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| TAX I | | | |
| **Basic Structure Of the ITA:** | | | |
| Tax Unit | **S.2(1**): **every person resident in Canada at any time in the year**  **s.248(1)** **“person”** or any word or expression descriptive of a person, includes any corporation, and any entity exempt because of s.149(1) from tax under Part I on all or part of the entity’s taxable income and the heirs, executors, liquidators of a succession, administrators, or other legal representatives of such a person  **s.248(1)** defines an ‘individual’ as a person other than a corporation.  **Choice of Unit** – in Cda we have an individual tax base  **Implications of Individual Taxation Under Progressive Rates** 🡪 strong incentive for income splitting  a) Indirect Constructive Receipt  **S.56(2)** an amount that would be included in a TP’s income if received by the TP is taxable to the TP if it is diverted to another person for the TP’s benefit or the benefit of that other person.  b) Attribution Rules –  **S.74.1(1) & (2)** –deem any income or loss from property transferred or loaned to a spouse, CL partner, or related minor child or prop’ty substituted therefore to be that of the transferor or lendor and not the recipient  **S.251(1)** stipulates that: i) Related persons are deemed not to deal at arms length. iii) Arms length questions are questions of fact.  c) Rules for Non-Arms Length Transfers  **69(1)** to ensure you tfr at market value  **S.120.4 -** imposes a special income splitting tax on certain types of income (through private corporations or trusts) received by individuals under the age of 18 by taxing at top rate of 29%.  **s.118(1)** – basic amt of income exempted f/ federal tax. | | |
| **Residence in Canada** – Generally, Canadian residents are subject to tax on their worldwide income  ***Thomson v. MNR***, the SCC held that residence is chiefly a matter of the degree to which a person in mind and fact settles into or maintains or centralizes his ordinary mode of living. Primarily a Q of fact. | | |
| Tax Base | **S.2(2)** defines “taxable income” as the TP’S income for the year plus additions and minus deductions permitted by Division C  **S.3** defines income by means of calculation (A + B) – (C + D)   |  | | --- | | Income from a source   * + Office+Employment – sub (a) (5-8)   + Business+Property – sub b (9-37) |   **A:** NET income from sources **includes** **total income from all sources : 3(a)** has independent authority to **tax anything not expressly defined in the act**  **B**: Net taxable capital gains **includes** net capital gains   * Built in deduction; capital gains (sub i) ***minus*** capital losses (sub ii) * **Capital losses can only be deducted against capital gains**, not deductible against other kinds of income   Capital losses and gains are ***segregated***here.  **s. 38: Taxes Cap Gains at ½**  **s. 40(2)(g)(iii):** Cannot Claim losses for personal use property i.e. Jewelry.  **C:** Other deductions: allows subtractions under Division C  **D:** allows **deductions** for specific losses.  ***Curran****: SCC* Discusses income: *“*the word must receive its ordinary meaning bearing in mind the ordinary concept and usages of mankind”.  ***Consolidated Textiles****:* “income” need not be recurring to qualify  **S.4(1):** compute income from each source separately | | |
| Accounting Period | **S.249(1):** defines taxation year as a fiscal period in the case of a corporation and a calendar year in the case of an individual  **S.11(1):** where an individual is a proprietor of a business, the income from the business for a taxation year is deemed to be the income from the business for the fiscal periods that end in that year  *Interpretation Act*, **s.37(1)(a):** calendar year is a period of 12 consecutive months commencing January 1 | | |
| Tax Rates – s. 117(2) | Progressive/Graduated Rates:  **NOTE:** If you make $150,000 – you aren’t paying %29 on all of that. You pay 15% of the first $42,707, 22% of the next bracket, etc.  Tax rates are indexed to inflation | | |
| Tax Credits | Sections 118-127.41 applicable   * Deducted directly from the amount of tax payable, or credited to the taxpayer as a payment of tax * Where a credit is subtracted directly from tax otherwise payable, the credit is called **non-refundable**; where a credit operates as overpayment of tax, it is described as **refundable** * **Credit** is a deduction (subtraction) in computing tax – offset against tax payable * A **true deduction** is a subtraction in computing income or “taxable income” * **Deduction is worth more to a high earner, than a credit** | **Family Relationships:**  **s. 118(1):**  personal credits in relation to family relationships for: support of spouse or dependent who earns no more than $751; shared accommodations with aged or disabled relatives over 17  **S.118.2** allows taxpayers to claim medical expenses  **S.118.3** provides for a disability credit | |
| Introduction to Interpretation: | | | |
| **Modern Rule** | ***Stubart*** [1984 SCC] rejected the strict construction rule and affirmed the modern rule. Combine the textual emphasis of the plain meaning rule with the purposive considerations   * Read words in entire context   + **Internal context**: internal context of statute/four corners of statute that help us determine the meaning (immediate)   + **External context**: external assumptions we bring in reading of text: avoid absurdity, concepts of fairness and unreasonableness (broader statute as a whole) * Read words in grammatical and ordinary sense   + **Context** will help decide which ordinary meaning that makes most sense. Sometimes must determine whether a technical/legal meaning is suggested   + **Associated words principle**: read word in context with other words described   + **Limited class principle**: when you see a general word following a list of narrow words or list, the general word is read down to include the other words with which it is connected in identified list * Harmoniously with scheme of Act, object of Act, and intention of Parliament   + **Purpose of provision**: preamble, government white paper reports, infer from Act. Purpose is broad, goes to Act itself vs intention: how would legis want this case to be decided   + **Intention**: referencing Interpretation Act. Can look to specific statements of legislative intent in     - Pepper v. Hart – UK case about how to deal with legislative intent       * This case gave 3 part framework:  (1) problem in legislation – ambiguity – that doesn’t clarify; (2) some specific statement by someone closely connected to legislation; (3) the statements are clear   ***Will-Kare Paving & Contracting Ltd.***, SCC 2000: Major J. The act will not be read to make a K for service a K for sale, Legislature knew enough to use specific words. | | |
| Tax Avoidance | | | |
| Approaches | **tax evasion** involves an illegal breach of specific statutory duties such as failing to file a return or deliberately concealing or falsifying reported information.  **tax avoidance** involves a legal effort to order one’s affairs so as to minimize tax  *- US Approach: Gregory v. Helvering* (Commissioner of Internal Revenue) 1935: Look at what the statute intended, **Business Purpose Test:** Court reads in a requirement for *bona fide* business purpose to reorganization. **Sham Doctrine** – Doctrine of economic substance over legal form – *Bona Fide* “business purpose test”.  *- Canadian Approach: Commissioners of Inland Revenue v. Duke of Westminster* 1936: *“every man is entitled if he can to order his affairs so as that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioners of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax.”*  ***Implications:***   1. Legal substance over form doctrine 2. Sham and ineffective transactions doctrines 3. Specific Anti-Avoidance Rules (SAARS)    1. Rules mandating the inclusion of specific amounts;    2. Rules disallowing or limiting the deductions of specific amounts;    3. Rules governing the timing of inclusions or deductions;    4. The “deeming” provisions | | |
| SAARS | **1. Specific Inclusion Rules** – While rules such as these merely specify amounts that must be included, they can be viewed as anti-avoidance provisions in that they foreclose what would otherwise be fairly simple methods of avoiding tax.  **2. Rules Disallowing or Limiting Deductions** – These rules prevent the deduction of expenses which are primarily for personal or tax-motivated reasons, not for the purpose of earning income.  **3. Timing and Inclusions of Deductions** – rules that prohibit deferring income or accelerating deductions  **4. Deeming Provisions** – such as the above discussed Deemed income if free transfer to spouse. | | |
| GAAR | **S.245(2)** charging provision of GAAR: tax will be assessed as reasonable in the circumstances in a way to deny the benefit that would have resulted, directly or indirectly, from the avoidance transaction or series of transactions if not for this rule  **S.245(3)(a):**  “***avoidance transaction”*** is a transaction that would result, directly or indirectly, in a tax benefit, unless the transaction may **reasonably** (*objective test for purpose of transaction*) be considered to have been undertaken or arranged **primarily for *bona fide* purposes** other than to obtain the tax benefit (*business purpose test*)  **S.245(3)(b):** Step transactions doctrine – series of transactions where a transaction is inserted not primarily for *bona fide* non-tax purposes but results in tax benefit, the benefit may be denied.  **S.245(4):** (2) will only apply where the transaction(s) would “result directly or indirectly in a **misuse of the provisions** of” the Act, Regulations, or Application Rules, a tax treaty, or any other relevant enactment  **GAAR applies when:**   1. **There is a tax benefit (s.245(2))** – factual determination, low threshold: ***Burden on taxpayer*** 2. **Transaction primarily tax motivated (s.245(3))** – factual determination, deference to tax court judge. Minister state purpose. ***Burden on taxpayer*** to disprove purpose. 3. **There is misuse or abuse (s.245(4))** – ***Burden on minister***   ***Canada Trustco* Test for Misuse or Abuse (para 67, then *Copthorne Holdings* par 72):**   1. Identify the relevant policy of the provisions or the Act as a whole 2. Use 3 stage test to asses whether facts constitute a misuse or abuse under that policy: 3. Result is one the **provisions** relied upon **sought to prevent** in first place 4. **Defeats the underlying rationale** of the provisions relied upon 5. **Circumvents certain provisions** in a manner that **frustrates the object, spirit, or purpose** of these provisions   **s245(1):** *Tax benefit:* a **reduction, avoidance or deferral**of tax | | |
| Income From Office or Employment | | | |
| Characterization as Employee. | **5(1)** defines a TP’s income for a taxation year from an office or employment as the salary, wages and other remuneration, including gratuities, received by the TP in the year.  **5(2)** defines a TP’s loss for a taxation year from an O or E as the amount of the TP’s loss, if any, from the taxation year from that source computed by applying...the provisions of the act respective of the computation of income from that source.  **s. 6** specifies amounts that must be included in computing income from an office or employment  **8(2):** limited deductions 🡪 unless its specified in the act, you don’t get a deduction (as opposed to biz/prop 🡪 net profit)  “OFFICE” defined in s**.248(1):** **the position of an individual entitling the individual to a fixed or ascertainable stipend or remuneration -** “*Office” position exists independent of person filling it*  “EMPLOYMENT” defined in **s.248(1):** **the position of an individual in the service of some other person**    *Wiebe Door Services Ltd. V. MNR* (1986 FCA): Legal substance over nomenclature: court will look at actual relationship despite how parties characterize their relationship.  *1.Control Test:* works mostly on own, free to accept or refuse a call, not required to work at or attend place of business, did TP hire own workers etc  *2. Ownership of tools*  *3. Chance of profit and risk of loss*: terms of remuneration? Who bore the risk of loss for faulty job?  *4. Integration/Organization test*: The integration test should be carried out from the worker’s perspective  *Alexander (1969, ExCt):* A contract for services is one under which a party agrees to a certain *specified work* that will be done for the other.  *Royal Winnipeg Ballet (2006, FCA)* –intentions of the parties matter. | | |
