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General Anti Avoidance Rule

- several years after *Stuart*, gov't developed a rule to prevent artificial tax avoidance
- applies to transactions on or after Sept 13, 1988
- **Section 245: (2) where transaction is avoidance transaction**, tax consequences shall be determined as is reasonable in the circumstances to deny a tax benefit ...
- Three Requirements of the GAAR
 1. transaction/series of transactions results in a tax benefit
 2. cannot reasonably have been undertaken for primarily non tax purpose (245(3))
 3. transaction can reasonably be considered to result in a misuse/abuse (245(4))

AVOIDANCE TRANSACTION 245(1) defines 'transaction' INCLUDES an arrangement or event

- 245(3) defines 'avoidance transaction'
 - any transaction or series of transactions that would RESULT in a tax benefit
 - unless the transaction may **REASONABLY** be considered to have been undertaken or arranged primarily for *bona fide* purposes other than to obtain the tax benefit

TAX BENEFIT def'd ss 245(1): reduction, avoidance or deferral of tax or an increase in a refund otherwise payable

- *Canada Trustco*: whether or not there is a tax benefit is a question of fact reviewable by the courts (Tax Court), burden on taxpayer to refute the Minister's assessment

SERIES OF TRANSACTIONS: 245(3)(b) if the transaction is part of a series of transactions designed to avoid tax it will fall under the GAAR even if it alone does not avoid tax

- any step in a series of transactions could be an avoidance transaction
 - *Canada Trustco* - series of transactions: INCLUDES a number of transactions that are pre-ordained in order to produce a given result with no practical likelihood that the pre-planned events would take place in the order

MISUSE OR ABUSE 254(4): GAAR in 245(2) applies to only if it may reasonably be considered that the transaction

- results directly or indirectly in a misuse of The Act,
 - or The Regulations, The Application Rules, a tax treaty or any other enactment relevant to computing tax
- would result directly or indirectly in an abuse having regard to provisions as a whole
- developed in object and spirit of Act - some transactions are for tax motivations b/c of incentives etc

MISUSE OR ABUSE TEST: two step process (*OSFC Holdings* affirmed in *Canada Trustco*)

- i. identify relevant **policy of the provision or Act as a whole** (must be clear and unambiguous)
 1. doubt will be resolved in favour of taxpayer
 - ii. **assess facts** to determine whether the avoidance was a misuse or abuse considering the policy (misuse/abuse must be clear)
- burden on the Minister to prove on BofP that the avoidance transaction results in an abuse/misuse w/in the meaning of 245(4)
 - court has generally considered misuse/abuse to be the same (ex *Canada Trustco*) but Duff thinks that it is clear that 'abuse having regard to the provisions as a whole' is a broader test

TAX CONSEQUENCES 245(2): tax consequences of avoidance transaction are what is reasonable in the circumstances in order to deny the benefit

- 245(5): deduction, exemption, exclusion may be allowed disallowed, etc
- requires court to identify a benchmark transaction to compare against the avoidance transaction to identify amount of tax benefit that will be denied
- note: in the absence of a penalty, some taxpayers may be willing to take the risk that their transaction will be subject to the GAAR

INCOME OR LOSS FROM AN OFFICE OR EMPLOYMENT & OTHER INCOME

- 3(a): income from office and employment INCLUDED

INCOME FROM OFFICE OR EMPLOYMENT DEF'D 5(1): salary, wages and other remuneration including gratuities, received by TP in the year

CHARACTERIZATION - (office/employment treated the same for tax purposes) - def'ns from 248(1)

- Office: position of an individual entitling them to a fixed or ascertainable stipend or remuneration including judicial office, Crown, Senate, House of Commons, director of corporation etc
 - denotes a subsistent, permanent position that will continue even after the person vacates it ie. somebody must fill the office, it exists independently
- Employment: position of **an individual in the service of some other person**, including gov't
 - note: corporation not an individual so corp cannot have employment income
 - employee: a person holding such a position of employment

Employee versus Independent Contractor

- generally employees and employers prefer to characterize incoming amounts as 'business' income rather income from employment for favourable tax treatment
 - no need to pay WCB, EI for employers or remit tax
 - more freedom for tax purposes for independent contractors: more generous expense deductions for business income
- employee: person who works in the service of another person under an express or implied contract of hire, under which the employer has the right to control the details of work performance
- courts typically distinguish between '**contract of service**' (employment) and '**contract for services**' (independent contractor)

EMPLOYEE V I/C TESTS

- court looks at many factors when determining employee/independent contractor: **total relationship between the parties** (*Wiebe Door*)
- IMPORTANT FACTORS: (*Wiebe Door*)
 1. **degree or absence of control exercised by alleged employer**
 2. **entrepreneurship**: ownership of tools, chance of profit and risks of loss
 3. **organization/integration**: PERSPECTIVE OF EMPLOYEE - integration - is the relationship exclusive, how many people does the agent work for
 4. summing up: **is the employee/agent doing the work as a person in business on their own account - specific result?**
 5. **more recent emphasis on intentions of parties** (*Wolf, Winnipeg Ballet*) - issue of legal substance v form
 - note: in *Wiebe Door* the Tax Court said that the control test was not determinative, tests leaned towards I/C as he owned own tools, trucks were provided an extra part, chance of profit & risk of loss found in favour of I/C b/c the faster they worked, the more they made, organization/integration test originally found in favour of employee b/c there would be no business w/out the employees - CA said the court erred in application of this test by focussing on perspective of the employee - is the worker integrated into the business
- CONTROL TEST: - traditionally used but rejected as sole criteria in *Wiebe Door*
 - does the employer have the right to tell the person **what to do** (could still be I/C) and **how to do it** (employee)
- OTHER:
 - method of remuneration - commission suggests contract for services, fixed salary suggests employment
 - hiring of helpers
 - degree of responsibility for investment/management
 - principal workplace - home/own office/employer's office
 - specific results - hired to produce a result?
 - exclusivity
 - whether business was already established

