularly as to do so would increase burden on lawful businesses
* In *Mann v Nash* (1932) Rowlatt J considered the argument that by taxing gains from illegal activities, the government can be seen to be profiting from this illegality
	+ Rejected this view as misconceived

### B. Damages and Other Compensation

* Damages and other compensation are another category of amount the inclusion of which in computing a TP’s income from a business or property depends on judicial decisions rather than statutory rules

#### Canada v Manley (1985, FCA)

* TP found purchaser, shareholders refused to pay finder’s fee; TP sued Mr. Levy, awarded damages for breach of warranty of authority
* R received, in damages, what he would have realized in profit, from adventure in nature of trade
* Surrogatum principle is to be applied
	+ Where, pursuant to a legal right, a trader receives from another person compensation for trader’s failure to receive sum of money, which, if it had been received, would have been credited to amount of profits, if any, arising in any year from trade carried on by him at time when compensation is so received, it will be treated for income tax purposes in same way as had it been received instead of compensation
* Compensation in this case was for failure to receive finder’s fee
	+ Treated the same for income tax purposes

##### Notes

* In *Prince Rupert Hotel v Canada* (1957, FCA), majority characterized payment as business income
	+ Replaced management fees to which TP would otherwise have been entitled
* In *Donald Hart Limited v MNR*, payment made for purpose of filling hole in A’s profit, which had been lost to it by reason of the tortious acts of D
* In *HA Roberts Ltd v MNR* (1969, SCC) TP received sum from one client and sum from another when they discontinued long term contracts
	+ Court characterized these as separate businesses that ceased to exist, since contracts themselves were capital assets of enduring nature, value of which built up over years
	+ Payments were non-taxable capital receipts
* CRA’s views concerning separate businesses
	+ Whether carrying on of two or more simultaneous business operations by TP is same business is dependent on degree of interconnection, interlacing or interdependence
		- Extent to which they have common factors
		- Whether operations are carried out on the same premises
		- One operation may exist primarily to supply the other
		- Whether the operations have differing fiscal year-ends
		- Whether the TP’s accounting system records the transactions of both operations as if they were those of one business
* CRA’s views on characterization of payments received on cancellation or non-performance of a business contract
	+ May be income or capital receipt
		- If receipt relates to loss of income producing asset, it is a capital receipt
		- If it is compensation for the loss of income, it constitutes business income
	+ Factors:
		- If received for failure to receive a sum of money: income receipt
		- To absorb shock as a normal incident: revenue receipt and not capital receipt
		- Destroys or materially cripples the whole structure of the recipient’s profit making apparatus: capital, not revenue receipt
* CRA: payment from landlord to tenant on cancellation of a lease is a capital receipt
	+ Tenant considered to have relinquished right or rights in respect of leasehold interest
		- Such an amount represents proceeds of disposition of part or all of the leasehold interest
* *CIR v Fleming and Co*
	+ Drew a distinction between cases where a business is designed to absorb the shock
		- If TP is big and can absorb shock, damage characterized as business income
		- Where the profit making apparatus will be destroyed or crippled then capital
	+ How big to you have to be for you to be crippled or not?
* Punitive damages cases: *Bellingham*, *Cartwright and Sons*
	+ That additional award is not compensation, it is a penalty designed for the future
	+ These awards not something you can expect in life, not compensating you for something you were entitled to; windfall

### C. Voluntary Payments

* Voluntary payments are made ex gratia, without any legal entitlement on part of recipient

#### Federal Farms Ltd v MNR (1959, Ex Ct)

* A’s farm flooded, substantial quantities of vegetables in ground destroyed and of no value
* A relief fund received donations
	+ To provide emergency assistance to hurricane flood victims
	+ To care for the dependents of individuals who lost their lives
	+ To compensate for losses of household contents, clothing and property
* A received a sum for his loss
* For income tax purposes, all expenses incurred in seeding and cultivation of crops destroyed were allowed as deductible operating expenses, as well as other expenses occasioned by flooding and in connection with which the amount in question was spent
* A carried no insurance for flood, and received nothing from any other source
* Issue: was this sum income?
* The whole amount received in respect of insurance on destroyed stock is a trade receipt
* Here the relief fund received nothing from A in contribution, premiums, services etc
* A had no legal right to demand payment, and no expectation of getting anything
* The gift here is entirely of a personal nature, unrelated to business activities of A
* In this case, payment was in no proper sense compensation or income
* The court concludes this is a gift, in the nature of a voluntary, personal gift

##### Notes

* CRA Interpretation Bulletin IT-273R2
	+ Government compensation for loss or damage to personal use property does not ordinarily result in tax consequences
	+ Assistance for capital property is ordinarily netted against cost of repairs made to property, or reduces cost or capital cost of replacement property
	+ When government assistance is received for damages inventory, amount will be included in income under para 12(1)(x) to extent that assistance does not reduce amount of costs incurred related to that damage
* In *McMillan v MNR* (1982, TRB) insurance broker received sum for three years from another insurance broker after a longstanding client requested the latter to make the payments
	+ Payments were gratuitous; A had no legal expectation, non-taxable windfall
* In *Canada v Cranswick* (1982, FCA) TP offered to pay sum per share to minority shareholders or purchase their shares for sum, in the hope of avoiding controversy or potential litigation
	+ Payment was non taxable windfall to which TP had no enforceable claim, TP engaged in no organized effort, no foreseeable element of recurrence
* In *Mohawk Oil Co v MNR* (1992, FCA) TP received sum in settlement of claim for damages resulting from negligent construction of waste oil reprocessing plant installed in 1980 but taken out of service in 1981
	+ Payment received partly on account of income in recognition of lost profits, partly on account of capital in recognition of capital outlay involved in construction of plant
* In *Frank Beban Logging Ltd v Canada* (1988, TCC), TP received sum from BC after its operations came to an end when federal and provincial governments agreed to create national park
	+ Payments of this sort not uncommon
	+ It is not intended that these amounts be taxable
	+ If such payments were made as an expression of goodwill, then any warm feeling thus engendered would quickly evaporate around April 30 of the following year
* In *Campbell v MNR* (1958, TAB), TP had reputation as professional swimmer; entered into contract with Toronto Star
	+ Agreed to attempt to swim Lake Ontario in exchange for sum, and further amount upon completion
	+ Although she didn’t complete the swim, paid sum in recognition of effort
	+ TP treated this as non taxable gift
	+ TAB concluded payment was taxable as income from business
		- True nature of transaction was payment for performance of services

### D. Prizes and Awards

* Like voluntary payments more generally, prizes and awards are often received without any legal entitlement on the part of the recipient

#### Abraham v MNR (1960, TAB)

* TP, operated grocery store in Ottawa, won sum of cash after entering draw held by distributor from whom he purchased his stock in trade
* Whether he took cash or car, was still a prize
	+ Won by pure chance and not presented as remuneration for services rendered
* The cheque received by A was in the nature of a non-taxable prize
* Courts: where sufficient element of chance, breaks connection with business

##### Notes

* In *Poirier v MNR* (1968, TAB) advantage given to A by Ford did not constitute income because origin of advantage had none of the characteristics of a taxable income
	+ Benefit to A was neither rent, nor interest, nor dividend, nor profit, nor salary
* In *Rother v MNR* (1955, TAB) TP, professional architect, received sum as participant in design competition
	+ Selected to participate in final competition for commission to design the gallery
	+ Payment was non-taxable receipt, of prize or gratuitous award received in competition
* In *MNR v Watts* (1966, Ex Ct) TP, who was also an architect entered a design competition
	+ Received 2 sums as prizes, and asked to submit further drawings
	+ Characterized both payments as taxable income from a contractual relationship that had been created between the TP and the CMHC by virtue of entering into this competition by R and filing of drawings pursuant to it
* In *Rumack v MNR* (1992, FCA) TP won cash for life, paying a sum each month
	+ Court held income element taxable by virtue of paras 56(1)(d) and 60(a)
		- Lottery prizes have traditionally been exempted from income tax in Canada
		- A stream of payments monthly has the character and quality of income
			* Payments are regular, certain, foreseeable, expected and enforceable
			* Endure for payee’s lifetime, and inexhaustible
		- The value of the prize is a windfall
			* The monthly payments are something different
* Legislative Response: paragraph 56(1)(n)
	+ Includes prizes won for achievement in field of endeavour ordinarily carried on by TP
	+ Excludes amounts received “in the course of business” or ”in respect of, in the course of or by virtue of an office or employment”
	+ Excludes “prescribed prizes” – defined in Reg. 7700 as prize recognized by general public and awarded for meritorious achievement in arts, sciences or service to public”
		- Excluding amount reasonably regarded as received as compensation for services

### G. Prizes

* Para 56(1)(n) includes in income: total of amounts received by TP as or on account of a prize for achievement in a field of endeavor ordinarily carried on by TP, other than a prescribed prize
	+ Less the $500 exemption in para 56(3)(c)

### 1. Prize for Achievement

#### Canada v Savage (1983, SCC)

* TP received a sum from her employer on successfully completing courses
* Para 56(1)(n): prize for achievement is income from source under s 3, just as income from office or employment is income from source under s 3
* If a prize under $500 would still be taxable under sections 5 and 6, the $500 exclusion in para 56(1)(n) would never have any effect
	+ First $500 of income received during year falling under 56(1)(n) is exempt from tax

##### Notes

* At the time this case was decided, para 56(1)(n) did not contain the parenthetical words excluding amounts received in the course of business, amounts received in respect of, in the course of, or by virtue of an office or employment
* Effective for amounts received after May 23, 1985, para 56(1)(n) was amended by excluding from the provision, “amounts received in the course of business, and amounts received in respect of, in the course of or by virtue of an office or employment”
	+ The purpose of this amendment was to reverse the result in *Savage*
		- Some employers give awards, prizes or similar payments to their employees in the course of employment
			* These payments represent taxable benefits to the employee and are intended to be fully included in income
* Courts are no longer confronted with the conflict between inclusion of a prize under para 56(1)(n) and its inclusion as income from an office or employment from a business
* In *Turcotte v Canada* (1997, TCC) the court accepted that the study of Quebec cinema was not a field of endeavor ordinarily carried on by the TP
	+ The payment was not taxable under para 56(1)(n)

### 2. Prescribed Prize

* Regulation 7700 defines a prescribed prize as:
	+ Prize recognized by general public and that is awarded for meritorious achievement in arts, sciences or service to public but does not include amount reasonably regarded as having been received as compensation for services rendered or to be rendered
* In *Foulds v Canada* (1997, TCC) TP operated business managing band; received 2 music prizes
	+ Prize for achievement in field of endeavor ordinarily carried on by TP, not received in course of business or in respect of, in the course of, or by virtue of an office or employment, court considered whether awards fit within definition of prescribed prize
		- Court finds prizes were awarded for meritorious achievement in arts, as provided for in Regulation 7700 of ITA
	+ The prizes are not business income, but fall within the taxing parameters of para 56(1)(n) and are prescribed prizes under Regulation 7700

### K. Non Competition Payments

* Where former employee receives amount as consideration for entering into agreement not to compete with former employer, this amount generally deemed to be remuneration under subsection 6(3) of Act
	+ Taxable as income from an office or employment
* In *Fortino v Canada* (1996, TCC) court rejected the Minister’s argument that non-competition payments not subject to deeming rule in subsection 6(3) should be characterized as income from unenumerated source under para 3(a)
* In *Manrell v Canada* (2001, TCC) MacArthur TCJ held that payments were proceeds from disposition of property right; taxable as capital gains
* Minister of Finance announced that the results in *Fortino and Manrell* would be reversed by statutory amendments designed to tax such amounts as ordinary income
	+ These have not yet taken force
* Proposed subsection 56.4(4) defines tax treatment of non-competition payments for purchaser
	+ Providing that these are to be treated as wages if the payment is included in computing the recipient’s income from an office or employment under section 5 or 6
	+ And as an outlay incurred by the purchaser on account of capital
	+ If payment it taken into account in computing the recipient’s cumulative eligible capital
		- And as a cost of the share or partnership of interest if included in the recipient’s proceeds of disposition of either kind of property