| **Incorporated Employees – Personal Service Business:**  **125(7)** a personal services business is a business providing services where: a) An individual who performs services on behalf of the corporation b) Any person related to the incorporated employee is a specified shareholder of corp, and the corp EE would reasonably be regarded as an officer or EE of ER but for the corporation unless: 1. There are 5 full time employees.  **18(1)(p)**: limits deductions for personal services businesses  **248(1)** – “Specified Shareholder” means a TP or related person who owns at least 10% of the issued shares of any class of the corporation  **251(6)** – ‘related persons’ – blood relationship, marriage or partnership, adoption, ”  *Engle v MNR* 1982: no employee relationship, There’s no sham here, Biz purpose test is rejected. Substance was a K b/w his corp. and employer, and there was no privity of K between EE and TP.   * **Note**: income received by interposed corporation can be distributed to non-arm’s length persons such as the spouse of the incorporated employee and income received from the investment of corporate distributions may escape the attribution rules in **74.1 to 74.5**   *Dynamic Industries:* Test under 125(7) and 18(1)(p) requires that “but for” the corporation, the Corproate EE would be an EE of the person or firm that is employing the ER. Here the court uses the test from *Weibe Door* to asses whether TP would be an employee “but for.” Looked at work history and found that he did other contracts for other firms in previous years, determined he did not fit the “but for” test.  *533702 Ontario Ltd. v. MNR* (1991 TCC): Brouwer – TP: Tries to inject a business purpose approach to this analysis. | | |
| Inclusions | | | |
| General | Tree possibilities: Income from a source/Capital Gains/Gifts and Windfalls.  **5(1)** **Income from an Office or Employment** – Subject to other rules in part I, a TP’s income for a taxation year from an office or employment is the salary, wages and other remuneration, including gratuities received by the TP in the year.  **6(1) Amounts to be Included:**  **a. Value of the benefit –** Pay tax on benefits from ER.  **b. Personal Living Expenses**  **c. Director’s and other fees.**  **6(3) Payments by employer to employee**   * 1. during a period while the payee was an officer of, or in the employment of the payer, or   2. arising out of an obligation made prior, during, or after a pd of O or E w/ payee   shall be ***DEEMED*,** Regardless of legal form or effect, to be remuneration… unless it cannot reasonably regarded as having been received:   * 1. as consideration or partial consideration for accepting the office or entering into K of employment   2. as remuneration or partial remuneration for services as an officer under the K of employment, or   3. in consideration or partial consideration for a restrictive covenant re: before/after employment K.   *Fries:* Benefit of the doubt to TP. No tax on strike pay. | | |
| Remuneration | * Dictionary definitions:   + *Salary*: fixed payment made by employer at regular intervals, usu. monthly or quarterly, to person doing other than manual or mechanical work (employment)   + *Wages*: amount paid at regular intervals esp. by the day or week or month, for time during which the workman or servant is at employer’s disposal (employment)   + *Fees*: sum payable to a public officer for performing his function (office)   + *Gratuity*: a gift or present (usu. of money), often in return for favors or services, the amount depending on the inclination of the giver ( a “tip”)   + *Remuneration*: to pay for services rendered or work done; payment; reimbursement; reward; recompense; salary; compensation | | |
| Gratuitous Payments | *Goldman v. M.N.R.* [1953] C.T.C. 95: distinguishes the voluntary payment: expectations/intentions. Gratuity will be taxed if already have office of employment for which gratuity was received. Voluntary payment is income IF PAID in exchange for services pursuant to O/E; a voluntary agreement to compensate isn’t a gift | | |
| Strike Pay | Strike pay provided by a union or affiliated organization is typically paid in respect of the *non-performance* of services by the employee  *Canada v. Fries [1989] (F.C.A.):* **s. 8(1)(i)(iv):** Union dues are tax deductible. **s. 149(i)(h)**: exempts union dues from tax on interest accrued on invested union dues. Characteristic of income: regular / periodic/recurring payment, replacing former income; not capital or windfall, thus default is income.  *Canada v. Fries SCC:* Overturned the above, wants to give the benefit of the doubt to the TP.  **Side Cases:**  ***Ferris v. MNR***: TP’s union published a newspaper, distributed profits during labour dispute as strike pay🡪 found to be taxable payments from a commercial venture | | |
| Tort Damages for Personal Injury or death | ***Cirella v. Canada [1978]* C.T.C. 1:**  **Tort damages not taxable,** does NOT have the character of income, Not remuneration for services rendered. Compensation for lost EARNING CAPACITY (different), as it has a capital nature.  Surrogatum Principle: Damages are neutral payments, and must be categorized. Test: would the sum of money for which compensation is replacing have been otherwise taxable? | | |
| Inducement Payments | *Curran v. M.N.R. [1959] S.C.J. No. 66*: Contract is in consideration of Curran quitting his current job whether or not he accepts new job. **True character” of payment for personal services not loss of benefits. “True Nature”** to be found in terms of agreement and surrounding circumstances: fine line b/t legal substance and economic substance. Case stands for proposition that income can be taxed under s.3 as income from an unenumerated source. | | |
| Termination Payments | **S. 5** does not include “in lieu of” but the words are found elsewhere in the act. Traditionally not taxable.  ***Quance v. Canada (1974 FCTD):* :** payments were made as replacement for salary which would have been awarded with proper notice – this gives them the quality of income (came from implied obligation to give reasonable notice of termination inherent in employment contract) -Payments are deemed to be remuneration for TP’s services during period of employment and therefore fall within s.6(3)  ***Canada v. Atkins (1975, FCTD)*:** no evidence that money was intended by employer to be salary or replacement thereof  ***Canada v. Atkins (FCA):***  monies paid in respect of breach rather than in respect of the employment agreement: Money paid in lieu of wages is taxable, but if it is damages from termination of K, it may not be. | | |
| Retiring Allowance | **s. 56(1)(a)(ii):** when computing income, include any amount received in the year on account as, on account of, or in lieu of, or in satisfaction of, a retiring allowance -“Without restricting generality of s.3”: intent to capture income from all sources  **S.248(1)** retiring allowance = an amt (other than pension amt), received:   * On or after retirement from O + E in recognition of TPs long service * **In respect of** (*Mendez-Rous*) TP’s **loss** (*Schwartz*) of O or E, whether or not received as, on account or in lieu of payment of, damages or pursuant to an order or judgement or judgement of a tribunal   By TP, or after TPs death by dependant, relation or legal rep of the TP  *Mendes-Roux v. Canada [1997] T.C.J. No. 1287 (T.C.C.)*: ***‘in respect of’ ought to be given a wide scope of meaning.*** Needs to be **causal link** between amount paid and loss. Broken if amount paid arises from the *way* or manner in which the loss came about   |  |  | | --- | --- | | Taxable: loss of wages, overtime, earned vacation, and earned sick leave | NOT taxable: damages for mental distress and costs are **not within definition** of retiring allowance and are **NOT TAXABLE** |   ***Niles [1991] TCC***: employee filed a discrimination claim after being fired. The parties settled the claim for $5000. There was no finding of discrimination-the court found that it was ‘in respect of’ O + E and was taxable as a retiring allowance. Characterization is important.  *Schwartz v. Canada [1996] S.C.J. No. 15:* HERE EE quite to join another Co. but position closed before her got there. Reached $400K settlement including legal cost with prospective employer later for damages plus costs. **TCC** found ‘retiring allowance’ did not include prospective or intended employment; **FCA** agreed that damages not retiring allowance; found most of damages taxable ($342K) under s.3a for lost salary and stock options **SCC** found FCA wrong to overturn finding of fact by trial judge, some evidence of intention of parties is required.   * CJ says not retiring allowance because office wasn’t lost, he was never in the service, position never came into existence * Purpose/intent: Act refers to ‘intended’ office in other sections (interest free and low interest loans); if wanted to tax this under s.56(1)(a)(ii) would have included it. Act amended twice and still did not specifically include this situation * S.3 (unremunerated source) should apply, but there is no determination of amount that would fit it. S. 56(1)(a)(ii): is the specific provision, but wording does not capture this scenario. | | |
| Covenants – Noncompetition agreements | Generally deemed remuneration under **s.6(3)**.  Where a non-competition agreement accompanies the sale of a business, exceptions would allow taxpayers to characterize non-competition payments as capital receipts relating to the sale of the goodwill of the business or as proceeds from the sale of shares in a corporation or interest in a partnership to the extent that the restrictive covenant increases the FMV | | |
| General Benefits | | | |
| **General** | **6(1)(a)** applies where a benefit is **received or enjoyed** by a TP in respect of, in the course of, or **by virtue of an office or employment**.  **S.67:** deductions limited to amount “reasonable in circumstances” (on employer side)  **S.67.1:** business meals and entertainment deductible at 50% only (on employer side)  3 Steps: (1) **characterization** of the benefit; (2) determination of the **nexus** between the benefit and the office or employment; (3) **valuation of the benefit** to be included in computing the TP’s income.  **Material Advantage**: if no material benefit / advantage, not taxable  *Cutmore*: taxpayer required to use employer’s accountant for tax return; court determined it was a benefit. Compulsion not a factor  *Deitch*: legal aid lawyer had insurance paid by employer; court determined it was a benefit even though employer would have required employee to be insured  *Dunlap 1988*: employer put employees up in hotels for Christmas party to prevent drinking and driving; assessed as a benefit. Costs were not trivial – significant benefit to taxpayer even when unilaterally conferred. | | |
| Characterization | *Lowe v. Canada* [1996] F.C.J. No. 319 (F.C.A.): Purpose of s.6(1)(a) is to equalize tax payable between employees who receive compensation in cash and those who receive compensation in kind (*Professor v. Krishna*). ***Test for characterization of a benefit: 1) non-incidental economic value 2) primary purpose*** *for the benefit of EE or ER?* EE pleasure is De Minimus. **Test**: a material acquisition which confers an economic benefit on the taxpayer  ***Huffman v. MNR*** – CSI had cleaning allowance for clothing 🡪 not a benefit, because it put him back in position he would be in but for employment (clothes always bloody). **BENEFITS VS REIMBURSEMENTS** | | |
| Relationship to Office or Employment | *R. v. Savage [1983] S.C.J. No. 80:*  S.56(1)(n) provides $500 exemption for tuition, scholarships and bursaries. Savage argued specific provision (56(1)(n)) should apply over general provision (6(1)(a)). **Test**: whether the benefit had been conferred on the employee as an employee or simply as a person (*Phaneuf*).   * S.6(1)(a) “benefit of any kind whatever” is very broad, encompasses her ‘prizes’: **no requirement that payment must have character of remuneration for services** * “In respect of office or employment”: widest possible scope (*Nowegijick v. The Queen*) 🡪 “in relation to”, “with reference to”, or “in connection with” * There was a benefit here, and she got in in the course of employment, but the specific provision of s. 56 wins.   ***Notes***  ***Mindszenthy*:** president of company gave gold Rolex to TP to use in company meetings 🡪 TCC ruled it would not have been given to him had he not been an employee, and therefore was a benefit of employment  **SCHOLARSHIPS, FELLOWSHIPS AND BURSARIES**  s. 56(1)(n) Requires TPs to include the amount, if any, by which: total of all amounts received on account of or as a scholarship, fellowship or bursary, that exceeds the exemption under s. 56(3)  - Exemption for S, F and Bs not available when received “in respect of, in the course of or by virtue of an O or E. | | |
| Valuation of Benefits | *Detchon v. Canada* [1995] T.C.J. No. 1342: Marginal and Alternative Cost are not appropriate methods of valuation – marginal cost not relevant since parents did receive an economic benefit and b/c child did receive a value in the education. There is no obligation for an employer to charge its employees for a good or service any more than its actual costs of the good or service. Valuing the benefit at the **average cost** per student is an appropriate method of valuation  ***Notes:***  ***Spence:*** same facts as *Detchon* above, but FCA said its fair market value  ***Giffen:*** value of a benefit is not always what cost is to employers. price in which employee **would have been obligated to pay** for the ticket on same flight in same class of service  ***Wisla***: TP given ring for longstanding service. TCC determined it was a benefit, but no resale value since ring personalized with corporate logo (lowers FMV) 🡪 therefore value is scrap value **RATIO: value of items is MARKET VALUE.** | | |
| Allowances and other benefits. | Allowance: money paid to cover special expenses (*Concise Oxford Dictionary*)   * *MacDonald v. Canada (Attorney General)* [1994] F.C.J. No. 378: “**ALLOWANCE**” for s.6(1)(b): An allowance is an **arbitrary amount** that is a predetermined sum set **without specific reference to any actual expense or cost.**    + **Allowance:** S.6(1)(b) encompasses allowances for personal or living expenses, or any other purpose, so an allowance will usually be **for a specific purpose.** An allowance is in the discretion of the recipient in that **the recipient need not account for the expenditure** of the funds towards an actual expense or cost🡪DISCRETIONARY   **Reimbursement**: NOT arbitrary🡪need to submit detailed receipts to be reimbursed for what you actually paid, Non-taxable benefit if it does not represent payment of employee’s personal expenses | | |
| Forgiveness of Debt. | **s. 6(15)(a):**  deems a benefit to have been enjoyed by a TP “any time an obligation issued by any debtor is settled or extinguished” by the employer 🡪 equal to the “forgiven amount” as per s.6(15.1) and s80(1)  **6(15)(b)** deems the value of the benefit to be the forgiven amount at that time in respect of the obligation.  **6(15.1)** refers to **s.80(1)** – if you have a loan from an employer and its forgiven, that’s the benefit   * Forgiven amount is generally the lesser of the amount of the total value of the loan and the unpaid balance of the loan, less any amount paid in satisfaction of the principal   McArdle v M.N.R. 1984 TCC: **Contract of employment motivated the forgiveness of the loan** – brings TP under 6(1)(a), forgiven debt to be included in TP’s income | | |
| Relocation Assistance | **6(23):** amount paid or the value of assistance by any person in respect of, in the course of or because of, and includes O or E in respect of the cost of, financing of, use of or the use to use, a residence, is a benefit received by TP b/c of the office or employment- deemed benefit.  ***Pezzelato (1995 TCC)*** – TP transferred, receives a 13K reimbursement for interest expenses on money borrowed to acquire residence. Held that there is no difference between paying the interest, contributing the principal amount or paying a higher salary – they are all benefits under 6(1)(a)  ***\*\* Important Cases***  ***Pollesel*** – TPs employer reimbursed him for moving expenses when he accepted a new job; court said TP had not received an economic benefit, therefore not taxable  ***MacInnes*** – TP received lump sum payment upon retirement to cover moving; TP was being moved back to where he originally lived before job, so court says “he has received no economic gain, advantage of benefit” | | |
| Benefits in Respect of a Housing Loss | Many employers require employees to relocate, therefore, first $15,000 paid by employer not taxed; one-half amount in excess included in income and taxable (eligible housing loss)  **S.6(19):** amount paid in respect of housing loss is taxable – **nexus test** – deems amount paid at any time in respect of a housing loss  **S.6(21):** housing loss is difference between cost paid for house and price sold for, also contemplates that house is sold for less than market value in previous 6 mos  **S.6(20):** deems the benefit re: an eligible housing loss to be only to the extent of the amount by which (valuation rule (eligible housing loss only)):  - One half of the amount, if any, by which the total of all amounts each of which is so paid in the year or in a preceding taxation year exceeds 15K ($15K of compensation is tax free) 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 a loss.  **S.6(22):** defines eligible housing loss as loss in respect of eligible relocation (s248(1): have to move at least 40K closer to new location and for work reasons AND TP ordinarily resided at old residence before relocation and at new residence after relocation) (loss for only one residence))  **S.248(1):** defines eligible relocation 248(1) – defines “eligible relocation” as a relocation which enables a TP to be employed at a new work location provided that the TP ordinarily resided at the old residence before relocation and at the new residence after relocation and that the new residence is 40Km closer to the new work location than the old residence.  - **Note** that the above provisions limit the decision in Ransom on equality grounds – TPs who move with employer assistance receive a benefit that others do not.  **S.6(23)** catches housing subsidies paid by employers, including relocation assistance  *Ransom v. M.N.R. [1967]* C.T.C. 346: Court characterized payment as non-taxable reimbursement for loss incurred in the course of employment, same category as ordinary traveling expenses 🡪 Personal expenses incurred while employee is away from home arise because employee is required to perform duties away from his home temporarily; different from remuneration for services 🡪 reimbursement cannot be characterized as remuneration or a benefit. | | |
| Interest-Free and Low-Interest Loans | **S.6(9)** includes “an amount in respect of a loan or debt” that is “deemed by 80.4(1) to be a benefit received in a taxation year by an individual  **80.4(1)** reads that where a taxpayer receives a loan or otherwise incurs a debt of or as a consequence of a previous, current or intended office or employment, the individual is deemed to have received a benefit in the taxation year equal to the total by which (a +b) – (c +d):   * 1. Total of all interest @ prescribed rate +   2. Interest paid/payable on debt by the employer or person related to employer (3rd party)   -   * 1. Interest paid on loan no later than 30 days of the end of year +   2. amount under b reimbursed within 30 days of end of year   - Rule operates to require an individual to include as a benefit an amount equal to the difference b/w prescribed rate and amounts paid by the debtor either as interest or by way of reimbursement of interest paid by the employer or a person related to the employer.  - Formula means that the more money you borrow, there may be no taxable benefit 🡪 incentive to pay people in loan subsidies as opposed to loans  **80.4(3)(a):** rule doesn’t apply where the rate of interest on the loan or debt is equal or greater than commercial rates and not paid by someone other than the debtor.  **80.4(3)(b):** this rule doesn’t apply if loan included in computing income  **80.4(1.1):** loan or debt deemed received if it is reasonable to conclude but for office or employment, the terms of loan or debt would have been different or loan would not have been received or debt incurred (reverses *Krull*)   * Nexus test: the loan or debt was incurred b/c of or as a consequence of employment 🡪 **the benefit does not have to be linked but the loan.** Interpretation is more narrow than “in respect of”   **80.4(4):** provides protection for employees subjected to the deemed interest benefit rules: prescribed rate of interest cannot exceed that which was in effect at the time that a home purchase loan (ss. **80.4(7)**) or home relocation loan (**248(1))** was received. For those purposes, if the term of the loan is more than 5 years, the prescribed rate of interest on the fifth anniversary of the loan (and each subsq 5th year) is deemed to be the rate in effect at the time the loan was received, by virtue of **80.4(6)** 🡪 interest ‘cap’ reset every five years  **80.4(7):** ‘Home relocation loan’ (248(1) – computation of a benefit will remain fixed at inital rate for 5 yrs 🡪 will protect you against rising rates  **110(1)(j):** deemed interest (under 80.4) of 25K of loan is deductible in computing taxable income  *Krull v. Canada (1996 FCA)* ***– overruled by 80.4(1.1):***  **80.4(1)** The language ‘as a consequence of’ requires a strong causal connection between the debt or loan and employment, a connection closer than required by the language of ‘in respect of’ found in **6(1)(a)**. **Dissent**: But for their employment with PC K would not have received a monthly interest subsidy. 🡪 Pretty much the 80.4(1.1) enactment agreed with te dissent. | | |
| Insurance Benefits | **6(1)(a)(i):** excludes benefits derived from **contributions** by TP’s **employer** to or under a **group sickness OR accident insurance plan, private health services plan, OR group term life insurance policy**  **6(1)(f):** requirements must be met if employment insurance plan benefits are taxed: Payable on a periodic basis, Pursuant to a wage-loss replacement plan, Employer has been a contribution to the plan  ***Dagenais v. Canada (1995 FCC) -***To be exempt, employee must demonstrate that it is fully an employee paid plan  ***Tsiaprailis v. The Queen (2005 SCC) –*** a lump sum payment in settlement of a claim for benefits held to be partly taxable under surrogatum to the extent that the payment related to accumulated arrears. SCC willing to apply *surrogatum* principle to employment context, which they had been previously unwilling to do (retirement benefits). Reflects a shift (at least among majority) that allows Rev authorities to get at payments using *surrogatum*. | | |
| Option to Acquire Securities | **S. 7** – includes as employment benefit the full amount of any gain resulting from the acquisition of securities or the disposition of an option to acquire securities  **s. 7(5)** stipulates that s. 7 doesn’t apply if benefit conferred was not received “in respect of”, in the course of, or by virtue of, the employment.  *Taylor v. M.N.R.*: Directorship is an office, holder of an office is an officer, officer is an employee. Court takes broad definition; intent of Act is to give it an inclusive definition, not exclusive  ***Busby v. Canada*** – TP had personal relationship with business man – he gave TP options and brought her on as a nominal director. Benefits received were deemed as received by her as a person for considerations extraneous to such employment, namely her special relationship with man. [this was dismissed in Taylor]  ***Grohne v. Canada*** – TP was director, sh/holder and president, received options. Court concluded options received by virtue of TPs relationship with company as shareholder, not officer or employee. | | |