### E. Interest

### 1. Characterization

* The act does not define “interest”
* *Miller v Canada* (1985, FCTD): one must look to the general principles of interpretation, dictionary definitions and jurisprudence
* Oxford Dictionary: interest is defined as money paid for the use of money lent or for not exacting repayment of debt
* Black’s Law Dictionary: interest is defined as the compensation allowed by law or fixed by the parties for the use or forbearance of borrowed money

#### Perini Estate v MNR (1982, FCA)

* TP sold shares for
	+ Initial sum payment
	+ Additional payments based on post tax net profits
	+ Interest on these additional payments, computed at an annual rate of 7% from the closing date to the date of each additional payment
* A argues that despite name given to them in agreement, payments were not interest, but part of purchase price; not of an income nature
* Obligation to pay additional sums on account of purchase price under these provisions was a conditional one or a contingent liability
	+ Depended on two conditions which might or might not be fulfilled
* Unless and until these conditions were fulfilled, no additional sum owing
* Appeal dismissed
* Court held that the parties to a contract could give a contingent liability retroactive effect such that it could qualify as a principal sum to which interest could be referable
* Interest depends on when entitlement existed; even a contingent right is good enough

##### Notes

* In *RG Huston v MNR* (1962, Ex Ct): payments received from war claims fund, although called interest and calculated as interest, were simply grants
	+ TPs had no property or legal or equitable right of any kind in the amount on which the alleged interest was computed
* In *Shaw v Canada* (1993, FCA) TP received interest as part of a settlement of an action for additional compensation following the expropriation of a farm
	+ FCA held that this payment was taxable as interest under para 12(1)(c) of the Act, not as damages or compensation for expropriation
	+ Entitled to compensation when property was expropriated; interest
* In *Ahmad v Canada* (2002, TCC) TP received sum as a pre-judgment interest after successful legal action for breach of contract
	+ No principal amount in reference to which interest could accrue until judgment determined that he had been wronged, that he had suffered a loss from the wrong and amount of loss
	+ Rejected that the payment was taxable as interest
* In *Coughlan v Canada* (2001, TCC) TP received damages and prejudgment interest
	+ Court concluded payment was interest on liquidated amounts wrongfully withheld and properly taxable under para 12(1)(c)
* In *Hall v MNR* (1970, Ex Ct), court held that amounts received for bond coupons were taxable because amounts were received in lieu of payment of interest
* In *The Queen v Greenington Group Ltd* (1979, FCTD) court upheld assessment that corresponding reduction in purchase price of an amount received in lieu of payment of, or in satisfaction of, interest was taxable as income under 12(1)(c)
* In *MNR v Yonge-Eglington Building Ltd* (1974, FCA) court rejected TP’s characterization of additional payments as interest within meaning of 20(1)(c)
	+ He paid a percentage of revenue; called interest, but does not have character of interest
		- Not referable to principal sum, and does not accrue day by day
* In *Sherway Centre Ltd v Canada* (1998, FCA) court stated that jurisprudence interpreting meaning of definition of interest has not developed alongside of, or has not taken into account new and innovative financing schemes for new business ventures
	+ Allowed deduction under para 20(1)(c)
	+ Modifies Yonge
	+ Decision makes no sense, was driven by facts, but is now the law
* CRA’s views on characterization of interest income
	+ Has been described by courts as:
		- Return or consideration or compensation for the use or retention by one person of a sum of money, belonging to, in a colloquial sense, or owed to, another
	+ Interest does not arise unless there is an amount due to, or belonging to another person for the period in which the interest is calculated
	+ Since 1983 where award for damages, such an amount will constitute interest income
		- Liability for damages originates on the date of the injury
			* Amount owing to injured party is from that date, even if determined at later date
	+ Similarly, where enforceable agreement for sale of property is executed, but negotiated price not paid until subsequent date, interest received by vendor from date of agreement to date of payment is interest income in vendor’s hands

### 2. Payments of Interest and Capital Combined

* Para 16(1)(a) applies where “under a contract or other arrangement, an amount can reasonably be regarded as being in part interest … and in part an amount of a capital nature
	+ The part of the amount reasonably regarded as interest shall be deemed interest
* Para 16(1)(a): anti-avoidance provision to enable courts to characterize reasonable part of payment as interest where reasonable to regard payment as part capital and part interest
	+ Para 16(1)(a) seems to permit the courts to characterize payments as interest
		- That the parties describe as something else
		- And payments that would not otherwise be characterized as interest on the basis of the legal relationships actually established

#### Groulx v MNR (1967, SCC)

* Issue: whether sums received by A, pursuant to provisions of contract of sale, may be considered interest within meaning of s 16(1) of ITA
* In order to consummate a sale, he decided to waive interest
* The property was sold at a price in excess of fair market value
* By sacrificing interest, A demonstrated that his intention was to assure a capital price
* The full amount of installment payment can reasonably be regarded as interest
* Appeal is dismissed

##### Notes

* In *Vanwest Logging Co Ltd v MNR* (1971, Ex Ct) agreement did not pay for payment of interest, except in case of overdue installments
	+ After reviewing *Groulx,* court stated in order to determine whether part of each installment could reasonably be regarded as payment of interest, must consider:
		- Terms of agreement reached between the parties
		- Course of the negotiations leading to it
		- Relationship of price paid to the apparent market value of property at the time
		- Common practice with respect to payment of interest on sale of timber limits
	+ Court allowed TP’s appeal; not reasonable to regard as interest
* Subsequent cases involving installment sales have considered four criteria in *Vanwest,* but have tended to regard relationship between price paid for property and its FMV at time of purchase as most important factor
	+ See *Club de Courses Saguenay Ltee et all v MNR* (1979, TRB)
		- Board regarded difference between purchase price and FMV of assets sold as interest
	+ See *JE Martin v MNR* (1980, TRB)
		- Board concluded that because a parcel of land was sold at its FMV, it is unreasonable to presume that there was a part payment of interest
* CRA’s views
	+ Where property is sold on deferred or installment payment basis, and no interest is specified in contract other than for payment in arrears, it will be question of fact whether each payment received by the vendor contains an income element
		- Subsection 16(1) does not apply unless there is sufficient evidence that the selling price of the property is greater than its fair market value
* Subsection 16(4) provides that subsection 16(1) does not apply to any amount received by a TP in a taxation year
	+ As an annuity payment or
	+ In satisfaction of the TP’s rights under an annuity contract
* Subsection 16(5) states that subsection 16(1) does not apply in any case where subsection (2) or (3) applies

## Deductions

### 4. Business Expenses and the Statutory Deduction

* section 67.5 – illegal payments
* section 67.6 fines and penalties
* paragraph 18(1)(l) – recreational facilities and club dues
* section 67.1 – meals and entertainment
* subsection 18(9) – home office expenses
* paragraph 20(1)(c) – interest expenses

#### Symes v Canada (1993, SCC)

Iacboccui J (majority)

* TP, practicing lawyer, employed nanny
* Revenue authorities disallowed deduction, substituting lesser amounts
* Business income: interrelationship of subsection 9(1), paras 18(1)(a) and 18(1)(h)
	+ By virtue of 9(1), TP’s income from business is stated to be the TP’s profit for year
		- 18(1)(a): in computing business income, no deduction shall be made for expense, except to extent that it was made or incurred by TP for purpose of gaining or producing income
		- Para 18(1)(h): prohibition against deducting personal or living expenses
	+ Profit concept in 9(1): inherently net concept; presupposes business expense deductions
		- Ordinary principles of commercial trading or well accepted principles of business practice
* Personal expenses and para 18(1)(h)
	+ Traditional tax analysis characterized child care expenses as personal expenses
	+ Significant social change in late 1970s and into 1980s; influx of women of child bearing age into business and workplace
	+ It may be time to revisit classification of child care expenses
* Business expenses and para 18(1)(a)
	+ To be deductible as business expenses, A’s child care expenses must have been incurred for purpose of gaining or producing income from business within meaning of 18(1)(a) of the Act
	+ Traditionally, expenses that make TP available to business not considered business expenses; TP is expected to be available to business
	+ A would not have incurred child care expenses but for her business
	+ The need which is met by child care expenses exists regardless of A’s business activity
	+ No evidence to suggest that child care expenses are considered business expenses by accountants
		- But many women confront child care expenses in order to work
	+ Uncomfortable with suggestion that A’s decision to have children should be viewed solely as a consumption choice
	+ Section 9 and paras 18(1)(a) and 18(1)(h) cannot be interpreted to account for child care business expenses deduction in light of language used in s 63
* Effect of section 63
	+ Act’s definition of child care expenses specifically comprehends the purpose for which the A incurred her nanny expenses
		- Nanny expense is one incurred in order to provide child care services to enable TP to carry on a business either alone or as a partner
	+ Para 63(1)(e) further operates to cap the deduction
	+ Section 63 places limitations on child care deduction according to TP’s income
	+ Section 63 was intended by Parliament to comprehensively address child care expenses

L’Heureux-Dube (dissent)

* Does not agree with Iacobucci regarding section 63
* Does agree with Iacobucci’s characterization of business expense, 9(1), 18(1)(a), (h)
* The reality of A’s business life necessarily includes child care
	+ Should be considered deductible business expense pursuant to 9(1), 18(1)(a) and (h)
	+ Section 63 is no bar
		- Nothing in its wording which overrides application of s 9
		- Such an interpretation is in contradiction with purpose and historical basis for enactment of s 64, with traditional approaches to diverse deductions under Act, and Charter
		- In 1972 when that section was enacted, societal ideals had not evolved to where they are today
* Had Parliament intended to submit the deduction of child care expenses to the application of s 63 it would have expressed so in clear language
* S 63 is permissive rather than negative like para 18(1)(b) and (e) – limiting allowable deductions
* TP in this case is not seeking to claim a s 63 deduction from a source, but rather a source deduction, independent of s 63 deduction for child care, for a business expense
* Section 63 is ambiguous in its effect on subsection 9(1)
	+ Ambiguities are to be resolved in favour of the TP
* Subsection 63 and 9(1) can co-exist

## Deductions Part 2

* First test to determine deductibility of a particular outlay or expense:
	+ Whether made or incurred by TP in accordance with ordinary principles of commercial trading or well accepted principles of business practice
		- Business practices test
* Income producing purpose test in para 18(1)(a) disallows deduction of any outlay or expense
	+ Except to the extent that it was made or incurred by the TP for purpose of gaining or producing income from business or property
* Para 18(1)(h) prohibits deduction of personal or living expenses of TP, other than travel expenses incurred by TP while away from home or in course of carrying on TP’s business
* Section 67 limits amount that may be deducted in respect of an otherwise deductible outlay or expense to an amount that is reasonable in the circumstances

### A. Illegal Payments

* TP’s must include gains from illegal activities

#### Espie Printing Co v MNR (1960, Ex Ct)

* Issue: whether sums paid for overtime wages are deductible in computing income
	+ Some were incurred in circumstances that may have had an illegal character
* Profits of illicit businesses are subject to *Income War Tax Act*
	+ But the business itself is not illegal
* The wages in question are deductible in computing A’s income for the years in question

##### Notes

* In *Muller’s Meats Ltd v MNR* (1969, TAB) TP sought to deduct various “under the table” payments to chefs and purchasing agents
	+ TP had no receipts and refused to disclose names
	+ Board disallowed deductibility of these amounts on the basis that the TP had failed to discharge onus of proving the expenses had been incurred
		- If TP is willing to pay a bribe to do business, it throws open to question how much reliance can be placed on his unsupported and uncorroborated evidence as to the actual amounts he paid to informants, or whether indeed he paid out any amounts in this fashion
	+ In *United Colour and Chemicals Ltd v MNR* (1992, TCC), despite lack of detailed records, court accepted TP’s evidence that amounts had been paid and incurred for purpose of gaining or producing income from TP’s business
	+ In *Neeb v Canada* (1997, TCC) TP sought to deduct sum for marijuana and hash seized
		- Although cost of lost inventory is normally deductible in computing income, court disallowed deduction
			* No reason why Canadian public should subsidize a drug dealer’s loss through forfeiture of illegal drugs
		- See also *Burnett v The Queen* (1992, TCC) where loss of a van seized under *Narcotic Control Act* was held non-deductible due to public policy

### B. Damage Payments

#### Imperial Oil Ltd v MNR (1947, Ex Ct)

* A was obliged to pay settlement damages from a sea collision between ships
* Para 18(1)(a) disallows deductions for expenses not in connection with earning income
* Leading English authority: *Strong and Co Ltd v Woodifield* (1905)
	+ If a trader has to pay damages for negligence of servants under such circumstances that the loss is really incidental to his trade, then amount so paid is deductible
* Leading Australian cases:
	+ *Todd v Commissions of Taxation* (1913)
		- The events were necessary to production of income
	+ *Herald and Weekly Times Ltd v Federal Commissioner of Taxation* (1932)
		- Liability to damages incurred in connection with publishing newspaper
			* Flows as a necessary or natural consequences of business
* Negligence on the part of A’s servants was in the operation of its vessels
	+ Normal and ordinary risk of marine operations, and incidental to A’s business
* Amount sought to be deducted by A is properly deductible according to ordinary principles of commercial trading and well established principles of business and accounting practice
* Appeal allowed

##### Notes

* In *Strong and Company of Romsey Ltd v Woodifield* (1905): remoteness test
	+ The deductibility of a particular item of expenditure is not to be determined by isolating it
		- It must be looked at in the light of its connection with the operation, transaction or service in respect of which it was made so that it may be decided whether it was made not only in the course of earning the income, but as part of the process of doing so
* In *Davis v MNR* (1964, TAB), pig farmer sought to deduct damages and legal costs arising from car accident that occurred en route to brother’s house
	+ Board denied deduction; accident not incidental to business of farming or hog raising
* In *Fairrie v Hall* (1947, KB) TP angery at government’s buying policy concerning his business
	+ The associated libel was only remotely connected with TP’s trade as a sugar broker
* But in *Herald and Weekly Times Ltd v Federal Commissioner of Taxation* (1932) High Court of Australia permitted TP to deduct compensation paid in respect of libels published in its paper
* In *Income Tax Case No 8* (1923) TP allowed to deduct compensation for injuries; connection to its business
* In *Poulin v Canada* (1996, FCA) TP paid damages to former client after broker made false and fraudulent representations resulting in client’s damages
	+ He sought to deduct payment of damages in computing income
	+ Court disallowed deduction: did not correspond to a necessary risk to carry on business
* In *McNeill v Canada* (2000, FCA) TP, CA, was required to pay damages
	+ Court held damage payment deductible as expense under para 18(1)(a;) TP’s actions were for purpose of keeping clients and business
* CRA’s views on deductibility of damage payments
	+ Must meet following tests
		- Outlay or expense must have been made for purpose of gaining or producing income from business or property 18(1)(a)
		- Outlay must not be of capital nature 18(1)(b)
		- Outlay must not have been made for purpose or producing exempt income 18(1)(c)
		- Outlay must not be a personal expense 18(1)(h)
		- Outlay must be reasonable in the circumstances 67

C. Fines and Penalties

* Traditionally courts have disallowed deduction of fines and penalties on the grounds
	+ That such payments were not incurred for the purpose of gaining or producing income
	+ Deductibility would contradict public policy
* In *Day and Ross Inc v Canada* (1976 FCTD) court allowed TP to deduct provincial fines imposed for overweight trucking violations: penalties resulted from day-to-day operation of business and were necessary expense; not an outrageous transgression of public policy
* Similarly, in *TNT Canada Inc v Canada* (1988 FCTD) court allowed deduction of fines imposed under *Customs Act* and *Excise Tax Act:* TP’s actions were taken to earn income and were too few to constitute a significant violation of public policy
* In *65302 BC Ltd v Canada* (1999, SCC) SCC considered deductibility of fines and penalties for first time
	+ Court held that over-quota fines incurred by TP were deductible business expenses
	+ In response to this case, Department of Finance enacted s 67.6, applicable to fine and penalties imposed after March 22, 2004
		- No deduction shall be made in respect of any amount that is a fine or penalty imposed under a law of a country or political subdivision by any person or public body that has authority to impose the fine or penalty
	+ Although legislatively overturned, this case still provides a useful review of development of law in this area

#### 65302 BC Ltd v Canada (1999, SCC)

Iacobucci (majority)

* Issue: whether levies, fines, penalties may be deducted as business expenses from TP’s income
* Levy incurred as part of A’s day to day operations
	+ Decision to produce over-quota was a business decision to realize income
* Act not silent on issue of restricting deduction of some expenses incurred for purpose of gaining income
	+ Strong indication that Parliament directed its attention to the question, and where it wished to limit deduction of expenses or payment of fines it did so expressly
* Cannot agree that the deduction of fines and penalties should be disallowed as being contrary to public policy
	+ Capable of falling within 18(1)(a)
* Bastarache proposes a test in which the distinction between deductible and non-deductible levies must be determined on a case-by-case basis
	+ This approach would be onerous for the TP who would be forced to undertake difficult task of determining object or purpose of statute when filling out tax return

Bastarache (dissent)

* Cannot agree that all types of fines and penalties are deductible as a matter of course
* It was not the intention of Parliament to allow all fines to be deductible
* In this case it is possible to interpret the act in a manner that is consistent with the object of other legislative enactments
* Distinction between deductible and non-deductible payments must be determined on a case-by-case basis
	+ Main factor: whether primary purpose of statutory provision under which payment is demanded would be frustrated or undermined
* The deduction of a compensatory levy does not operate to frustrate or undermine purposes of *Marketing Act* or of the *BC Egg Marketing Board Standing Order*
	+ Such levies are not primarily geared towards punishment or deterrence
		- Instead, directed at efficient operation of regulatory scheme
* Allow deduction for purposes of computation of profit

### G. Recreation, Meal and Entertainment Expenses

* Although these expenditures are often incurred for the purpose of business promotion, they also confer personal benefits

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

* This decision was reversed by introduction of subpara 18(1)(1)(ii) in 1972
	+ Court’s analysis of “profit” and relationship between this concept and general limitation in what is now 18(1)(a) is still relevant
* Most important part of A’s business was acting as executor and trustee of estates and trusts
* Requires officers to take active part in community, partly by joining clubs to attract business
	+ This policy has resulted in business for it from which income was gained or produced
	+ Other trust companies followed same policy, and considered it good business to do so
* *Imperial Oil Ltd v MNR* (1947): deductibility of disbursements or expenses to be determined according to ordinary principles of commercial trading or well accepted principles of business and accounting practice
	+ Unless deduction was prohibition by s 6(a)
* But in some cases it is not necessary to consider 6(a) at all
	+ If not permissible by ordinary principles of commercial trading or accepting business and accounting practice
* It was consistent with ordinary business practice
	+ They were made for the purpose of gaining income
* The payments in question were properly deductible

##### Notes

* The specific decision in *Royal Trust* was reversed by subpara 18(1)(1)(ii)
	+ In computing income of TP from business or property, no deduction shall be made in respect of outlay or expense made or incurred by TP after 1971 ... as membership fees or dues … main purpose to provide dining, recreational or sporting facilities to its members
* Enactment of subpara 18(1)(1)(i): no deduction shall be made in respect of … outlay or expense made or incurred by TP after 1971 … for use or maintenance of property … yacht, camp, lodge or golf course
	+ Unless TP made or incurred outlay or expense in ordinary course of business
* Although subpara 18(1)(1)(i) disallows the deduction of amounts expended for the use or maintenance of the properties identified in the provision, it does not prohibit deduction of capital cost allowances in respect of capital cost of property
	+ But after 1974 regulation 1102(1)(f) prohibits deduction of capital cost allowance in respect of any property for which the costs of use or maintenance are non-deductible by virtue of subpara 18(1)()1(i)
* For subpara 18(1)(1)(i) to apply property must be a yacht, camp, lodge or golf course or facility

Yacht

* In *John Barnard Photographs Ltd v MNR* (1979, TRB) court emphasized that the provision is aimed at recreational facilities including a yacht used for pleasure
	+ For purpose of subpara 18(1)(1)(i), word yacht should be determined by considering use that is generally made of the vessel
		- Not simply whether it has a bow, stem, hull, cabin or motor
	+ Board allowed deduction
* In *MNR v CIP Inc* (1988, FCTD) the court allowed TP to deduct sum which it paid to rent a converted tugboat for the purpose of business entertainment on the grounds that the vessel could accurately be described only as a tugboat or perhaps a converted tugboat
* According to Interpretation Bulletin IT-148R3
	+ If yacht primarily used to entertain clients, suppliers, shareholders or employees, deductibility of any interest expense on funds borrowed to purchase yacht generally denied under 18(1)(1)(i)
		- Expenses for food and beverage while dining on yacht not subject to 18(1)(1)(i) if dining facilities are used on their own, not in conjunction with recreational nature of property, and genuine business purpose to use of facilities

Camp or Lodge

* In *Fehrenback v MNR* (1994, TCC) the TP sought to deduct expenses incurred to maintain a condo in Collingwood that the TP used primarily for personal use, but occasionally to entertain clients and prospective clients
	+ Court refused to stretch the meaning of camp or lodge to include the condo of A
		- Parliament could not have intended such a wide application of 18(1)(1)(i)
	+ Court still disallowed deduction on grounds that the expenses were neither reasonable within meaning of s 67 nor incurred for the purpose of gaining income under 18(1)(a)
		- Rather, were personal expenses
			* Deduction prohibited under para 18(1)(h)

Golf Course or Facility

* In *Groupe Y Bourassa Associes Inc v Canada* (1998, TCC) TP sought to deduct expenditures for golf tournaments conducted to promote business with clients
	+ Green fees were related to direct use of golf course, while costs of meals and beverages consumed at golf club and prizes from pro shop were incidental expenses, also prohibited by 18(1)(1)(i)
* ITA bulletin is consistent with *Groupe Y Bourassa*
* In *Roebuck v MNR* (1961, TAB) TP invited clients to bat mitzvah for daughter
	+ Court disallowed deduction of a % of bat mitzvah expenses based on ratio of business guests to all guests
	+ Expenses neither in accordance with principles of commercial trading or accepted business practice, nor incurred for purpose of gaining or producing income
* In *Fingold v MNR* (1992, TCC) TP’s corporation paid proportionate share of bar mitzvah and wedding expenses
	+ Court disallowed expenses: no evidence that business guests were aware they were guests of corporation rather than TP
* In *Grunbaum v Canada* (1994, TCC) TP expended on a wedding reception
	+ Expenses were proportionate
	+ Invitations were sent through company and identified name of company
	+ All correspondence with business guests was handled exclusively through the company
	+ Wedding expenses a deductible expense; not taxable benefit to TP
* In *Scott v Canada* (1998, FCA) courier who delivered packages by foot and public transit, sought to deduct cost of additional food and water that he consumed as part of routine
	+ Court analogized the food and water to the gasoline used by couriers who use cars

### B. Meals and Entertainment

* Subsection 67.1(1) limits amount TP may deduct for amounts paid or payable in respect of consumption of food or beverages or for enjoyment of entertainment to 50% of the lesser of amount actually paid or payable and amount reasonable in circumstances
	+ 67.1(4)(b) defines entertainment to include amusement and recreation
	+ 67.1(4)(a): no amount paid or payable for travel on airplane, train or bus in considered in respect of food, beverages or entertainment consumed or enjoyed while travelling
		- Where TP attends conference, convention or seminar, subsection 67.1(3) deems amount payable in respect of food, beverages or entertainment to be $50/day where not otherwise specified
	+ 67.1(2) lists further exceptions

### I. Home Office Expenses

* Amounts expended on home office may provide personal benefits and business advantages

#### Locke v MNR (1965, TAB)

* Having fitted a rooms in Thornhill residence as study or office, TP claimed 1/6 of cost of his total home expenses as expenses incurred for purpose of producing part of his income
* Addition was for purpose of receiving 15-20 calls during the day, see clients in evening, read law and work at home
	+ Included a desk, law library, couch, chairs, phone, Dictaphone and possibly a TV
* He was an active and industrious lawyer who took work home
* Appeal dismissed
	+ His home office is used principally for own personal convenience