| Exceptions | **S.6(1)(b)** is subject to exceptions set out in s.6(1)(b)(i)-(ix):   * (v): reasonable allowances for **traveling expenses** in respect of a period when the employee was employed in connection with the selling of property or negotiating contracts for the employer * (vii): reasonable allowances for **travel expenses** for traveling away from :   + (A) The municipality ordinary worked at or reported to, AND   + (B) Metropolitan areas where the establishment was located or duties performed * (vii.1): reasonable allowances for use of motor vehicle for traveling in performance of duties   **Travel Expenses**   1. Common deduction for employees under 8(1)(h) – for travel - and (h.1) – for motor vehicle expenses. 2. Allowances taxable under 6(1)(b) but not for reasonable allowances for travel – as per 6(1)(b)(v), (vii), (vii.1) 3. Exemptions for allowances and benefits in respect of work at a special work site – 6(5); also one under 81(3.1) for travel for part time work   *Blackman v. M.N.R. [1967] Tax ABC 480 p372 (*Travelling vs. Sojourning) **Travelling**: moving back and forth within a short period of time 🡪 **Sojourning**: living temporarily in a place (3-4 Months in this case) | | |
| Statutory exclusions | **S.6(6)** exempts certain benefits or allowances received by a taxpayer employed at a “special work site” or remote location (response to *Blackman*)   * a) **board and lodging** for the period, and * b) **transportation** between work site and residence   **S.6(16)** exempts certain disability-related benefits or allowances  **6(6)(a)(i)** - defines **special work site** as a location at which the duties performed by the TP were of a temporary nature, if the TP maintained at another location a self-contained domestic establishment as the TP’s principal place of residence  - of a **temporary nature** (but greater than 36h)  - While maintaining a **self-contained domestic establishment** (s.248) as a **principal place of residence** at **another location**  - To which the TP could not **reasonably** be expected to **return daily** because of distance  **FACTORS:**  Distance from worksite to principal residence, Hours of work, Type of road traveled, Time of day traveled, Physical and mental health of taxpayer  *Guilbert v. M.N.R. [1991] T.C.J. No. 127 p377* (Characterization of Special Work Site): A “work site” is a “work site” and **cannot refer to just any place of work.**  Temporary Job in the City which includes a free apartment is not a special work site.  ***IT-92R4*** *–* “temporary nature” refers to the duration of the duties performed and not the duration of the project as a whole – where it can reasonably be expected at commencement that the duties will not provide continuous employment beyond a period of two years  ***IT-92R4*** *–* “principal place of residence” is the place where the employee maintains a self-contained domestic establishment – a living unit with restricted access that contains a kitchen, bathroom and sleeping facilities.  ***Smith (1998 TCC)*** *–* TP lived 30 K away; it is not uncommon in Canada for people to commute 60km  ***Jaffar v R* 2002 TCC p380 – Not taxable**: TP employed at employer main site but transferred to client site for 1.5yrs during which employer paid lodging and travelling expenses to return home. Client site was unusual work place: “special” place is an unusual or exceptional workplace (*Oxford English Dictionary*) – special work site may be any place in the world including urban centres.  ***Charun v MNR* 1983 p382 – Not Taxable**: temporary work site 60km from TP principal residence but TP worked long hours and had complex commute. In interpreting “by reason of distance”, Court considered: number of work hrs required at temporary work site, type of road TP must travel by, travel time and time of day TP must travel, general physical and mental heath of TP, amount of relax time once home. CRA added: means of transportation available and condition of route (para. 9 IT-91R4 | | |
| Deductions | | | |
| Main Provisions | **8(1)** TPs may in computing their income from an office or employment deduct specific amounts as indicated “as are wholly applicable to that source” or “as may reasonably be regarded as applicable thereto.”  **8(2)** limits deductable amounts in income from O or E to the amounts specifically listed in **8**.   * 1. **8(1)(b):** legal expenses to establish a right to or to collect salary and wages   **60(o.1)**:added to include retirement allowances  **8(10)**: requirement for certificate for some deductions  **118(10):** new tax *credit* for $150 for employment expenses (comes off the bottom)  **67** stipulates that in computing income, no deduction shall be made in respect of an outlay or expense in respect of which any amount is otherwise deductible under this Act, except to the extent that the outlay or expense was reasonable in the circumstances.   1. **67.1** limits the amount that may be deducted in respect of the “human consumption of food or beverages or the enjoyment of entertainment” to 50% of the amount otherwise deductible. 2. **67.2 – 67.4** limit the amount that may be deducted in respect of a passenger vehicle. | | |
| Travelling Expenses | Where not reimbursed or part of an allowance, these expenses are properly regarded as a cost of earning the TP’s income from the O or E, which ought to be deductible in computing TP’s income from this source.  **8(1)(h)** allows the TP to deduct “amounts expended by the TP in the year (other than motor vehicle expenses) for travelling **in the course** of the office or employment,” provided that the TP in the year,   * 1. was ordinarily required to carry on the duties of the office or employment away from the employer’s place of business or in different places, and   2. was required under the contract of employment to pay the travel expenses incurred by the TP in the performance of the duties of the office or employment,   except where the TP,   * 1. received an allowance for travel expenses that was, because of **6(1)(b)(v), (vi) or (vii)**, not included in computing the TP’s income for the year, or   2. claims a deduction for the year under **8(1)(e), (f) or (g)**. (for specific types of jobs)   **8(4)**: meals not included under 8(1)(h) unless consumed when TP was required to be away from the municipality or metropolitan area for more than 12 hours  **8(1)(h.1)** allows TPs to deduct amounts expended in respect of motor vehicle expenses incurred for travelling in the course of an office or employment, also provided that the TP, in the year (subsections like 8(1)(h)).  **TEST:**  for s.8(1)(h) and (h.1)   1. **ORDINARY REQUIREMENT:** Employee must have been ordinarily required to carry on the duties of the office or employment away from the employer’s place of business or in different places; 2. **PAID FOR THEMSELVES:** Employee must have been required under the contract of employment to pay the travel expenses incurred in the performance of the duties; and, 3. **NO ALLOWANCE:** Employee must not receive travel allowance exempt from tax under s.6(1)(b) | | |
| Travel in the Course of O + E: *Luks v. M.N.R. [1958] C.T.C. 345* (Travel in the Course of an Office or Employment): To deduct expenses, he **must be necessarily obliged to incur them**; obliged by the very fact he holds the office and has to perform duties (*Ricketts v. Colquhoun*, [1926] AC 1). Commute made in *consequence* of employment; not sufficient to meet Act requirements  ***Chrapko (1988 FCA)*** – C sought to deduct expense of travel from home to each of three race-tracks where he worked. Court disallowed deduction for 2 racetracks in TO where he worked 75% of time, but allowed deduction for Fort Erie on grounds that **8(1)(h)** encompasses travel to a place of work AWAY from the places which the TP *USUALLY* works.  ***Evans (1999 TCC)*** – follows ***Merten*** reasoning on grounds that usual place of business was administrative office but often had to travel direct to schools. Allowed home-work travel on secondary basis that E had to carry files in her trunk on a permanent basis and had no alternative but to do so. 🡪 hard to square w/ *Luks*  Possible distinctions from *Luks*: files were not hers, had to travel to different locations, not one | | Food Expenses: **s.8(4)** Meals Must be consumed**: a)**During a period while taxpayer was required to be away f**or a period of 12+ hours** **b**) **Away from the municipality** where the taxpayer ordinary works AND **away from the metropolitan area** (if applicable) where it is located    **Healy v. Canada, [1979] C.T.C. 44:** Lists posted at each track to inform employees where they are working, HQ delivers paycheques via courier to employees at their post, Disciplinary matters handled initially at track but final disposition at HQ.   * **where did employee ordinarily report for work**: from the facts, it logically follows that the appellant usually worked in Metropolitan Toronto; Fort Erie is not the municipality in which he ordinarily works 🡪 This brings the appellant within s.8(4) * **was the employee away for more than 12 hr**s: YES   S.8(4) is designed to prevent abuses in the application of s.8(1)(h) but not to prevent legitimate deduction of expenses properly incurred while working at different places |
| Moving Expenses | **ELEMENT 1 – “Is it an Eligible Expense?” – s. 62(3): Reasonble expenses**, 🡪 INCLUDES Cost of transportation and storage, meals and lodging, lease cancellation, legal fees of buying new place, etc.  **ELEMENT 2 -** **MUST be an “eligible relocation” – s. 248(1):**   * + - 1. from old to new residence **40km closer to new work location**       2. in order **“to enable” the taxpayer to be employed** or carry on a business or post-secondary at the “new location” (both old and new are in Canada)   **ELEMENT 3 - limitations on what you can deduct – s. 62(1):**  cannot deduct: tuition, cost of connecting appliances, minor renos, changing locks etc.  *Storrow v. Canada* [1978] C.T.C. 792: “moving expenses” must be construed in their ordinary and natural sense in the context of statute. **“Moving expenses”:** do not mean costs incurred in connection with the acquisition of the new residence; **only costs incurred to effect the physical transfer of the taxpayer, his household, and belongings to the new residence are deductible** | | |
| Eligible Relocation | **S.248(1)** a relocation that occurs :   1. to enable the TP carry on a business or to be employed at a “new work location” in Canada or full-time post-secondary student 2. both new and old res in Canada (although not for post-secondary students) 3. you moved at least 40K closer from where you ordinarily reside   *Dierckens v. Canada (New work location)*: you can choose the time of your move – not reasonable to read in to definition of eligible relocation a requirement that person must move within a certain amount of time after commencing employment at “new work location.” *“New work location”* – not appropriate to interpret the word ‘new’ as creating any additional requirement in relation to the location – its just a term for preceding operative.  Notes:  ***Grill v. Canada [2009] TCC:*** TP had commuted to work for 10 years. Sought deduction for moving expenses after he and his wife separated, and he moved 40km closer to work.  **Court:** DISALLOWED. ITA clearly contemplates a ‘new work location,’ for which there was not one here.  ***Gelinas v. Canada (2009) TCC:***TP commuted 65 km to work for part time position. Moved 40km closer upon obtaining full time position.  **Court:** ALLOWED. Ignored the “new work location” requirement. TCC thought that the critical words were “enable to be employed…at a location,” NOT the “new work location” part.  ***Moreland v. Canada (>2009) TCC:***TP assigned new employment duties at same location.  **Court:** DISALLOWED 🡪 rejected *Gelinas* approach, disallowed on basis that did not meet the ‘new work location’ req’t.  *Rennie v. M.N.R. [1989] T.C.J. No. 1105* (Characterization of Residences): The appellant cannot have 2 simultaneous residences under s.62; “residence” does not govern the provision, rather “ordinarily resident” is the key phrase. One is ordinarily resident in the place where in the settled routine of his life he regularly, normally or customarily lives   * The appellant was ordinarily resident in Victoria in 1984; he had moved from Montreal 3 years earlier and his home was either in Edmonton or Victoria   Notes:  ***Jaggers (1997 TCC)*** **Deductible**– TP allowed to deduct cost of sale of house 2 years after move. Held that it is sensible to retain old home where prospects of new job are uncertain.  ***Pitchford (1997 TCC)* Deductible** – TP moved from Victoria to Moose Jaw and then MJ to Saskatoon sought to deduct expenses incurred in transporting furniture most of which remained in storage until S. Held that **the TP had no settled routine of life where they normally or customarily lived until S** and therefore did not take up ordinary residence until S.  ***Ringham (2000 TCC)*** **Deductible** – TP accepted offer to work in Budapest, sold home in Kanata and rented condo in K while travelling weekly to Thornhill where he stayed at a Holiday Inn. TP then moved to Richmond Hill to work full time at his employer’s office in Thornhill after Budapest project cancelled. TP sought to deduct sales cost on the house in K. **Held that there was realistically only one move as the rental premises was temporary and not an ordinary residence.**  Giannakopoulos v. M.N.R. [1995] FCA (Distance): **Shortest Normal Route Test:** the shortest route that one might travel to work should be coupled with the notion of the normal route to the traveling public | | |