##### Notes

* In *Logan v MNR* (1967, TAB) court allowed deduction of home office expenses based on ratio of home office to area of the house as a whole
	+ A proved that
		- He purchased the house because a room was available to work in
		- The room was separated from house
		- He had a phone and Dictaphone
		- 5-8 doctors came weekly to discuss patients
		- He used the office for report writing and consultation with doctors
* In *Mallouh v MNR* (1985, TCC) TP, OB and gynecologist maintained home office in portion of basement served by separate entrance
	+ Court disallowed deduction: TP did not treat or receive patients at home, had no business phone, did not indicate anywhere that he had this office, did not purchase home with primary purpose of establishing medical office
* Since 1987 s 18(12)(a):
	+ No amount deducted in respect of an otherwise deductible amount for any part of self-contained domestic establishment in which individual resides, except if work space is
		- Individual’s principal place of business or
		- Used exclusively for earning income from business, and used on a regular and continuous basis for meeting clients, customer or patients in respect of business
* In *Ellis v Canada* (1994, TCC) court disallowed a deduction of work space
	+ The studio was physically connected to house and was accessible form house
	+ The studio shared electrical, heating and water facilities
* In *Vanka v Canada* (2001, TCC) court allowed deduction: office was used on a regular and continuous basis for meeting patients
	+ Physician met his patents by making himself available to answer queries by phone

### J. Travel Expenses

* Para 18(1)(h): travel expenses incurred by TP while away from home in course of carrying on TP’s business specifically excluded from other personal and living expenses, deduction of which is disallowed in computing income from business or property

#### Cumming v MNR (1967, Ex Ct)

* TP was anesthetist with no place at hospital to carry out administrative functions of practice
* Where professional lives at a distance from office or chambers, expense of travelling between home and office not regarded as incurred wholly and exclusively for purposes of practice
	+ Rather are personal or living expense (*Newsom v Robertson* - 1952, CA in England)
* Whether or not the above reasoning is applicable in Canada is a matter to have some doubt
* A’s choice of living half a mile from hospital dictated by desirability to live conveniently to work
* A had no base of practice at hospital; necessary to have location off hospital premises
* When A went to hospital to serve patients, it was for purpose of gaining income from practice
* All such expenses are properly deductible

##### Notes

* Decision in *Cumming* was followed in *Prowse v MNR* (1971, FCTD)
	+ TP did not have office set aside in hospital for personal use
		- Base of TP’s business was home and travel expenses were incurred in the course of carrying on his business under 12(1)(h)
* In *Henry v MNR* (1972, SCC) court disallowed travel expenses by another anesthetist: TP not distinguished from any other self employed business owner who leaves home in morning and returns late afternoon
* In *Forestell v MNR* (1991, TCC) TP, independent contractor engaged solely by ROM commuted to Toronto weekly, renting a small apt as an office
	+ Taylor TCJ: expenses of travelling to and from Toronto and for meals properly deductible
* In *Brown v Canada* (1998, TCC) TP lived in Sault St Marie and worked as independent contractor in Toronto, staying at hotels, and returning on weekends to see family
	+ Disallowed deduction of travel: not reasonably attributable to business in Toronto
* In *Friedland v MNR* (1989, FCTD) Collier J accepted testimony that cars used 80-90% for business purposes; allowed deduction of BMW and Rolls Royce expenses during the years of 1973-1975
* Effective since 1987: amount deductible in respect of a luxury vehicle used in a business limited under paras 13(7)(g) and (h) and subsection 20(16.1) and section 672, 67.3 and 67.4
* In *Waserman v MNR* (1969, TAB) TP operated fur shop in Pembroke and Ottawa, resided 100 miles away in Ottawa, travelling between
	+ - He had offices, business phones, bank accounts, fur storage services and advertised in both locations
* In *A-1 Steel and Iron Foundry Ltd v MNR* (1963, TAB) TP sought to deduct sums in respect of expenses to Europe taken by president and controlling shareholder and wife
	+ Board upheld minister’s assessment allowing only 35% of total expenses
		- Disallowed the rest as personal expenses
* *Randall v MNR* (1967, SCC) TP had business in Vancouver and Portland for horse racing
	+ One business carried on in various geographical locations; travel expense deductible

### A. Reasonableness

* S 67 is derived from subsection 6(2) of Income War Tax Act, which allowed Minister to disallow as an expense the whole or any portion of a salary, bonus or commission or director’s fee which in his opinion is in excess of what is reasonable for the services performed
* S 67 should be viewed as an anti-avoidance rule
	+ Application considered in conjunction with the reasonable expectation of profit test
	+ Deference to business judgment; if something else going on (tax avoidance motive) courts more likely to step in and apply the rule
* *Cippolone (Aka Dr. Phela Goodstein) TCC 1994*
	+ Owned and operates the “institute of humor”
	+ Got into trouble with revenue authorities after running series of losses
	+ CRA claimed she had no reasonable expectation of profit

### K. Interest Expenses

* Subpara 20(1)(c)(i) permits deduction for legal obligation to pay interest on … borrowed money for purpose of earning income from a business or property
* Subsection 20(3) specifies that using borrowed money to repay money
	+ Look to what you used the previous borrowed money for
	+ Deemed to have used new borrowed money for purpose of original borrowed money
* McLachlin J in *Shell Canada Ltd v Canada* (1999, SCC) identified 4 elements
	+ Amount must be paid in year or be payable in year in which it is sought to be deducted
	+ Amount must be paid pursuant to legal obligation to pay interest on borrowed money
	+ Borrowed money must be used for purpose of earning non-exempt income from business or property
	+ Amount must be reasonable, as assed by reference to first 3 requirements

#### Bronfman Trust v Canada (1987, SCC)

* Instead of liquidating capital assets to make allocations, trustees retained trust investments and financed allocates by borrowing funds from bank
* Immediate and direct use of borrowed funds: capital allocations to beneficiary, not to buy income earning properties
* Purpose of 20(1)(c)(i): encourage accumulation of capital which produces taxable income
	+ Interest on borrowed money used to produce tax exempt income is not deductible
	+ Interest on borrowed money used to buy life insurance policies is not deductible
	+ Interest on borrowings used for non-income earning purposes, such as personal consumption or making of capital gains is not deductible
* What is relevant is TP’s purpose
	+ Inquiry must be focused on use to which TP put borrowed funds
* With exception of *Trans-Prairie,* jurisprudence has generally been hostile to claims based on indirect, eligible uses when faced with direct but ineligible uses of borrowed money
* Even if there are exceptional circumstances in which, on a real appreciation of a TP’s transactions, it might be appropriate to allow TP to deduct interest on funds borrowed for an ineligible use because of an indirect effect on the TP’s income earning capacity, these circumstances are not present
	+ At minimum, TP must satisfy court that bona fide purpose for funds was to earn income
* Allow appeal and restore assessments of MNR
* The court doesn't quite reject *Trans Prairie*
	+ In that case the loan was actually used to expand a business
		- Rather in this case the loan wasn't actually used to earn income
* Rejects indirect use argument in this fact situation
* Must look at what TP did; not what they could have done

##### Notes

* In *Mark Resources Inc v Canada* (1993, TCC) court held overriding ultimate economic purpose for which borrowed funds were used was to enable TP to import losses of its US subsidiary
	+ Earning of dividend income cannot be real purpose of use of borrowed funds
	+ Net gain to A is not from the production of income, but from a reduction of taxes, otherwise payable in Canada
	+ This case is decided with the spirit of Bronfman Trust
* In *Canwest Broadcasting Ltd v Canada* (1995, TCC) court must ensure that the purpose used for a para 20(1)(c) analysis is one that represents TP’s real intentions; not what they appear
* In *Zwaig v MNR* (1974, TRB) court disallowed the deduction
	+ One must look to whole picture of transaction to discover substance, and find out if borrowed money was used to earn income
	+ On the facts of this case, borrowed money, according to form of transaction, used to repurchase securities; according to substance, to purchase life insurance policy
* In *Robitaille v Canada* (1997, TCC): focus must be not on direct and immediate result of use to which the funds were put, rather on ultimate economic objectives sought by transactions
	+ Court disallowed deduction of interest expenses incurred on the borrowed funds
	+ Ultimate purpose was purchase of residence, not investment in law firm
* In *Singleton v Canada* (2002, SCC) court allowed deduction: TP had used the borrowed funds to refinance his capital account
	+ Court insisted that the transactions must be viewed independently
	+ Court must simply apply 20(1)(c)(i) rather than search for economic realities of situation
	+ *Robitaille* all over again but with a different result
	+ Unlike Robitaille, the court doesn't care about the order of the transactions
* In *Ludco Enterprises v Canada* (2001, SCC) SCC allowed TPs to deduct sum of interest expenses: term income in 20(1)(c)(i) does not refer to net income, but to income subject to tax
	+ TP’s ancillary purpose to earn income is equally capable of providing requisite purpose for interest deductibility in comparison with any more important or significant purpose
	+ This case is essentially like *Mark Resources*
	+ As a result of this case, you just need to have some income, even $1
		- Duff is very upset about this
	+ Could the GAAR apply to this transaction if it were to occur today?
* Effect of Ludco and Singleton is to undo Bronfman Trust
* In *722540 Ontario v Canada* (2003, FCA) court disallowed deduction under former subsection 245(1) on basis that transactions would artificially reduce TP’s income
* In *MNR v Attaie* (1990, FCA) Tax Court allowed TP to deduct mortgage interest (before *Bronfman Trust)* notwithstanding that TP and his family occupied home as principal residence
	+ On appeal, FCA disallowed deduction of interest payments on mortgage
		- Trial judge committed error, both in fact and law, in concluding that ineligible use of borrowed funds ceased when TP invested other funds in income earning term deposits
		- Once property became occupied as personal residence, could not be found that direct and actual use of borrowed moneys was for purpose of earning moneys from business or property
* In *Grenier v MNR* (1992, FCTD) court allowed TP to deduct interest payable of new loan in relation to new residence
	+ He borrowed money on old home which was used to earn income
		- When he sold house, he used proceeds to repay original loan, and took out new loan on new house
	+ Series of transactions, net result of which enabled TP to borrow money in order to earn income from his business, using his private homes as collateral for loan
* In *Canadian Helicopters Ltd v Canada* (2001, FCA) court accepted TP’s bona fide purpose in using borrowed funds to earn management fees from running operations of competitor and increasing business income through amalgamation of operations
	+ Court allowed deduction of interest expenses: used for eligible indirect use, notwithstanding that their direct use was not to earn income
* In *Tennant v MNR* (1996, SCC) money was borrowed and used by TP to produce investment income, and continued to be used for this purpose even though investment vehicle for producing income changed
	+ Implicit in *Bronfman Trust* that ability to deduct interest not lost simply because TP sells income producing property, as long as TP reinvests in an eligible use property
	+ SCC allowed TP’s appeal
* In *Hills v MNR* (1970, TAB) TP sought to acquire home, 25% of which used for rental purposes
	+ Board characterized remaining 75% of interest expense as a personal living expense
* In *Emerson v Canada* (1985, FCTD) FCTD concluded that TP had failed to establish existence of a source of income to which interest expense continued to relate
	+ Because borrowed funds could no longer be traced to an eligible use, deductibility of interest expenses disallowed
	+ This result may have been reasonable in this case
		- But requirement that borrowed funds be traceable to a continuing source of income could result in hardship where TP borrowed money to invest in source of income that ceased to have REOP or ceased to exist altogether
* In *Leslie v Canada* (1998, TCC) court emphasized distinction between employment and business
	+ Expenses of gaining education, and interest paid on money borrowed for purpose of paying those expenses are personal or living expenses
* In *Sinha v MNR* (1981, TRB) TP who had borrowed money in form of a Canada student loan, did not use funds for educational or living expenses, but invested them in interest bearing securities
	+ TRB allowed TP’s appeal: TP had used the funds to earn income regardless of original purpose for which they were borrowed
* In *Shell Canada Ltd v Canada* (1999, SCC) court held that borrowed funds were used by TP for purpose of earning non-exempt income from its business, notwithstanding purpose for which New Zealand dollars were borrowed
	+ And that the interest rate negotiated with the NZ lender was a reasonable rate
* In response to *Shell,* federal government enacted s 20.3 applicable after 2000
	+ Limits deduction of interest expenses on weak currency to amount that would have been payable if TP had incurred debt directly in final currency used for purpose of gaining or producing income
* In *Gifford v Canada* (2004, SCC) court addressed question of whether interest payments were payments on account of capital, in context of determining deductibility of interest paid by employee on sum borrowed to acquire a client list from another employee
	+ Clear distinction between describing interest as payment on account of capital and capital expenditure
		- If funds borrowed in order to add to financial capital of TP, then interest payments will be payments on account of capital
			* Regardless of whether payments would otherwise be appropriately characterized as capital expenditures

## V. TIMING ISSUES

* Business income is typically computed on accrual basis:, revenues are included in computing a TP’s income in taxation year which they are earned, even if they have not been received
	+ Expenses deducted in taxation year in which they are incurred, even if not paid
	+ Other amounts are included only when they are received
* 2 ways of computing income
	+ Cash basis
		- Receipts/payments
		- Received/paid or expended
	+ Accrual basis
		- Payable/receivable
		- Pure accrual

### A. Inclusions

* S 9 defines TP’s income for taxation year
	+ 9(1): TP’s profit from that business or property for the year
	+ 9(2): TP’s loss, if any, for the taxation year from that source computed by applying the provisions of this Act respecting computation of income from that source with such modifications as the circumstances require
* Para 12(1)(a): amount received that have not been earned
* Para 12(1)(b): amounts receivable in respect of property sold or services rendered
* Para 12(1)(c): interest paid or payable depending on method of computing income
* Para 12(1)(g),(j),(k): royalties and dividends received
* Courts are looking for the true picture of the taxpayer's income
	+ Legal accounting principles:
		- Matching principle
			* Expenses should be matched with revenue
		- Realization principle
			* It is uncertain until you sell
			* SCC applied this to *Friedberg*
		- Conformity
			* Should be conformity between tax accounting and financial accounting
			* Courts have been reluctant to go this way
		- Consistency
			* Same method from 1 year to the next

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

* Issue: tax timing
	+ Whether estimates of unbilled revenue at Dec 31, the end of TP A’s taxation year, must be included in its income from business in that year
* Until 1979 accounting practice followed by A did not take account of unbilled revenue
	+ In that year A change its practice and recorded income on estimate of revenue anticipated to be received
		- For operation and for tax purposes
	+ In 1983, while maintaining the accrual basis for calculating income for annual statements, A changed from accrual to a billed basis for its income tax return
		- Eliminating from its income an estimate of revenue unbilled at year end
* Court agrees with Professor Brian J Arnold
	+ Requirement of conformity between financial statements and income tax accounting is undesirable
		- Result in distinctions in tax burdens of TPs on basis of criterion largely irrelevant to tax system
		- Operate unevenly with respect to different types of TPs
* Accrual method of accounting adopted in 1979 for both financial and tax purposes presented a truer picture of A’s revenue: more accurately and fairly matched revenue and expenditure
* Colford rule
	+ An amount receivable not defined in Act
		- Recipient must have a clearly legal, though not necessarily immediate right to receive it; collectible, whether or not due
* Language of para 12(1)(b) makes distinction between receivable and due so that amount may be receivable even though not due until a subsequent year
* A had clear legal right to payment for electricity supplied; irrelevant that they haven’t billed client yet
* Principle to be applied: truer picture or matching principle
	+ Has effect of denying A right to use billed account method
* Inappropriate to consider applicability of subsection 9(1) taken apart from para 12(1)(b) or of 12(2) in light of holding

##### Notes

* *Canderel Ltd v Canada* (1998, SCC): determination of profit in 9(1) is question of law, not fact
	+ Legal determinants
		- Express provision in ITA which dictates specific treatment to be given to particular types of expenditures or receipts
			* Including general limitation in 18(1)(a)
		- Established rules of law resulting from judicial interpretation over the years
	+ GAAP are non legal tools and are external to the legal determination of profit
		- Provisions of the Act and other established rules of law form its very foundation
	+ Financial accounting concerned with providing comparative picture of profit from year to year; tax computation solely concerned with achieving accurate picture of income for each individual taxation year for benefit of TP and tax collector
	+ GAAP should not be minimized; will generally form foundation of well accepted business principles applicable in computing profit
* Relationship between matching approach and truer picture doctrine
	+ In *Canderel* referring to West *Kootenay*:
		- SCC held matching principle was interpretative aid; not established rule of law
		- *Kootenay*: whichever method presents truer picture of TP’s revenue, which more fairly and accurately portrays income, and which matches revenue and expenditure, must be followed
	+ In *Canderel: s*ignificance of above statement is to confirm a much sounder proposition that goal of legal test of profit is to determine which method of accounting best depicts the reality of the financial situation of the particular TP
		- If some other method is appropriate, is permissible under well accepted business principles and not prohibited by Act or specific rule of law, then no principled basis for minister to insist that matching principle be employed
* In *Ikea Ltd v Canada* (1988, SCC) court held that payment was fully taxable
	+ Matching principle is not an overriding rule of law
	+ Ikea received sum of money with no conditions attached to use in 1986 taxation year
		- Free to dispose of money whenever it chose and in whatever manner it saw fit
	+ Serious distortion of Ikea’s taxation picture to ignore that this entire amount was freely available to it in 1986 taxation year
* In *Publishers Guild of Canada Ltd v MNR* (1956, Ex Ct) court accepted accounting method of TP: installment system of accounting adopted by TP is acceptable system, appropriate to TP’s business and more accurately reflects income position than other system of accounting
	+ A system of accounting appropriate to one kind of business not necessarily appropriate to a different kind
* In *Boosey v Hawkes* *(Canada) Ltd v MNR* (1984, TCC) court allowed TP’s appeal: TP consistently adopted cash method of reporting income since at least 1958
	+ Minister failed to establish that this method did not accurately reflect income of A in taxation year at issue

### B. Deductions

* Taxation year in which amounts may be deducted is determined by “profit” and “loss” (subsections 9(1) and (2) of the act) and by other rules
	+ Where TPs compute income on accrual basis, expenses generally deductible in taxation year in which they are payable, even if not actually paid until subsequent taxation year
	+ Where TPs permitted to compute income from business or property on cash basis, expenditures not deductible until taxation year in which they are actually paid
* Para 18(1)(a) disallows deduction of outlay or expense except to extend paid or payable
	+ Brought into play because an expense was not incurred (timing issue)
* Para 18(1)(e) disallows deduction of amounts: reserve, contingent liability, sinking fund, except as expressly permitted by ITA
* Para 18(1)(b) disallows deductions in respect of an outlay, loss or replacement of capital, a payment on account of capital or allowance in respect of depreciation, obsolescence or depletion, except as expressly permitted by ITA
* Para 18(9) allocates deduction of prepaid expenses to taxation year to which outlay or expense can reasonably be considered to relate

### 1. Amounts Payable

#### JL Guay Lte v MNR (1971, FCTD)

* A is a general building contractor and delegates to sub contractors
* In accordance with normal business practice, A withholds % of monthly estimates submitted and accepted, which it pays after work is finally approved by architect
* A contends that balance owing constitutes amounts payable under ITA
	+ Must accordingly, be included in contract expenses, deducted from A’s profits for year
* Far from certain that the amounts so withheld will be paid in full to sub-contractor
	+ Until architect has issued certificate and 35 days have elapsed, general contractor is under no obligation to pay this amount
		- Not claimable by sub-contractor
* Appeal dismissed

##### Notes

* In *Samuel F Investments Ltd v MNR* (1988, TCC) TP sought to deduct amount of unpaid bonus, even though it was not paid, and later cancelled
	+ Disallowed deduction
	+ Amounts are payable when amount is ascertainable

### 4. Prepaid Expenses

* Subsection 18(9) requires TPs to defer deduction of various prepaid expenses prohibiting their deduction in taxation year in which they are made or incurred, allowing these amounts to be deducted instead in subsequent year which they can reasonably be considered to relate
	+ Purpose of this rule: provide truer picture of TP’s business income for each taxation year by matching expenses and revenues
* In *Urbandale Realty Corp v MNR* (2000, FCA) court held that 18(9) did not require a one-time tax to relate to a “period” as indicted in subpara 18(9)(a)(ii)
	+ Not imposed in respect a period after the end of the year
* In *Canderel Ltd v Canada* (1998, SCC) court concluded that TP not required to amortize amounts paid to induce tenants to enter long term leases: subsection 18(9) does not include tenant inducement payments (TIPs) in list of amounts that must be amortized

### 5. Running Expenses

* English and Canadian courts have traditionally held that expenses not easily matched with specific revenues may be deducted in year in which they are incurred, even if amount of deduction may be particularly large and distort TP’s income for that particular year

#### Oxford Shopping Centres Ltd v Canada (1981, FCA)

* P paid city sum in respect of road construction by city affecting access and use of P’s parking area
* For tax purposes matching principles will apply to expenses related to particular items of income, and with respect to computation of profit from acquisition and sale of inventory
	+ Does not apply to running expense of business as a whole even though deduction of particularly heavy item of running expense in year in which it is paid will distort income for that year
* Minister is not entitled to insist on amortization of the expenditure or on the P spreading the deduction in respect of it over a period of years
* Appeal succeeds, and reassessment referred back to Minister
* The court likes the matching principle for things that are attributable to income
	+ But if it is just a general expense, it can't be matched to anything

##### Notes

* In *Canderel Ltd v Canada*: facts gave rise to a choice between two difficult positions
	+ Permit distortion of TP’s income for a single year by allowing immediate deduction of a running expense
	+ Or require distortion of its income for number of years by forcing arbitrary amortization of expense which was clearly not referable to any particular item of future revenue
	+ To apply matching principle as a well accepted business principle would not have assisted in obtaining accurate picture of TP’s income
	+ FCA concluded that TIPs not running expenses and subject to matching principle
	+ On further appeal SCC concluded that TIPs were running expenses to which matching principle does not apply
* In *Vallambrosa Rubber* *Co Ltd v Farmer* (1910, Ct Sess) court commented that nothing ever could be deducted as an expense unless expense was purely and solely referable to a profit which was reaped in the year
* In *Naval Colliery Co Ltd v CIR* (1928, KB) TP incurred expenses to recondition equipment after national stoppage in the coal mining industry, which revenue authorities disallowed as deduction in computing TP’s excess profit duty for 1921 taxation year
	+ No expenditure was made until after this accounting period
* In *MNR v Tower Investment Inc* (1972 FCTD) court concluded that method adopted by TP of deferring some advertizing expense into future years was in accordance with GAAP and more accurately reflected truth about TP’s income position
	+ Option available to TP to defer deduction of running expense

### 3. Capital Expenditures

* As a result of 18(1)(b) even if outlay or expense made or incurred in taxation year within meaning of para 18(1)(a), its deduction may be disallowed on basis constituting capital loss, or capital expenditure
* Where TP incurs capital loss in taxation year, allowable portion of the loss (1/2) generally deductible only against taxable capital gains for year
	+ Capital expenditures, like inventory costs, not fully deductible in taxation year in which they are made or incurred; must be deferred in whole or in part to subsequent taxation years in which gains or losses are realized or deductions are permitted by Act
* Since act does not define words “outlay of capital”, “replacement capital”, or “payment on account of capital”, characterization of an amount as capital expenditure depends on legal tests developed by courts

#### Canada v Johns-Manville Corp (1985, SCC)

* Issue: can TP, when purchasing additional surface area needed for enlargement of cone, charge purchase price of land as production expense
	+ Or must TP capitalize land cost?
* In *BP Australia Ltd v Commissioner of Taxation of the Commonwealth of Australia* (1966, AC 22) Privy Council stated that the answer in classifying and accounting nature of expenditure depends on practical and business point of view
	+ Were these sums expended on structure within which the profits were to be earned or were they part of money earning process?
* In *Hallstroms (Australia),* Dixon discussed difference between capital and income expenditures
	+ Between acquisition of means of production and use of them
	+ Between establishing or extending a business organization and carrying on business
	+ Between implements employed in work and regular performance of work
	+ Between an enterprise itself and sustained effort of those engaged in it
* In *Sun Newspapers Ltd v Federal Commission of Taxation* (1938 – Australia)
	+ Three matters to be considered:
		- Character of advantage sought
		- Manner in which it is to be used, relied upon or enjoyed
		- Means adopted to obtain it
			* Periodical payments v final provision or payment
* If property were treated as undepreciable capital asset, then on disposition of properties and assets, question would arise whether TP had realized capital gain or capital loss, depending on relationship between proceeds on disposition and cost of acquisition
	+ But if interpretation is unclear, one reasonable interpretation leads to credit and another interpretation leaves TP with no relief from clearly bona fide expenditures in course of business activities
		- In this case, the expenditures were made for a bone fide purpose
			* Not disqualified under para 12(1)(a)
* Helpful to observe
	+ Purpose of expenditures from practical and business outlook
	+ Were expenditures incurred yearly as integral to operations
	+ Easily discernible element of production
	+ Not acquired for intrinsic value but by reason of location
	+ Transitional benefit with no enduring value
	+ Do not produce permanent wall or perimeter in mining operation, but a transitional location of wall
	+ Incurred annually
	+ Will not produce an asset for company
	+ Expenditures to prevent halt of operation
	+ Expenditures relative to business are small
* Appropriate taxation treatment is revenue, not capital