| **Limitations on Deductability** | **S.62(1)** limits the deduction of moving expenses in several ways:  **S.62(1)(a):** moving expenses are not deductible to the extent that they were paid on the taxpayer’s behalf in respect of the office or employment  **S.62(1)(d):** disallows deductions to the extent that reimbursements or allowances received by the taxpayer are not included in computing income  **S.62(1)(c):** limits deductible amount for a year to: The taxpayer’s income for the year at the new work location or carrying on *the* business | | |
| Income or Loss From Business or Property and Other Income | | | |
| Introduction | **s. 3(a)** Identifies each business and each property as sources of income  **s. 3(d)** Permits taxpayers to deduct their losses from each business or property.  **s.9(1)** defines income from a business or property as the profit from that business, implying deduction of reasonable expenses incurred  **s.9(2)** defines loss as “the taxpayer’s loss, ifany,… from that source computed by applying the provisions of the Act, respecting computation of income from that source with such modification as the circumstances require.  **s. 9(3)** income from a property and loss from a property does not include capital gains or losses from disposition of the property.  **s. 38** Where the gain or loss is of a capital nature, only one-half of the gain is taxable, and only one-half of the loss is deductible, and only against the taxable cap gains (s.3(b)) | | |
| Characterization: | | | |
| Business Discussion on Gambling | **“Business:”** a habitual occupation or profession, trade (Oxford)   * **Ordinary Meaning:** Broad in nature, object is the acquisition of gain through labor and capital in varying combinations. * **Extended Meaning:** “Business” (s.248(1)): includes a profession, calling, trade, manufacture, or undertaking of any kind whatever, and an adventure or concern in the nature of trade (AINT) but does not include an office or employment – income from a combination of labor and capital.   **Property:**   1. **Ordinary –** Right to possession use, or disposal of anything similarly broad in nature. Everything that is subject to ownership, corporeal or incorporeal, tangible or intangible, visible or invisible (oxford and Black’s) 2. **Extended Meaning 248(1)** – property of any kind whatever, whether real or personal or corporeal or incorporeal.   *M.N.R. v. Morden* [1961] C.T.C. 484 [ordinary meaning]: Gambling is taxable if it is organized as a business, needs to meet the enterprise of commercial character test.  Notes:  ***MacEachern (1977 TRB***) – Search for sunken treasure. Income earned was heldto be income from a business as partners intended to sell anything they found for profit, it was a well organized endeavour and there was potential for substantial profit. Troubling case b/c court calls it a hobby with a potential for profit, so is this a business or hobby?  ***Tobias (1978 FCTD)*** -- TP involved in unsuccessful treasure hunt. Consistent with *MacEachern*,full deductions allowed as uncertainty of profit does not preclude expenses from being considered business expenses.  ***Cameron (1971 TAB)*** – TP, salmon + herring fisherman, engages with others to catch and sell two killer whales. TP said he wasn’t a whaler. Held that the captures were fortuitous (windfall) and not business income | | |
| Treasure Seeking Cases (AoCINT) | *M.N.R. v. Taylor, [1956] C.T.C. 189* (Extended Meaning) (AINT): Positive signs or banners   * + 1. Manner of dealing – is the transaction carried out as if by a professional trader?     - Soliciting buyers, quick turn-around, not necessary to have frequency of sales or organization.   + 2. Nature and quantity of subject matter: 50k tons of lead might be more than personal use.     - Might want to 1. Sell it 2. Invest in it 3. Personal use.   + 3. Intention**:** do you intend to make profit?   - Same test used in ***IT-459*, and** approved by the SCC in *Friesen* (1995)  *Regal Heights Limited* (1960 SCC): ‘Secondary Intention’ Doctrine’ AINT because the TP had a “secondary intention” to resell the property, notwithstanding that the “primary intention” was to build a shopping center [income from an asset]. Subsequent cases have established that a transaction can only be AINT where *but for* the possibility of re-sale at profit, wouldn’t have acquired the property. | | |
| **Reasonable expectation of Profit** | *Stewart v. Canada, [2002] S.C.J. No. 46* (REOP Reasonable expectation of Income): The profitability of an activity does not affect the deductibility of expenses. SCC rejects the broad judicial test for REOP as a source of income. The determination must be rooted in the Act.   * + **Step 1**. Is the activity in **pursuit of profit, OR is it a personal endeavor?**     - REOP can be used only where there is a personal element to the transactions. Must look at a variety of additional factors (objective) and not exhaustive.     - “Does the TP intent (predominately) to carry on the activity for profit and is there evidence to support this intention?” Do not use hindsight to judge business decision.     - Elements to consider:       * The profit and loss experienced       * TP’s training       * TP’s intended course of action       * Capability of the venture to show profit   + **Step 2** – source of income: determine whether it is business or property. | | |
| Inclusions s. 9(1): a TP’s income from a business or property is the TP’s “profit” from business or property. Profit is a net concept which Implies that expenses have been deducted from gross income. | | | |
| Gains from Illegal Activity | No.275 v. M.N.R. (1955), 13 Tax ABC 279 (Gains from Illegal Activities): This is an operation in the Nature of trade and therefore is taxable. They were earnings derived from a business, and the policy here is that not taxing would actually encourage illegal activity as it is tax-free.  Notes:  ***Smith (1927) PC*** – S taxed on bootlegging profits. No valid reason for finding that Parliament meant to exclude this type of activity from tax. | | |
| **Damages and other compensation** | *Canada v. Manley [1985] 1 C.T.C. 186* (Surrogatum Principle 🡨 damages): Amount to be included in income where:  1) Received pursuant to a legal right for compensation  2) Characterization for tax purposes follows characterization of the amount that should have been received before the breach.  Notes  1. ***Donna Rae Ltd (1980 TRB)*** – Damages paid 70% for gear 30% for lost profit. Taxable 70% capital 30% income.  2. ***Donald Hart (1959 Exch.)*** – Damages for TM infringement stole business = income so damages taxable.  Capital Receipt  H.A. Roberts (1969 SCC): 1. Mortgage department was a separate business 2. Long term K’s were capital assets of an enduring nature. | | |
| **Voluntary Payments** | *Federal Farms Limited v. M.N.R. [1959] C.T.C. 98* (Voluntary Payments)  - Different than insurance, as there is *no legal right* to payments, no K, not set up in advance and there is no expectation, and did not result from a business operation.  - Just because the payment made was related to an to some extend measured by amount of loss does not affect its nature as a gift.  Voluntary payments are ex gratia without legal entitlement of the recipient. Campbell (1958 Tax ABC) – Women Ks to swim across Lake Ontario, doesn’t make it. Paid anyway. *No legal right* to the money, but Voluntary payments arising out of services rendered are not gifts and are taxable. | | |
| **Windfalls** | *Cranswick (1982 FCA):*  **Analysis –** There was no obligation for payment here. Not something they could have invested in getting:  i. Did the recipient have enforceable claim?  ii. Was there an organized effort to recover the payment?  iii. Was the payment sought after or solicited?  iv. Was the payment expected?  v. Did the payment have any element of recurrence?  vi. Was the payer a customary source of income?  vii. Was this consideration for or in recognition of property, services or anything provided by TP (earned?).  Notes:  **Frank Beban Logging Ltd (1998 TCC) –** Logging operation ends when National Park is created. Province nicely gives 800K to Company, although no legal obligation. Held as a windfall as there was no legal right | | |
| **Prize and Awards** | **s. 56(1)(n) –** 1972 amendment – Prizes that are not received in the course of business may be taxable: TP’s income to include “all amounts… received by the TP in the year… as or on account of… a prize for a field of endeavor ordinarily carried on by the TP” to the extent that it exceeds the $500 scholarship exemption under  **s. 56(3)** – exempts bursaries and scholarships for post-secondary study.  *Abraham v. M.N.R. (1960) 24 Tax ABC 133* (Prizes and Awards) Prizes from Draws are not taxable (business connection severed by chance): Prize was not taxable as it was pure chance and was not received as remuneration for services. The less likely you are to win, the less likely it is to be taxable    Notes  **Rother v. M.N.R. (1955), 12 Tax ABC 379** – Non-taxable prize received in Competition  - Taxpayer was an architect, and received 2k in a competition. Not taxable receipt on grounds that it was nt received as employee or officer, nor for services, or as purchase fee. (Duff things this is in virtue of his work)  **M.N.R. v. Watts, [1966] C.T.C. 260** – Taxable prize from a contractual relationship  Architect again. Received in course of business but court construes there to be a K between the holder of the competition and holder of the competition, to say that this was in the course of business. Duff states that they just didn’t want to overrule *Rother*. Annuity Payments: *Rumack v. M.N.R.* [1992] F.C.J. No. 48 – Paid Annuity as Taxable Income: Taxation takes place as if the TP owned the annuity. Capital is not taxable (interest), but the income element is taxable under 56(1)(d) and 60(a). **Has the characteristics of income**: regular, foreseeable, expected, and enforceable. Prizes for Achievement *Canada v. Savage,* [1983] S.C.J. No. 80 – Prize for achievement in a field of endeavor: ***The word ‘prize’ should be construed broadly***. To tax it under 56(1)(a) would run counter to principles of statutory interpretation, by using a more general rule over a specific one.  - No competition is necessary for there to be a prize (read within the context. No wording in statute points to competition) Prescribed Prize: **56(1)(n)(i)**: exemptions fr prizes “… other than a prescribed prize”  ***Regulation 7700 -*** ‘**perscribed prize**:’ any prize that is **recognized by the general public** and is awarded for **meritorious achievement**  in the arts, sciences, or service to the public but does not include any amount that can be reasonably be regarded as having been received as compensation for services rendered to to be rendered  *Foulds v. Canada [1997]* T.C.J. No. 87 – Prescribed Prizes (not taxable): Prize was for ‘meritorious achievement in the arts;’ was recognized by the public in that area/field. Not argued that it was in the course of business, but fits into the category.  *LaBelle v. The Queen [1994]* T.C.J. No. 836 – Prescribed Prize (not taxable): Professor one a competition, MNR wanted it taxes as not recognized by the general public. Minister must show that the general public didn’t recognize the prize, he can’t just state that.  **Decision tree for prizes:**   1. Is prize awarded in course of business?    1. If Yes, taxable as Business or O and E income    2. If No, was it for an endeavour ordinarily carried on by the TP?       1. If Yes, falls under **56(1)(n)(i)**          1. Is it prescribed?             1. If Yes, not taxable             2. If No, taxable with $500 exemption in **56(3)**       2. If No, not taxable (windfall) | | |
| Inclusions: Property Income s. 9(1) Income – A TP’s income for a taxation year from a business or property is the TP’s profit from that business or property for the year. | | | |
| Interest | | | |
| Characterization | **12(1)(c) -** Income includes any amount received or receivable by the TP in the year, as on account or in lieu of payment of or in satisfaction of **interest**…  **1. Three Elements of Characterization of Interest** – The courts have recognized three elements to legal interest:  **a.** Compensation for use or retention of principle sum;  **b.** Referable to a principal amount (and apportion able to it)  **c.** Day to day accrual (even if only paid on intervals)  *Perini Estate v. M.N.R.* [1982] F.C.J. No. 12 (Definition of Interest) This is the leading case, - contingent payments may be deemed interest if they are retroactively referable to a principle sum: TP had a legal right to a contingent amount. Parties to a K can give a contingent liability retroactive effect such that it could qualify as a principle sum to which interest could be said to be referable. - Even though the payments were contingent, they became referable to sum when the conditions were satisfied, thus the payments could be deemed interest on principal. | | |
| **Participatory Interest Cases** | Sherway Centre Ltd. v. Canada [1998] F.C.J. No. 149 (Interest Deductions): The court must allow new and innovative financing schemes, allowed a deduction under 20(1)(c). Interest must only be ascertainable on a daily basis, not necessary that it be expressed on a daily basis | | |
| **Payments of Interest and Capital Combined** | **s. 16(1)(a)** is an anti-avoidance provision “where part of a payment can reasonably be regarded as interest and part as capital, the part that is interest shall be tax as interest, irrespective of when the contract or arrangement was made or the form or legal effect therefore.  *Groulx v. M.N.R.* [1967] C.T.C. 422 (Interest and Capital Combined) – factors in determining interest component of lump sum:  1. Normal Business Practice: e.g. charging interest on the transactions.  2. Relationship of price to FMV – Sum at closing was excess FMV  3. Intention test. – Here TP was sophisticated and it looked like TP intended to capitalize on the interest.  *Van West Logging Co. Ltd. v. M.N.R.,* [1971] C.T.C. 199: adds 4th factor: the course of negotiations leading up to the agreement. **16(1)** should be used only where there is something in the intention of the TP to avoid paying tax on interest that would otherwise be payable.  ***Notes***  ***Rodmon Construction (1975 FCTD):*** FMV is the most imp factor, definition: “highest price available in an open and unrestricted market between informed, prudent parties acting at arm’s length”. | | |
| Deductions Part 1: Illega Payments, Damages, Fines | | | |
| **6 tests:** | 1. Be of an income nature (not a capital expenditure 2. Profit under **9(1)** is a net concept – (revenue expenditure) – capital not included. 3. ***Business Practices Test*** – Whether the outlay or expenses was made or incurred by the TP in accordance with the ordinary principles of commercial trading or well accepted principles of business practice. 4. Be Reasonable in amount **(s.67)** 5. **S. 18(1)(a) –** no deduction shall be made in respect of…. An outlay or expense except to the extent that it was made or incurred by the TP for the purpose of gaining or producing income from the business or property.    1. ***Income producing purpose test*** 6. Not a personal expenditure – **18(1)(h)** – disallows personal or living expenses, other than travel expenses, incurred in the course of carrying out the TP’s business. 7. Not be expressly prohibited by the act    1. **S. 67.1 for example,** limits deductions to %50 of meals and entertainment).    2. S. **18(12)** home office. 8. Not constitute abusive tax avoidance – GAAR **s. 245.** | | |
| **Illegal Payments** | *Espie Printing Co. v. M.N.R.,* [1960] C.T.C. 145 – Illegal payments are deductible: Illegal payments are deductible. The illegality of the payments made to the TP’s employees should have no bearing on their deductibility.  **Notes:**  **65302 BC Ltd (200 SCC)** overrules ***Neeb*** that had rejected the TP’s claim to deduct drugs and equipment that had been seized from him. You can deduct fines and penalties. | | |
| **Damage Payments** | *Imperial Oil Limited v. M.N.R.,* [1947] C.T.C. 353 Ex.Ct - Damages payments are deductible where they satisfy business practices test: 9(1) and income producing purpose test (18(1)(a): Deductibility of disbursements or expenses should be according to the ordinary principles of commercial tradition an business practice, unless expressly prohibited. Here damage payment was made in respect of a loss wholly incidental to the operation of the TP’s business. The risk of a liability for a collision due to negligence is a normal and ordinary risk of the TP’s business. - For the purpose of earning income should not be read literally – rather, was it expended as part of the operations, transactions or service by which the TP earned his income?  - Do not look at the deduction in Isolation – while the liability here was particularly large, nothing unusual about the collision itself.  Notes:  ***Poulin(FCA)****.-* real estate broker had to pay damages for false and fraudulent representations. Held that these damages did not correspond to a risk that was necessary for the TP to assume in order to carry on his business. | | |
| **Fines and Penalties** | 65302 British Columbia Ltd. v. Canada, [1999] S.C.J. No. 69: .  **Rejects Public Policy:** In general, on the basis that nothing to that effect was actually stated in **18(1)(a)** and that it made the system uncertain.  **Rejects “avoidability” test and “remoteness”:** as there is nothing to this effect in **18(1)(a).**  **Rejects the “incidental” test:** from the *Imperial Oil* case on the basis that it was based on a much more restrictive in the Income War Tax Act than in **18(1)(a)** today.  **Endorsed the strict “income producing purpose” test:** This was accepted as the “Benchmark” test. Even if the expense passes this test, it could still be denied if it is “**egregious or repulsive**” so as not to be justifiable.  **. 67.6:** Overrules 65302 BC for *statutory fines: In computing income, no deduction shall be made in respect of any amount that is a fine or penalty (other than a prescribed fine or penalty)”* imposed b any state or political sub-D of state that has the authority to impose a fine.  **67.5**: no bribes allowed. | | |
| Deductions (Part 2: Personal Vs. Business Expenses) | | | |
| **Recreation, Meals and Entertainment** | The Royal Trust Company v. M.N.R. [1957] C.T.C. 32 Ex.Ct. – approach to deductions – 18(1)(a) a narrowing provision on definition of “profit” under 9(1): Start with **s. 9(1)** – the section that authorizes the deduction. Deductions are inherent in net concept of “profit.” Deductions are generally allowable under s.9(1) if they are in accordance with the ordinary principles of commercial trading or well-accepted principles of business practice. Apply the “business purpose” test or “income producing” test of s. 18(1)(a) – was the expense incurred for the purpose of earning income? Don’t have to actually earn income, but have to have an intention to do so.  s. 18(1)(l)(ii): - No deduction of membership fee’s or dues to any club, if the main purpose is to provide these things for its members. (overrules Royal Trust).  - **IT-148R3:** Tp determine “the main purpose” of the club, look at the by-laws, how it is organized, whether 50% of its assets are used to provide dining, recreational or sporting facilities.  **s.18(1)(l)(i):** non-deductibility of costs for use or maintenance of yacht, camp, lodge, or golf course or facility  ***CIP Inc.* –** Tugboat was not a yacht, is deductible for renting expenses.  ***Groupe Y. Bourassa –***Deduction for golf tourney disallowed because green fees were related to “direct use of a golf course of facility” and meals and beverages expenses where also disallowed as incidental.  **18(1)(h): No deduction for personal living expenses:**  ***Roebuck (1961 Tax ABC)*** – TP tried to deduct some expenses for daughter’s bat mitzvah because some clients were invited; disallowed because not in accordance with principles of commercial trading or accepted business practice (9(1)) or under 18(1)(a) test  **Corporate Expenses:**  ***Grunbaum (1994 TCC)*** – unlike in *Fingold*, invitations sent under company name, all correspondence through company, so business guest expenses were deductible since it was clear they were biz guests. Distinction made between business guests and personal guests, only expenses related to biz guests allowed. | | |
| Limitations on Deductions | | | |
| **Meals and Entertainment** | **67.1(1)** limits the amount that a TP may deduct for amounts paid or payable in respect of human consumption of food or beverages or the enjoyment of entertainment to 50% of the lesser of the amount actually paid or payable and an amount that would be reasonable in the circumstances.  **61.1(4)(a)** no amount paid or payable for (food/entertainment while on) plane, train or bus shall be included – so food/beverages/movies *in transit* excluded from **(1)** 50% limitation (amount fully deductible?)  **67.1(4)(b)** – entertainment – defined to include amusement and recreation  **67.1(2)** – lists exceptions where an amount paid or payable by a person in respect of … Full Business Expense is: a) Compensation in the “ordinary course of business” b) Relates to charity, fund rasisng c)Reasonable compensation d) Food and beverages exempt from ban under 6(6)(a) e) 6 or fewer events for all employees  *Stapley v. Canada [2006]* F.C.J. No. 130 broad wording of 67.1 – need not be consumed by TP: The wording of 67.1 is very broad: ‘in respect of human consumption’ means section contemplates consumption by individuals other than the TP: s.67.1 to mitigate potential for tax avoidance and abuse; respondent’s deductions not an abuse targeted by s.67.1(1), many quotes emphasizing personal consumption which is not present case  In a conflict, clear language trumps court’s view of object / purpose (65302 BC)  Given that the expenses do not fall under any of the express exceptions, court must find he can only deduct 50% (however, court notes that this seems unfair) | | |
| **Clothing Expenses** | *No. 360 v. M.N.R. (1956)*, 16 Tax ABC 28 (Clothing Expense): These were nevertheless, personal expenses, primarily because other cases found likewise. She admitted she could wear these clothes in normal life Result might be different if they were period costumes or something like that.  Notes:  ***Giroux (1957 Tax A.B.C.)*** -- Allowed deduction for clothes and accessories that TP was required to wear, but could only suitably wear on stage or television. | | |