##### Notes

* In *British Insulated and Helsby Cables v Atherton* (1926, HL): expenditure is capital where made not once, but with view of bringing into existence asset/advantage for enduring benefit of trade
* Canadian cases where expenditures have been characterized as capital under test in *British Insulated*
	+ *Montreal Light, Heat & Power Consolidated* *v MNR*: TP’s decision to amortize expenses over a period of years suggests they were not ordinary annual expenditures
		- Disallowed deduction
	+ In *BC Electric Railway v MNR* (1958, SCC): characterizing termination of unprofitable railway as advantage of enduring benefit, payment on account of capital
	+ In *MNR v Haddon Hall Realty Inc* (1961, SCC) court emphasized that expenditures to replace capital assets which have become worn out or obsolete are different from ordinary annual expenditures for repairs which fall into income disbursements
		- Expenditure disallowed since payments were made once and for all with view to bring into existence asset or advantage for enduring benefit of TP’s business
* Canadian cases where courts have refused to characterize outlay or expense on basis that expenditure did not bring into existence advantage of enduring benefit for TP’s business
	+ In *Algoma Central Railway v MNR* (1967, Ex Ct) anticipated benefit of geological survey for increased traffic too remote and speculative to constitute advantage of enduring benefit within meaning of test in *British Insulated and Helsby Cables v Ahterton*
		- Court held expenditures deductible
	+ In *Canada Starch Co Ltd v MNR* (1968, Ex Ct) court considered nature of trademark
		- Payment had not brought into existence asset or advantage for enduring benefit of TP’s business
	+ In *Oxford Shopping Centres Ltd v Canada* (1980, FCTD) court concluded that advantage obtained by the TP was no more permanent in nature than expected to be realized from the geological survey in *Algoma*
		- Rejected Minister’s argument that payment was capital
* In *Damon Developments Ltd v MNR* (1988, TCC) owner of hotel deducted various items (drapes, tvs, washer and dryer)
	+ Distinguished *MNR v Haddon Hall Realty*
		- Items in question had shorter useful life in hotel than by tenants in apt building
		- Expenditures for hotel occur regularly at short intervals
* Canadian cases in which expenditures have been characterized as capital expenditures under test in *BP Australia, Sun Newspapers* and *Hallstroms*
	+ In *Cormack v MNR* (1965 TAB) court disallowed deduction
		- Travelling abroad was for purpose of increasing knowledge of special subject; capital expense
	+ In *Firestone v Canada* (1987, FCA) court disallowed deduction
		- Characterized expenditures as capital expenses incurred in course of putting together a new business structure
	+ In *Young v MNR* (1989, FCA) subscriptions in 5 investment publications characterized as capital expense
		- TP not trader or dealer in securities and had used information for deciding on purchase or sale of investments, managing such investments and general admin of expanding portfolio of capital assets
	+ In *Bancroft v MNR* (1989, TCC) court found that TP never commenced proposed business of a year round country retreat
		- Disallowed deduction of acquiring land since he was in the process of creating a business structure
	+ In *Neonex International Ltd v Canada* (1978, FCA) legal expenses incurred in connection with unsuccessful takeover bid characterized as capital expenses
	+ In *Park Royal Shopping Centre Ltd v Canada* (1995, TCC) fees paid to architects to draw up plans for proposed construction of building adjacent to TP’s shopping center non-deductible capital expenses
* Canadian cases in which courts have refused to characterize an outlay or expense as a capital expenditure on basis that expenditure was incurred for gaining or producing business income
	+ *Bowater Power Co Ltd v MNR* (1971, FCTD) expenses for engineering studies to assess opportunities for increasing production were incurred as part of cost of business
	+ In *Kruger Pulp & Paper Ltd v MNR* (1975, TRB) consulting fees and legal fees incurred by TP to acquire timber cutting rights and investigating a site for a plant allowed as deductible expenses in operation of business
* In *Canada Steamship Lines Ltd v MNR* (1966, Ex Ct) TP deducted repairs for:
	+ Replacing floor and walls of cargo carrying holds
		- Deductible repair costs
			* So long as ship survives as ship, and damaged plates are replaced by sound plates, ship is being repaired and it is deductible
			* Cost of repairs do not cease to be current repairs because they are extensive or of substantial cost
	+ Boilers by which ships were powered
		- Non deductible capital expenditures
			* Acquisition of new piece of plant or machinery to replace old which has an existence separate and distinct from the ship, even though used in ship and as part of equipment by which it is propelled
	+ An upgrade doesn’t include a repair made in light of new technology
* In *Canaport Ltd v Canada* (1993, TCC) TP operated offshore crude oil tanker unloading and receiving facility sought to deduct cost of fiberglass liner to prevent leakage and extend life of pipeline
	+ Comparing this to cost of repairing cargo carrying holds, court held expense deductible
* In *Canadian Reynolds Metals Co v Canada* (FCA, 1996) TP deducted expenses to replace carbon cathode lining in steel pots used to produce aluminum
	+ Capital expenditures to acquire capital assets of an enduring nature
	+ Is this consistent with the 2 previous cases?
* In *Shabro Investments Ltd v MNR* (1979, FCA) TP sought to deduct several expenses in connection with repairing building constructed on landfill site
	+ Court characterized expenses as improvements rather than repairs and disallowed deduction of most: payments were on account of capital
		- Repairs on account of defects in original structure, not wear and tear or aging
		- To remedy the defect is capital cost

## Allowances

* Notwithstanding para 18(1)(b), section 20 allows TPs to deduct a number of expenses that might otherwise be non-deductible capital expenditures
	+ (a) and (b) permit deductions for capital cost allowances and eligible capital expenditures
* For accounting purposes, cost of tangible capital property with a limited useful life is generally depreciated over its expected life in order to match the expense of the asset with related revenues over the course of its useful life
	+ Under straight line method, cost of property is deducted in annual increments over course of its useful life until unrecovered or undepreciated cost reaches 0
	+ Under declining balance method, a percentage of unrecovered or undepreciated cost is deducted each year, causing this book value to approach, but never reach 0
* For tax purposes, deductions in respect of depreciation are prohibited under para 18(1)(b)
	+ Para 20(1)(a) allows TPs to deduct capital cost allowances equivalent to depreciation
* Basic features of CCA
	+ Most CCAs are computed on a declining balance basis
	+ CCAs are generally computed by a class method
		- Rates are applied to similar kinds of property, cost of each of which is aggregated to produce an undepreciated capital cost of the whole class
	+ Deduction of CCAs under para 20(1)(a) is optional
		- Where TPs find it advantageous, they may maintain undepreciated capital cost of one or more classes of property by forgoing current deductions and deferring tax value of these deductions to subsequent accounting periods
* Deducting the capital cost allowance is the last deduction you do

### A. Depreciable Property

* Subsection 13(21) defines depreciable property: property acquired by TP for which TP has been allowed a deduction under para 20(1)(a) in computing income for that year or preceding taxation year
	+ Property must be acquired by TP and must be property in respect of which a deduction has been allowed under para 20(1)(a) or would be allowed if TP owned property at end of year
		- And if act were read without reference to 13(26)
	+ These kinds of property are defined in part XI and schedule II of the Regulations
* In CL provinces, courts have held that lease arrangements constitute an acquisition of property by lessee so that lessee and not lessor may deduct CCA
* Schedule II includes most kinds of tangible property and some kinds of intangible property
	+ Intangible property not described in schedule II is defined as eligible capital property
		- Percentage of which may be deducted on declining balance basis under para 20(1)(b)
* Inventory is not depreciable capital

#### Ben’s Ltd v MNR (1955, Ex Ct)

* A owns bakery and purchased 3 adjoining residential properties with intention to remove houses and use site to extend main building
	+ This scheme could not be carried out due to zoning
* A sold three buildings, and they were shortly after removed from the land
* Issue: was property referred to in Class 6 as a building of frame, acquired by A for purpose of gaining or producing income?
	+ Frame buildings on lands purchased not acquired for purpose of gaining or producing income
		- Sole purpose was acquiring land for expansion of factory
	+ A was not interested in renting houses, and could not put them to commercial use
* Appeal disallowed
* That A received rent for a few months did not form part of his intentions

Notes

* In *Hickman Motors Ltd v Canada* (1997, SCC) TP had a bunch of depreciable property assets
	+ They wanted to get depreciable property into a separate legal entity (parents)and have depreciation there
		- Parent held property for 5 days, then sold it
			* In those 5 days it deducted massive capital cost allowances which greatly exceeded their income
	+ SCC said they were allowed to do this, because they did indeed earn income
		- Duff finds this problematic
	+ That the assets produced revenues, establishes that they continued to be used for the purpose of producing incomes
		- Avoiding exclusion under regulation 1102(1)
	+ That income was small or earned over short period of time does not take them out of this category
		- Assets served one function: producing income
	+ TP’s intention was irrelevant

### B. Acquisition of Depreciable Property

* Pie:
	+ Adjusted cost base = pie
	+ Capital Cost Allowance (CCA) = slice taken to eat
	+ Undepreciated Capital Cost (UCC) = what’s left of the pie
	+ Recapture = put some pie back
* CCAs permitted under 20(1)(a) and regulation 1100(1) are based on undepreciated capital cost (UCC) to TP as of the end of taxation year of property of that class
	+ UCC is defined by 13(21) by a lengthy formula
		- UCC at any time = [A+B] – [E+F]
			* A: total cost of all properties acquired in class before time in question
			* B: amount of any recapture added to TP’s income in previous years in respect of class
			* E: total depreciation claimed for property of class before time in question
			* F: total amounts deducted from UCC before time in question as a result of dispositions of property of class
* Courts have held that there is no difference between capital cost of a depreciable property and its cost as commonly understood
	+ Generally includes (see CRA Bulletin)
		- Legal, accounting, engineering or other fees incurred to acquire property
		- In case of a property a TP manufacturers for own use
			* Material, labour, overhead costs reasonably attributable to property
			* Nothing for profit which might have been earned had asset been sold
* Capital cost of certain kinds of depreciable property is subject to specific rules in s 13
* Interpretation bulletin
	+ Generally, a TP will acquire depreciable property at earlier of
		- Date on which title to it is obtained
		- Date on which TP has all incidents of ownership even though legal title remains with vendor as security for purchase price
			* Possession, use, risk
* Regulation 1100(2) imposes a special limit known as half year rule on CCA that may be claimed for depreciable property acquired during a taxation year
	+ Where amounts added to UCC of class as a result of acquisitions of property exceeds aggregate amounts deducted from UCC as a result of dispositions of depreciable property of the same class
		- Then the CCA is based on UCC of class otherwise determined less half of the net addition during the year
* The effect of the above rule is to permit TPs who acquire depreciable property to claim only half the normal CCA in respect of that property during taxation year
	+ To discourage practice of acquiring new depreciable property near the end of taxation year to increase CCA deductions and reduce TP’s income for taxation year
* Computation
	+ 40(1)(a)(i) and 40(1)(b): general rules for computing gain or loss from disposition of property
	+ 248(1) definitions of disposition
* For our purposes, adjudged cost base is cost, or original capital cost (in case of depreciable property)
	+ Adjusted cost based = FMV at time of disposition (for purposes of this class)
		- Compare this to FMV to determine tax payable