| Home Office Expenses | **18(12) a).** No deduction for any part of a self-contained domestic establishment except:  Work space, which is part of establishment in which you reside, is either  - Principal place of business or  - Used exclusively for the purpose of earning income from business AND used on a regular and continuous basis for meeting clients, customers or patients of the individual in respect of the business  **b)** – Cannot generate a loss in a year  **c)** – If exceeds under (b), can be carried forward indefinitely (if continuity of qualification, i.e. residence)  *Locke v. M.N.R. (1965*), 38 Tax ABC 38 (Home Office Expenses) – gen principle for deductibility of home office expenses: Where a portion of the house has been definitely set aside for business purposes, and an appreciable amount of business has been transacted therein, the taxpayer might be entitled to deduct a reasonable amount: **FACTORS:**   * + Was the room in question definitely separate from living quarters of his family?   + Was an appreciable amount of business transacted in said room or was it just used for his convenience?   + Was his house partially municipally assessed for business purposes?   + Was his telephone ordered for business purposes?   + Was there a sign on his house announcing to the general public that a law office was being maintained therein?   + If he already has an office where he regularly practices his profession, was his home office, in fact, a second branch office?   🡪 onus will be high for TP’s who clearly have another place of business  ***Logan (1967 Tax ABC)*** -- Doctor allowed to deduct home office. Hospital was unacceptable for night-time work, and deliberately bought home that had room for office; showed income increased because of office; room separated from rest of house; other doctors came to office; no television or radio in office | | |
| **Travel Expenses** | ***18(1)(h)*** -- travel expenses incurred by the TP while away from the home in the course of carrying on the TP’s business” are deductible, in contrast with other “personal and living expenses”, which are disallowed  *Cumming v. M.N.R., [1967]* C.T.C. 462 (Travel Expenses) – deductible where travel in course of biz is from ‘base of operations’: Governing test is location of the “base of operations.” Here, home office is the base. Therefore, the journeys to and from the hospital were not commutes but were journeys made in the course of the practice and thus deductible. | | |
| **Reasonableness** | Cipollone v Canada, [1995] T.C.C (Reasonableness) ) – the ‘reasonableness’ of expenses may be looked at in comparison to expected revenues: Found as fact that TP spent money in order to earn to earn a profit and expectation of earning a profit was reasonable despite small revenues, good faith-potential for taxable income  Problem was attempt to deduct unreasonable expenses – expenses greatly disproportionate to revenues, many expenses that had a personal nature (travel, meals, clothing) | | |
| Deductions (part 3: Interest and Other Financing Expenses) | | | |
| **Interest Expenses** | **18(1)(b)** General rule—No deducting capital expenses  **20(1)(c)(i)**: you can deduct (*Shell Canada Ltd. v. Canada):*  Amount paid or payable  Pursuant to a legal obligation to pay interest on borrowed money  Borrowed money used for purpose of earning income (any income from *Ludco*)from a business or property (where most of the action is)  OR A reasonable amount in respect thereof, whichever is the lesser  **20(3)**where money is borrowed and used to repay previously borrowed money, that money shall be deemed to have been used for the purpose for which the initial loan was used  **20(1)(e-g)** – allow for deductions in some specific cases that were found to fall under 18(1)(b)  *Bronfman Trust v The Queen* (1987) S.C.C. – emphasis on direct use of borrowed money (has been taken back) but may be a deduction where borrowed money used indirectly for bona fide purpose of earning income:  **Eligible vs ineligible uses (rejected by *Singleton, Shell, Ludco*)**  Eligibility is contingent on the use of borrowed money for the purpose of earning income; focus of inquiry must be on the use to which the taxpayer puts borrowed funds  **Current use vs original use (rejected by *Singleton, Shell, Ludco*)**  Current, not original, use of borrowed funds is relevant focus in assessing deductibility  **Direct vs indirect use** [ONLY THING LEFT!!]  A direct ineligible use of money should not be overlooked for an indirect eligible use  Thus, you use the borrowed funds for the purpose of making income (modified in *Ludco*)  Look at the direct use of the borrowed funds that is relevant when assessing the deductibility of interest payments. Earning income from business or property must be a *bona fide* purpose.  *Singleton* (2002 SCC) p740 note 10–allowed- rejects Bronfman bona fide purpose test: imply apply s.20(1)(c)(i) and view the transaction independently by applying only the direct use test. The Commercial and Economic reality test is rejected. TP doesn’t have to show a *bona fide* purpose (undermining *Bronfman*). There is a direct link between borrowed money and an eligible use. Transactions should be viewed independently. **Revenge of the Duke**-- emphasis is now on the ***Duke of Westminster*** case. You are allowed to arrange your affairs so as to take advantages of the tax advantages available under the Act.  *Ludco Enterprises (or Ludmer) –* allowed-undermines Bronfman bona fide purpose test:income’ in 20(1)(c) means gross income, not net (not mentioning **9(1)**), Your primary purpose in borrowing can be a cap gain, so long as earning income is an *ancillary* purpose.Deducted $6 million in interest payments, received $600K in income, realized $9 million cap gain.  Disregards the *bona fide* test, as well as the exclusive, primary or dominant purpose test. Even an ancillary purpose is *bona fide* | | |
| Capital Expendatures | | | |
| **Characterization** | **S. 18(1)(b**) of the Act defines capital expenditures as: “outlay of capital,” “replacement of capital,” or “payment on account of capital.” None of these are defined in the Act.   1. The action is in the category of payments on account of capital. The consequences depend on the category and whether it is tangible property which is not land (depreciable property – cost not currently deductible per 18(1)(b)) 2. Special rule for deduction of interest expenses as expenses on account of capital under 21(1)(c). 3. Until 1972 Goodwill was a non-deductible capital expense, now it is an eligible capital expenditure with its own system. (add ¾ and deduct 7% over time) 4. Non-depreciable capital property – offset against proceeds on sale (1/2 deductible or taxable) 5. Capital expenses are expenses which bring into existence an enduring asset 6. Does it produce something certain that you have definite rights to (i.e. equipment vs. advertising). Usually turns on how you characterize the benefit. 7. Will be determined in large part by the nature of the business (if you buy and sell capital assets they are inventory) 8. Note that expenses incurred to set up the business structure, including research are capital expenses but there must be something that comes out of it or you get no deduction at all. 9. Where TP makes a capital expenditure, the amount is added to the cost of property on account of which the expenditure is incurred and either:    1. Subtracted from proceeds of disposition when that property is disposed of; or    2. Amortized and deducted over time from TP’s income from a business.   *Johns-Manville Canada Inc. v. The Queen (1985 SCC)* - Resurrects interpretive rule of residual presumption for benefit of TP where there is reasonable ambiguity (now a general rule to benefit TP for both inclusions and deductions): Here, court focuses on the surface and says it’s consumed each year; no enduring benefit. On the evidence & using the common sense approach SCC feels the expenditures should be treated as an income expenditure.  Generally, one of two tests will apply:   1. *British Insulated and Helsby Cables v. Atherton (1926)*, laid down the “once and for all” test – a capital expenditure is going to be spent once and for all but with a view to bringing into existence an asset or advantage for the *enduring benefit* of trade, an income expenditure is a thing that will recur every year. 2. an amalgam of the following    * 1. *BP Australia Ltd. (1966, P.C.)* (1) there is no rigid test – just use common sense, and (2) were the sums in question expended on the structure within which the profits were to be earned or if they were part of the money earning process?.      2. *Halstroms Pty. Ltd (1946)* described the difference b/w capital expenditures and expenses as the difference “between the acquisition of the means of production and the use of them; between establishing or extending a business organization and carrying on the business; between the implements employed in work and the regular performance of the work … ; between an enterprise itself and the sustained effort of those engaged in it.”      3. *Sun Newspapers Ltd. (1938)* 3 factors: (a) the character of the advantage sought, including lasting qualities; (b) the manner in which it is to be used; and (c) the means adopted to obtain it (i.e., periodic or lump-sum payments).   **TEST:** capital expenses = once and for all AND to produce an enduring benefit  Can use either UK or AUSTRALIAN test (when ambiguity which, use residual presumption in favour of TP)  Helsby Cases:  ***Haddon Hall Realty Inc. (1961, SCC)***: Cost to landlord to replace appliances in rental units a capital expenditure due to the fact that the expenditure was made once and for all to create a benefit of an enduring nature.  Did not create an enduring benefit:  ***Damon Developments Ltd.(1988, TCC)*** TP owned a hotel Distinguished form ***Haddon Hal****l* (the landlord case) b/c in a hotel such items have a much shorter life and thus less of an ‘enduring benefit’, expenditures to replace them are very regular.  Applied B.P. Australia, Sun Newpapers, and Hallstorm’s tests:  ***Cormack (1965****)*: Travel expenditures incurred to research similar businesses and thereby improve one’s own constitute a capital expenditure b/c it’s meant to improve one’s business.  Acquisition and Repair of tangible property:  ***Canada Steamship Lines Ltd. (1966, Ex. Ct.)***: TP replaced floors & walks, and replaced boilers. Former held to be income expenditures, latter to be capital expenditures. Reason: the skin is normal wear & tear in the course of business, while boilers are essential to the operation of the ship and constitute new plant and equipment.   * Factors to look for: cost of work compared to repair costs in an avg year, cost of replaced item compared to value of whole asset; if repair actually changes character of the thing its an improvement or upgrade. Exceptions: if new technology you don’t have to use old technology to keep it from being a capital cost; repair may be b/c of vandalism, latent defect, accident and still be a current expense – need not just be wear and tear   *Shabro Investments Ltd (1979, FCA) note 25 p 834 - capital:* with repairs/modifications, ask if the change is merely *repairing* damage to the fabric of the building (repair) as it had theretofore existed or whether it was an integral component of a work designed to *upgrade* the building by replacing a substantial part thereof with something essentially different in kind.  *Gold Bar Develpments Ltd (1987, FCTD)-deductible- Added subjective test:* court looks at *subjective* purpose for which outlay was made – was it elective, or mandatory? Here repair had to be made. Acknowledges rule from ***Canada Steamship Lines*** that where repairs are so major as to substantially replace a capital asset, that will be deemed a capital expenditure. Also acknowledges rule from ***Shabro Investments Ltd****.* that if repairs substantially improve a capital asset they will be deemed a capital expenditure | | |
| Prepaid Expenses | **S. 18(9)** disallows the immediate deduction of prepaid expenses for services to be rendered after the year, payments on account of or in lieu of interest, taxes, rent or royalties in respect of a period after the end of the year, or as consideration for insurance, which are instead deductible in the subsequent year to which the expense ‘can reasonably be considered to relate’   1. For certain categories of ‘prepaid expenses,’ you don’t get to deduct currently, but in the periods to which it will relate (e,g, prepayment for services @ end of yr, prepaid rent, royalties, insurance premiums).   ***Canderel Ltd (1998 SCC)****:* - SCC concluded that the taxpayer was not required to amortize amounts paid to induce tenants to enter into long-term leases on the grounds, *inter alia*, that subsection 18(9) does not include tenant inducement payments (TIPs) in the list of amounts that must be amortized. Matching principle is not a rule of law but an interpretive principle. Rule of law is the **True Picture** principle: which turns more on facts than principle.    Oxford Shopping Centres Ltd. v. The Queen (1980 FCTD) – running expenses currently deductible where expense cannot easily be matched with subsequent revenues | | |