### C. Deductions in Respect of Depreciable Property

* For most classes of depreciable property, CCA is computed according to a specified rate of the UCC of property of the class at the end of the TP’s taxation year
	+ For these classes, CCA is determined on a declining balance basis determined according to rate applicable to class
		- These rates are designed to approximate the rate of depreciation actually experienced by each kind of depreciable property
			* In practice, these rates tend to provide a more rapid recovery of the capital cost of depreciable property than the depreciation methods adopted for accounting purposes
			* Sometimes CCA rates are generous to provide incentives for TPs to invest in certain kinds of property
* Where a TP deducts an amount for capital cost of a particular class of depreciable property under para 20(1)(a), the UCC of the property of that class is reduced by CCA claimed
	+ Reduces amount of CCA that can be claimed for that class in future years
* TPs may defer the deduction of CCA when it is to their advantage to do so
	+ Unclaimed CCA cannot be carried forward
	+ But a failure to claim allowable CCA for a specific class will preserve the balance of the TP’s UCC in respect of that class
		- Permits higher CCA deductions in subsequent taxation years than would otherwise be possible in respect of depreciable property of that class

### D. Disposition of Depreciable Property

* Where TP disposes of depreciable property of particular class in taxation year, TP must subtract lesser of its proceeds of disposition and its capital cost in computing the UCC of the class
* Other rules deem depreciable property to be disposed of for proceeds equal to FMV where TP, having acquired property for purpose of gaining or producing income, has begun at a later time to use it for some other purpose 13(7)(a)
	+ And for proceeds equal to proportion of FMV of property where TP who has used depreciable property partly to gain or produce income and partly for another purpose decreases use regularly made of property for purpose of gaining or producing income
* SCC has held in *Canada v Compagnie Immobliere BCN Ltee* (1979, SCC) that the words “disposition of property” should be given their broadest possible meaning, including destruction of tangible property or extinction of an item of intangible property
* Recognition rules (deemed dispositions)
	+ Recognize gain or a loss even if you haven't disposed of property
	+ Subsection 70(5): deemed disposition immediately before taxpayer's death
	+ Subsections 128.1(4) and (1): deemed disposition on ceasing to be a resident in Canada and becoming resident in Canada
		- Once you leave Canada, you can't be taxed, so we will tax you now
		- Immigrants aren't taxable on gains they had before they got here
	+ Para 45(1)(a) and 13(7)(a) and (b): deemed disposition on change of use to or from income earning use
		- Can deduct expenses on depreciable property, for purpose of earning income
* Non recognition rules (rollovers)
	+ Subsection 70(6) and 73(1) rollovers on transfer of property to spouse or CL partner or spouse trust
		- Policy: property transfers to spouse are not an appropriate time to tax
	+ 70(6) is hard, so we will move on to 73(1)
	+ Subsection 85(1): elective rollover on transfer of eligible property to a taxable Canadian corporation for consideration including shares
		- We allow deferral of gain
			* Corporation will have to pay tax on gain at a later date
		- (a): elected amount = proceeds to taxpayer and costs to corporation
			* There are other rules which limit this choice
		- (c) amount will be deemed to be of FMV
			* What is this concept of election???
			* Can't elect less than cost unless FMV is less than cost
			* If there is a real loss, then you can elect to realize that loss
		- (b) relevant in *Lipson*
			* What if the corporation gives you an amount, and some shares?
			* Should you be allowed to defer gain, if you have actually realized amount?
			* This section is called boot: you get some shares, and some cash to boot
				+ In this act this is referred to consideration other than shares
			* Elaborate rule that allows you to elect within FMV
		- The above are several examples, but are not comprehensive

### E. Recapture and Terminal Loss

* When a particular item of depreciable property is disposed of, proceeds from disposition may be equal to, less than, or greater than undepreciated cost (UCC) in respect of the asset
	+ Where proceeds are exactly equal to undepreciated cost (UCC), rate at which property was depreciated is consistent with the actual depreciation in value of property
	+ Where proceeds are less than undepreciated cost, rate at which the asset was deprecated was insufficient to account for the actual depreciation in its value
		- Person disposing of asset suffers loss (terminal loss when last asset in class)
	+ Where proceeds are greater than undepreciated cost of asset, rate at which asset was depreciated must have been excessive
		- Person disposing of property will realize a gain
			* Equivalent to excessive depreciation recognized in previous accounting periods (recaptured depreciation)
	+ Where proceeds exceed original capital cost of asset, the person disposing of it will realize a further gain representing this appreciation in value of asset above original capital cost
* Although ITA generally does not recognize recapture or terminal loss on disposition of individual depreciable properties, it does so when disposition of individual properties has certain consequences affecting class as a whole
	+ Any negative balance in UCC of a class of property at end of the taxation year must be included in income for that year as recapture
* Where aggregate of CCA claimed for class of depreciable property and proceeds of disposition of class exceeds capital cost of depreciable property acquired by TP, excess amount added to TP’s income under 13(1)
* Where TP disposes of all depreciable property of a class for proceeds less than UCC of class prior to disposition, such that TP owns no property of a class that retains a positive balance in the UCC of any CCA and requires deduction of terminal loss equal to amount of remaining UCC
* Because rules for recapture and terminal loss apply to classes of depreciable property rather than individual assets, classification of depreciable properties into different classes has important implications for tax consequences attributable to their disposition

### A. Allocation on Disposition of Property or Provision of Service

* Vendors prefer to allocate proceeds to non-depreciable capital property (land) and depreciable property on which little or no CCA has been claimed
	+ To maximize any recapture on previously claimed CCA
	+ To maximize amount of any capital gain, only half of which is taxable
	+ To maximize terminal losses that might be realized on disposition of depreciable property
* Purchasers will prefer to allocate as much of the proceeds to inventory or services provided
	+ These are fully deductible in computing purchaser’s income
	+ Or to depreciable property, particularly with high rate of CCA,
		- To benefit from high CCAs and/or terminal losses on subsequent disposition
* Interests of those buying and selling a business or property are generally opposed
* In order to limit opportunities for abuse, s 68 is an anti-avoidance rule that applies irrespective of form or legal effect of a contract or agreement
	+ Reallocates proceeds from disposition of property

##### Notes

* In *Golden v Canada* (1986, SCC): determination of reasonable consideration for arm’s length transaction should be approached from perspective of purchaser as well as vendor
	+ Considerable deference to allocation determined between arm’s length parties
* In *Peterson v MNR* (1988, TCC) court rejected TP’s argument that allocation should be conclusive where parties deal at arm’s length, and allocation is not a mere sham
	+ Amount should be reasonable for one party
	+ Reallocation more likely where agreed amounts differ substantially from FMV and where no hard bargaining over allocation
* See also *Leonard v Canada* (1990, TCC): for similar result as *Peterson*

# Part 4: Taxable Capital Gains and Allowable Capital Losses

## I. INTRODUCTION

* Para 3(b) includes TP’s net taxable capital gain
	+ Determined by adding TP’s taxable capital gains for taxation year and TP’s taxable net gain for year from disposition of listed personal property under subpara 3(b)(i) and deducting TP’s allowable capital losses under subpara 3(b)(i)
* Capital losses are generally deductible only against capital gains under para 3(b)
	+ Similarly, losses from disposition of listed personal property are deductible only against listed personal property gains
* Capital gains are determined by subtracting cost of property and cost of selling property from proceeds received on disposition
	+ Capital losses occur where sum of cost and selling cost exceeds proceeds
* S 38 defines taxable portion of a capital gain and allowable portion of a capital or business investment loss as ½ of the amount of the gain or loss otherwise determined under subdivision c
* Only ½ of each capital gain is included in computing TP’s net income under para 3(b)
	+ Capital losses are only ½ deductible in computing TPs net income
		- Generally deductible only against taxable capital gains under subpara 3(b)(ii)
			* Or in computing TP’s net gain from dispositions of listed personal property under s 41(2)

## II. CHARACTERIZATION

* 39(1)(a)
* In *Friesen v Canada* (1995, SCC)
	+ The act defines 2 types of property:
		- Capital
			* Any depreciable property
			* Any property which creates a capital gain or loss upon disposition-
			* Includes
				+ Investment property
				+ Personal use property
		- Inventory
			* Cost or value of which is relevant to computation of business income
			* If it is not capital property, it is inventory
* As a general rule, a gain or loss from disposition of property will be characterized as income or loss from a business where the property is disposed of in the course of a business according to its ordinary meaning or pursuant to an adventure or concern in the nature of trade
	+ Where the gain is not so characterized, paras 39(1)(a) and (b) define the amount as a capital gain or capital loss
* Characterization depends on tests used by court
* Difference between investment property and inventory
	+ Adventure in the nature of trade
	+ First test from *Taylor* won't help us here
	+ The second test, manner of dealing test, will help us
		- Flip the property v holding it
			* The longer you hold property, the more likely it is an investment
			* If you flip the property quickly, it might look like inventory
		- What you are actively doing
			* If you are actively seeking out buyers, you likely have inventory
			* If you are not actively seeking buyers, you may have an investment
		- Whether taxpayer uses property to derive income
			* Rental properties derive income
		- Manner in which the property is financed
			* If you borrow money to buy property, and you won't make net income, because interest will exceed revenue, that might suggest inventory

### A. Real Property

* Real property or real estate refers to land and anything growing on, attached to, or erected on it, excluding anything that may be severed without injury to the land

#### Regal Heights Ltd v MNR (1960, SCC)

Judson J:

* Issue: whether A’s profit from sale of real estate was a profit derived from a venture or concern in nature of trade, and income from a business
* Primary aim of partners in acquiring land was to establish shopping center
	+ Secondary intention to sell at a profit
* Became apparent that a shopping centre could not be established
* When they sold the land at a profit, this was subject to tax under 3, 4, 139(e)
	+ Venture in the nature of trade

Cartwright J (dissent):

* Evidence does not support view that A or its promoters would have purchased lands in question as speculation looking to re-sale
	+ Lands were acquired and disposed of not as stock-in-trade or inventory of a dealer
		- But as capital assets of a developer, which owing to circumstances beyond A’s control, became impossible to develop
* Appeal dismissed

Notes

* In *Racine v MNR* (1965, Ex Ct) TPs borrowed money to purchase land and machinery which they sold 4-6 weeks later at a profit
	+ Relying on TP’s testimony that it had been their intention to carry on the business indefinitely as a long term investment, Exchequer Court rejected the Minister’s argument that they had a secondary intention to resell at a profit
* In subsequent cases courts have generally interpreted the secondary intention doctrine to require possibility of resale at a profit as motivating reason or consideration for TP’s decision to acquire land
* Where property is held for personal use, a gain or loss in disposition of property is generally characterized as being on account of capital
	+ See *Lemieux v Canada* (1973, FCTD)
* CRA:
	+ The courts have considered the following factors
		- TP’s intention with respect to real estate
		- Feasibility of intention
		- Location and zoned use
		- Extent to which intention carried out
		- Evidence of change in TP’s intention
		- Nature of business, profession, calling or trade of TP
		- Extent to which borrowed money was used to finance real estate acquisition
		- Length of time real estate was held
		- Other persons who shared interest in real estate
		- Nature of occupation and intentions of those other persons
		- Factors which motivated sale of real estate
		- Evidence that TP had dealt exclusively in real estate

## III. Computation

### A. General Rules

* Rules governing computation of taxable capital gains and allowable capital losses are contained in subdivision c of division B of Part I of the Act (sections 38-55)
* Subpara 40(1)(a)(i): TP’s gain for a taxation year from disposition of property:
	+ Amount by which TP’s proceeds of disposition exceed total of adjusted cost base to TP of property immediately before disposition
		- And any outlays and expenses to extent they were made or incurred by TP for the purpose of making that disposition
* Subpara 40(1)(b)(i): defines TP’s loss for taxation year from disposition of property:
	+ Amount by which total adjusted cost base of TP of property immediately before disposition and any outlays and expenses to extent that they were made or incurred by TP for purpose of making disposition exceeds TP’s proceeds of disposition
* Subparas 41(1)(a)(ii) and (iii) permit TPs who dispose of property for proceeds payable after taxation year end to defer recognition of a portion of a gain through deduction of a reserve
	+ Subpara 41(1)(b)(ii) requires TPs who realize a capital loss to recognize full amount of the loss in taxation year in which property is disposed of by defining the amount of capital loss in any year as nil