| Allowances | | | |
| Capital Cost Allowances | | | |
| **Allowances** | **s.20** allows TPs to deduct a number of expenses that might otherwise be non-deductible capital expenditures (ex. interest and other financing expenses which are usually characterized as capital expenses).  **s.20(1)(a)** – allows the TP to deduct “such part of the capital cost to the TP of property, or such amount in respect of the capital cost to the TP of property, if any, as is allowed by regulation.”   1. Property acquired by the TP for which capital cost allowance may be claimed under 20(1)(a) is defined as “depreciable property”. 2. For accounting purposes, the 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.    1. ***“Straightline Method”*** – cost of the property is deducted in equal annual increments over the course of its useful life until the unrecovered and undepreciated cost (or “book value”) reaches zero.    2. ***“Declining-balance Method”*** – a percentage of the unrecovered or undepreciated cost is deducted each year, causing book value to approach but never reach zero. 🡪 used in 20(1)(a)   ***Computing CCAs*** – Most CCAs are computed on a declining-balance basis. Part XI and schedule II of the Regulations set out a number of rates applicable to different classes of property.   1. CCAs are generally computed by a “class method” by which the specified rates apply to the aggregate undepreciated capital costs of all property of a similar class rather than to individual assets. | | |
| Depreciable Property | **s.13(21) *“Depreciable Property”*** “property acquired by the TP in respect of which the TP has been allowed, or would, if the TP owned the property at the end of the year and this Act were read without reference to subsection 13(26), be entitled to, a deduction under paragraph 20(1)(a) in computing income for that year or a preceding taxation year.”  ***Classes of Property***  Regulation 1100(1) gives rates for diff classes applied to the UCC  *Ben’s Limited v. MNR* (1955 ExCt) – depreciable property must have an income-producing purpose: Regulation 1102(1)(c) contains an income producing purpose test for a CCA deduction. Q is not whether the TP’s outlay as a whole was for the purpose of gaining income, but rather whether the outlay in respect of the piece of that property for which the CCA is sought was for the purpose of earning income.  *Hickman Motors (1998 SCC):* The fact that the assets did earn some income is sufficient to claim CCA, even if the amount earned is significantly smaller than the CCA. that this limits the ***Ben’s*** decision. Calls into question the court’s dismissal of the residual income as sufficient evidence of purpose to earn income to realize the CCA. | | |
| **Acquisition of Depreciable Property (A)** | **s.20(1)(a)** and ***Regulations*** 1100(1), CCA is based on the undepreciated capital cost (UCC) of the property in a class. The term “Undepreciated Capital Cost” is defined in **s.13(21)** by an involved formula. ABCD.   * 1. In determining the amount that may be added under A, two questions must be answered:   **What the “capital cost of property” is** – “Ordinary Business Principles Test”  Capital cost of property has quite a wide meaning. It should be interpreted in light of ordinary business principals, thus legal, accounting, architects, and other fees should be included where they augment the cost of acquiring a piece of property. ***Cockshutt Farm Equipement of Canada Ltd. (1966 Tax ABC)***  **When that cost can be added to UCC of the class**.   1. Per **13(21)**, the cost may only be added to UCC when the property is “acquired” by the TP.   ***Wardean Drilling Ltd.*** s In order to fall within any of the specified classes in Schedule II, there must be a right in the property itself rather than rights in a contract relating to the property which is the subject matter of the contract. The TP can only add the costs to UCC when she acquires the property, not when she acquires rights to the property by paying and completing the contract. | | |
| Deductions in Respect of Depreciable Property. (E) | CCA is computed on a declining-balance basis determined according to the specified rate of the UCC property classes. The rates are designed to approximate the rate of depreciation actually experienced by each kind of depreciable property.   1. **20(1)(a)** – The description of E in the definition of UCC in s.13(21) has the effect that where a TP deducts an amount in respect of capital cost of a particular class, the UCC of property of that class is reduced by the CCA claims, thereby reducing the amount of CCA that can be claimed in subsequent taxation years (b/c computed on a principal basis and deducted in terms of %). **The amount deducted on taxes is deducted from the pool, so the pool amount is lowered. (20(1) says it may be deducted).** | | |
| Disposition of Depreciable Property | **s.13(21)** requires that where a TP disposes of depreciable property, he subtracts from that class’ UCC the lesser of:   * 1. Net proceeds of disposition   2. Capital cost of the property (where the proceeds of disposition exceed the capital cost the excess is subject to capital gains tax)   **s.248(1)** “Disposition of Property” defined as any transaction or event entitling TP to proceeds of disposition   1. **s.13(21)** defines “Proceeds of Disposition” to include: Sale Price of Property sold, Compensation for property unlawfully taken, Compensation for prop destroyed, compensation for property taken under statute, compensation for prop destroyed and amount claimed under insurance etc.   Other rules deem property to have been disposed of at fair market value where the TP acquires it for the purpose of earning income, but later starts using it for some other purpose. | | |
| Recapture and Terminal Loss | When an item of depreciable property is sold or otherwise disposed of, the proceeds from the disposition may be equal to, less than or greater than the UCC with respect to the asset.   * 1. **Equal** – the rate at which the property was statutorily depreciated appears to match actual depreciation   2. **Less** – the rate at which the property was statutorily depreciated was insufficient to match actual depreciation. TP disposing of the asset suffers a “**Terminal Loss**”.   3. **Greater** – the rate at which the property was statutorily depreciated was exceeded the actual depreciation. TP disposing of the asset realized a gain - “**Recaptured Depreciation**”.   ***Recapture 13(1)*** – Where the aggregate of the CCA claimed for a class and the proceeds of disposition of depreciable property of the class exceeds the capital cost of property acquired by the TP (causing the UCC to become negative) at the end of a taxation year, the excess amount is added to the TP’s income.   * + 1. ***13(21)*** Then adds the excess amount back into UCC, bringing the balance to zero as a starting point for future calculations.   ***Terminal loss 20(16)*** – Where a TP disposes of all property in a class for proceeds less than the UCC of the class, they are entitled to deduct the entire remaining UCC *instead* *of* the CCA.   * + 1. ***13(21)***Then subtracts this amount from the UCC, bringing the balance to zero as a starting point for future calculations.   The obvious advantage of a terminal loss creates clear advantages to reducing the number of assets you need to trigger this loss. Conversely, if you want to cushion a gain (arguably more likely given the generous nature of the CCA provisions relative to accounting) having lots of assets in a class is a good thing. | | |
| Allocation on Disposition of Property. | arises as to how these global proceeds should be allocated among the various kinds of property or services included in the sale.   * 1. Vendors will prefer to allocate as much of the proceeds as possible to non-depreciable capital property and depreciable property on which little or no CCA has been claimed in order to minimize capture on previously claimed CCA; maximise any amount of capital gain; and/or maximize any terminal loss.   2. Purchasers will prefer to allocate as much of proceeds as possible to inventory or services provided since they are fully deductible; or to depreciable property with a high rate of CCA.   ***68(a)*** the part of the amount that can reasonably be regarded as being in consideration for the disposition shall be deemed to be proceeds of disposition of the particular property irrespective of the form or legal effect  *Golden (1983 FCA*) – if no sham, considerable deference to allocation of proceeds determined by arms-length parties, so long as reasonable consideration has been paid | | |
| Taxable Cap Gains | | | |
| **Characterization** | * Taxable capital gains and allowable taxable losses are not a source of income but a *type* of income from disposition of a source. Generally, capital gains are determined by taking the proceeds of disposition of property and subtracting the cost of the property and the cost of selling the property. Capital losses occur where the cost and selling cost exceed the proceeds.   **S. 38** – Capital gains are only *half*-taxable.  **s.39(1)** – capital gains and losses are gains and losses from the disposition of property.  **s**.**54** – ‘**disposition**’ – any transaction or event entitling a TP to proceeds of a disposition of property and any transaction by which: shares are cancelled, debts cancelled, option to purchase etc.  **s.248(1)** “Disposition of Property” defined as any transaction or event entitling TP to proceeds of disposition  ***Definition of ‘capital’*** – The Act does not define capital for the purpose of determining the source of a TP’s gain or loss. Paragraphs **39(1)(a) and (b)** define “capital gains” and “losses” as residual, meaning that a capital gain is a gain that would not otherwise have been included in income under s. 3, and a capital loss is a loss that would not otherwise be deductible.  ***Definition of ‘capital property’ (s.54)*** *–* depreciable property, where a gain of loss from the disposition of property would, if the property were disposed of, be a capital gain or loss, the Act defined the property as ‘capital property’. | | |
| **Real Property** | ***Real Property*** – refers to land and generally whatever is erected or growing upon or affixed to land. More generally includes any estate, interest or right in land and fixtures, including a leasehold interest but not including a mortgage secured by real property.   * Regal Heights Ltd v. Minister of National Revenue (1960 SCC) – ‘secondary intention’ doctrine: This was a speculative venture in vacant land (no guarantee they’d get a dep’t store); if the primary intention failed the secondary intention was to sell the land for a capital gain. But-for the additional motivating factor, TP would not have purchased land. Dissent: Evidence does not support that appellant bought land as speculation looking to resale. Land disposed of not as inventory but as capital assets of a developer. * Factors in determining whether inventory or capital:   + Holding period - presumption that short-holding pd = inventory, but this may be rebutted 🡪 *Hiwako*) ;   + Circumstances responsible for disposition - e.g. unsolicited offer tends to point against land as inventory v. marketing the property or if OG intentions were frustrated   + Method of financing and REOP - short term financing indicating intention to flip at a profit (e.g. rental income insufficient to cover interest expenses = no REOP) 🡪 inventory v. evidence of planning to make property a viable investment   + Other activities carried on by taxpayer or principal shareholder(s) – e.g. if TP is a developer, more likely to be income from business 🡪 look at history of buying and selling by TP   Administrative rules for change of use from investment purpose to inventory or vice versa: Other rules deem property to have been disposed of at fair market value where the TP acquires it for the purpose of earning income, but later starts using it for some other purpose.  **45(1)(a)** – deemed disposition when you change use of property from income-producing to non-income producing | | |
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