### C. Recognition and Non-Recognition Rules

### 1. Rollovers

* Permit actual dispositions to occur without triggering tax consequences
	+ Transfer of property to corporation or partnership which TP holds an interest
	+ Conversion of debt into equity
	+ Exchange of one share for another
	+ Other corporate reorganization
* Other rollover rules are designed to achieve other non-economic objectives
	+ Where property is unlawfully taken, destroyed, taken under statutory authority, subsection 13(4) and 44(1) ensure TP not further burdened by recognition of gains on these involuntary dispositions by allowing TP to defer any tax consequences that would otherwise apply
		- By using proceeds from involuntary disposition to acquire replacement property
	+ Where TP transfer capital property at death or inter vivos to a spouse or CL partner
		- 70(6) and 73(1) recognize economic mutuality by allowing deferral of recognition of gain or recaptured depreciation until spouse or CL partner disposes of the property
	+ Similar rollover rule applies for transfers of qualifying farm property to TP’s child
		- Facilitates retention of family farms from one generation to the next
* Where TP gives property to person with whom TP does not deal at an arm’s length
	+ Para 69(1)(b) deems TP to have disposed of property for proceeds equal to FMV
* Para 69(1)(c) deems person who acquires property by way of gift to have acquired it at FMV
* Where TP dies, para 70(5)(a) deems TP to have disposed of all capital property immediately before death for FMV
* 70(5)(b) deems cost of capital property to a person who acquires this property as a consequence of TP’s death to be FMV immediately before TP’s death
* Where recipient of gift inter vivos or transfer at death is transferor’s spouse or CL partner, 73(1) and 70(6) provide for a rollover that applies by default unless the transferor, in the case of a gift, or TP’s rep, at death, elects not to have the provisions apply
* Where property subject to this rollover was depreciable property, para 70(5)(e) deems capital cost of property to spouse, CL partner or trust to be original capital cost of property to TP and difference between this amount and cost of property to spouse, CL partner or trust to have been allowed to this person as capital cost allowance in previous taxation years
	+ Makes spouse, CL partner or trust liable for recaptured depreciation on a subsequent disposition of this property
* Like 73(1) and 70(6), 73(3) and 70(9) permit a rollover of capital property to TP’s child, but only for land or depreciable property that was, before TP’s death used principally for fishing or farming, in Canada, which TP, TP’s spouse or CL partner, or TP’s children were actively engaged on a regular or continuous basis

### B. Non-Arm’s-Length Transactions

* Where a person disposes of something to another for proceeds *greater* than FMV, transaction creates artificial gain or reduction in loss for transferor, matched by artificially high cost for transferee
	+ Where a person disposes of something to another for proceeds *less* than FMV, transaction creates an artificial loss or reduction in gain for the transferor and an artificially low cost for transferee
* Above transactions might be used to avoid tax by allocating gains to low income TPs and losses to high income TPs
* 69(1)(a) deems TPs who have acquired anything from such persons for greater than FMV to have acquired it at FMV
	+ If lower income earner spouse has property which cost $100, now valued at $600
		- Spouse sells it to higher earner for $2000, and higher earner sells it for $600
		- Spouse A gets a $1900 gain, and spouse B gets a massive loss
	+ You are deemed to have acquired it at a cost equal to FMV
* Para 69(1)(b) deems TPs who have disposed of anything to non-arm’s-length persons for less than FMV to have received proceeds of disposition equal to FMV
	+ You have a property purchased for $100
		- It is now worth $600
		- Gain of $500, with a taxable capital gain of $250 (1/2)
	+ Instead of selling the property directly you sell it first to your spouse for $100, who turns around and sells it to the outside purchaser
		- You have basically allocated capital gain to lower income earning spouse
	+ Deemed to have disposed of it for proceeds equal to FMV
	+ The provision functions to tax that gain twice
		- You and your spouse both get taxed on the gain: double tax!!
			* Quite punitive
* The above provisions
	+ Prevent income splitting
	+ Penalize TPs who engage in these transactions by taxing the amount by which the proceeds differ from FMV in hands of transferor and transferee
	+ 251(1)(a) deems related persons not to deal with each other at arm’s length
		- Para 251(2)(a) defines related persons to include
			* Individuals connected by blood, marriage or CL, or adopted
		- Para 251(2)(b) specifies that a corporation is related to a person who control the corporation, and persons related to controlling persons
		- Para 251(2)(c) lists the circumstances in which 2 corporations are related
		- Para 251(6)(a) defines persons connected by blood relationship
		- Para 256(6)(b) and (b.1) define persons connected by marriage or CL
		- Para 256(6)(c) defines persons connected by adoption

#### Marcantonio v MNR (1991, TCC)

* 1984 optometrist invited wife to join business as affiliated retailer to sell lenses and frames
* Prior to 1984 A purchased his optometric supplies direction from various suppliers
* A and Andrea were not dealing at arm’s length because Andrew was controlled by A’s wife
* There was a contractual relationship between A and patient, but no contractual relationship between patient and Andrew
* Under para 69(1)(a) A is deemed to have purchased the frames and lenses at their wholesale price rather than the retail price
	+ R was justified in reducing A’s costs of frames and lenses

##### Notes

* In *Allfine Bowlerama Ltd v MNR* (1972, TRB) courts are uncomfortable with double taxation that can result, and favour adjustments on both sides of these transactions
* Where non arm’s length persons are able to demonstrate that a transaction at an amount greater or less than FMV occurred by reason of an honest error and not by a deliberate attempt to evade or avoid tax, para 5 of IT-405: revenue authorities may permit adjustment in amount of proceeds of disposition or purchase price to reflect amounts deemed by 69(1)(a) or 69(1)(b)
	+ To avoid application of these provisions, non arm’s length parties may enter into agreement to adjust price in accordance with revenue authorities’ determination of FMV

## IV. ATTRIBUTION RULES

* Designed to prevent income splitting by deeming certain amounts received by specific persons to whom an individual has transferred or lent property to have been received by the transferor and not the transferee
* 74.1(1): income or loss from property transferred to a spouse or common-law partner deemed to be income or loss of individual
* 74.1(2): income or loss from property transferred to a person under age 18 who is related or a niece or nephew (“related minor”) deemed to be income or loss of individual and not minor
* 74.2(1): extends attribution rules to capital gains and losses from property transferred to spouse or common-law partner
* 74.5(1): attribution rules do not apply if:
	+ (a) FMV of property transferred does not exceed FMV of property received as consideration, AND …
	+ (c) if property is transferred to or for benefit of transferor’s spouse or CL partner, transferor elects out of rollover rule 73(1)
* Subsections 74.5(2) rules don't apply to loans for value
* Subsections 74.5(6)-(8)
	+ Rules apply to back-to-back loans and transfers and guarantees
* Subsections 74.5(9) rules apply to transfers or loans of property to a trust
* 74.5(11): attribution rules do not apply to a transfer or loan “where reasonably concluded that one of main reasons for transfer or loan was to reduce tax”
	+ Specific anti-avoidance rule
* Reverse attribution
	+ To get income in hands of lower income spouse, you get lower income spouse to take loan from bank and buy some shares
		- Spouse then sells shares to higher income spouse for cash, and repays loan
		- Lower income spouse at the end of the end has no loan and no shares
	+ The higher income spouse has paid cash and bought shares
	+ Tax results:
		- If lower income spouse does not elect out of rollover rule, rule in 74.5(1) does not apply; attribution rules do apply
			* Then income and capital gains on shares held by higher income spouse are attributed to lower income spouse
	+ Drafters considered this possibility
		- Reasonable to conclude that purpose of transaction: reduce tax but for 74.5(11)
		- For this case 74.5(11) applies to make this kind of transaction not allowed

#### Lipson v Canada (2009, SCC)

Lebel (majority)

* Issue: whether a series of transactions, beginning with a wife borrowing money to purchase shares in a family corporation and leading to a husband deducting interest on couples home mortgage loan results in an abuse and misuse of ITA as contemplated by s 245(4)
* In *Canada Trustco Mortgage Co v Canada* (2005, SCC) and *Mathew v Canada* (2005, SCC) court held that for 245(4) abusive tax avoidance occurs where impugned transaction frustrates the object, spirit or purpose of provisions relied on by TP
* R has established abusive tax avoidance
	+ GAAR applies to one of the transactions within series and can be used to deny one of the tax benefits sought by A
* The wife (Jordanna) borrows money from bank and buys shares from Earl at FMV
	+ Although shares paid for with proceeds of share loan rather than mortgage loan, 20(3) allows deduction for interest on money borrowed to repay previously borrowed money if interest on original loan is deductible
	+ Mortgage loan was treated as having funded share purchase
* They claim spousal rollover; Earl does not have to pay tax on gain from sale of shares (73(1))
	+ He doesn't elect out of the rollover
	+ He takes the cash and she gets shares of the company
	+ He takes the cash and buys the house, then mortgages house
* He borrows more money, which goes to Jordanna, and she repays the original loan
	+ Together (Jordanna) owes a sum on the mortgage to the bank
	+ She gets dividend income from the company, but she is also paying mortgage interest
		- In most of the years, the interest exceeds the dividends; net loss
		- Rule 74.5(1) does not apply, so attribution rules do apply (74.1(1))
			* The income she gets from the shares get attributed to Earl
			* It's a family company, so they get to decide what the dividends are
				+ Dividends are set at less than the interest; loss attributed to Earl
* Mr. Lipson deducted interest on mortgage loan pursuant to 20(1)(c) which permits deduction of interest on money borrowed for purpose of earning income from business or property
	+ As a result of attribution rule, dividend income and interest expense attributed to Mr. Lipson
* Provisions being used
	+ 20(1)(a)
	+ 20(3)
	+ 73(1) is being used to make sure Earl doesn't pay tax on the sale of the shares
	+ 74.1(1) attributes income or loss from property transferred between spouses back to transferring spouse for tax purposes
		- Losses attributed to husband
* She earned income on shares, and were it not for 74.1, would have been required to report that income for tax purposes
	+ Pursuant to 20(1)(c) would have been able to deduct the interest paid on money borrowed to purchase those shares
		- Purpose of 20(1)(c) is to encourage accumulation of income producing assets
			* Provision is concerned with legal relationships rather than true economic purpose of transaction or series
				+ Confirmed in *Singleton* where TP permitted to deduct home mortgage under 20(1)(c) because direct use of funds was to acquire income producing asset, not to purchase house
* A contextual and purposive approach to GAAR, mandated by *Canada Trustco* and *Kaulius*
	+ Requires court to consider purpose of each provision relied on, and whether that purpose was defeated by transaction or series of transactions
* GAAR denied a tax benefit where three criteria are met:
	+ Benefit arises from a transaction 245(1) and (2)
	+ Transaction is an avoidance as defined in 245(3)
	+ Transaction results in an abuse and misuse within 245(4)
* Lipson concedes that all the transactions were avoidance transactions
* Did the transactions result in a misuse and abuse?
	+ According to *Trustco*, a transaction can result in an abuse and misuse in 1 of 3 ways:
		- Where the result of avoidance transaction
			* Is an outcome that the provisions relied on seek to prevent
			* Defeats the underlying rationale of the provisions relied on
			* Circumvents certain provisions in a manner that frustrates the object, spirit or purpose of those provisions
* The problem in the transactions arose when Mr. Lipson and his wife turned to 73(1) and 74.1(1)
	+ To have him apply her interest deduction in his own income
		- Contrary to purpose of 74.1(1)
			* That purpose is to prevent spouses from reducing tax by taking advantage of their non-arm’s length relationship when transferring property between themselves
* SCC majority decides there is an abuse here because of the attribution principles
	+ It is the spousal twist that causes problems

Binnie (dissent)

* Spousal twist added to *Singleton* should not cause entire series of transactions to be characterized as abusive
	+ Nothing in the act to discourage transfer of property at FMV between spouses
* He wanted to sell shares to wife to trigger income earning use, but didn’t want consequences that a sale of shares would normally carry
	+ This is precisely the outcome contemplated by Parliament when it enacted the provision
* Outcome was not an abuse, but was a fulfillment of them
* Prof says that Binnie just doesn’t like the GAAR

Rothstein (dissenting)

* GAAR does not apply here because a specific anti-avoidance rule pre-empted its application
	+ GAAR was enacted as a provision of last resort
		- Not intended to introduce uncertainty in tax planning
	+ 245(4) requires all other relevant provisions be read before Minister can apply GAAR
		- Minister did have other recourse in this case
			* Should have used 74.5(11): artificial transactions rule
				+ TP doesn't want this to apply; they want nothing to apply
				+ Revenue Authority wants the GAAR to apply, not 74.5(11)
* Appeals should be allowed

Point: Tax Act is deeply confusing and at times idiotic