Incorporated Employees

- agents may incorporate to avoid characterization as employee - employer deals with the corporation instead of employee
- the income cannot be characterized as employment income b/c employment income must be paid to 'individual'
 - only way to get around it is to pierce corporate veil, b/c it is a 'sham'
- if the restructuring/corporation is created for valid non tax reasons as well as tax reasons it will not be subject to the sham doctrine *Engel* (GLOBAL TV CASE)

NOTE: applying the GAAR to the facts of *Engel*:

- test for GAAR:
 - tax benefit: yes
 - is a transaction primarily tax motivated: he could have become a sole proprietor and provided services to Global with alterations to the K in the form that he preferred but there were other reasons - there was a plausible way that he could have achieved his other goals w/out incorporating
 - is that transaction a misuse/abuse: tricky step, probably not a misuse

Statutory Anti-Avoidance Rules: Personal Services Business

- anti avoidance rule for incorporated employees: excludes 'personal service corporations' from low tax rate and prevent such corporations from deducting expenses other than employment expenses

PERSONAL SERVICES BUSINESS section 125(7):

- an individual who performs services on behalf of the corporation or any related person who is a specified shareholder
- incorporated employee would reasonably be regarded as an officer or employee of the person or partnership to whom or to which the services were provided but for the existence of the corporation
- exception if the corporation employs more than 5 full time employees
- limitation on business expense deductions 18(1)(p) - disallows the deduction of most expenses other than remuneration and benefits paid to incorporated employees in computing the income of a personal services business
- 127(5) excludes income from personal services businesses from the low corporate tax rate for CCPCs (Canadian Controlled Private Corporations)

TEST

- **it must be reasonable to conclude that but for the corporation's existence the TP would have provided the services as an employee** (*Dynamic*) apply factors in *Wiebe Door* to the person who is employed by the personal services corp
 - *Dynamic*: not reasonable to conclude that he would have been an employee despite exclusivity, employer office space used, hourly wage - why? he had risk of loss and could have worked for other people and had done so in the past
 - *533702*: reasonable to conclude wife of plumber would have been employee of the company if not for the corporation

Inclusions: Remuneration

Taxpayer's Income from Office or Employment

- NOTE DISTINCTION BTW CAPITAL, INCOME AND WINDFALLS
- 5(1) income for a taxation year from an office or employment is 'the salary, wages and other remuneration, including gratuities, received by the taxpayer in the year'
 - common elements: remuneration for services in cash
 - 5(2): loss from office or employment is computed w/same rules as you would compute income
- 6(1) particularizes amounts to be included including
 - (a) benefits
 - (b) personal or living expenses
 - (c) director's or other fees
 - other: benefits in respect of automobile, employee trust, salary deferral arrangement, forgiveness of employee debt, housing subsidies, stock options etc
- paragraph 6(1)(c) and ss 5(1) together enumerate the taxpayer's income from office or employment: fees, salary, wages, gratuities and other remuneration
 - none of the terms are defined in the Act - ordinary dictionary meaning used

SPECIFIC ANTI AVOIDANCE RULE FOR REMUNERATION

- 6(3): a payment is **deemed** to be remuneration for services rendered where it is paid

- (a) at a time when the payee is an officer or employee of the payer or
- (b) on account, in lieu of payment or in satisfaction of an obligation arising out of an agreement made by the payer with the payee immediately prior to, during, or immediately after a period of office or employment
- **and it is reasonably regarded as**
- (c) an inducement payment,
- (d) remuneration or partial remuneration of services, OR
- (e) in consideration or partial consideration of a covenant with reference to what the officer or employee is to do or not to do after termination of employment
 - regardless of the form or legal effect
 - note on interpretation - for 6(3) to apply, must have one of (a) or (b) AND reasonably regard it as one of (c), (d) or (e) regardless of form or legal effect (for c,d,e)

INCOME FROM A SOURCE

- ****income from unspecified source - would need to determine that the money has the character of income and then you must determine the source of the income (Cirella)**
- *Curran*: dissent found that payment in consideration of leaving former employment was income from a source
- *Fries*: strike pay is not income from a source
 - *Fries* FCA decision: money had to be either income or capital - it '**smack'ed**' of income, no specific exception in Act
 - **characteristics that suggested income from a source - length of time: recurring over a period of time, surrogate for employment income - same amount as would have been paid if taxpayer was still working,**

Inducement Payments

- inducement payment: where taxpayer is paid amount as inducement to accept office or employment
- 6(3) applies where the inducement payment is received by one person from another
 - (a) during a period while the payee was an officer of or in the employment of the payer or
 - (b) on account, in lieu of payment or in satisfaction of an obligation arising out of an **agreement made by the payer with the payee** immediately prior to... a period that **the payee was an officer of, or in the employment of, the payer**
- provision does not apply where an inducement is made by someone other than current or former employer
- *Curran*: provision does not apply if the payment is not made BY THE EMPLOYER but in *Curran* an amount paid before commencement of employment 'in consideration for resigning from previous employment' was a payment for '**personal services**' b/c substance of the matter was engagement by the taxpayer to work for the payer
 - DISSENT: this is income from a source under section 3

Tort Damages for Personal Injury or Death

- when taxpayer receives tort damages for injury or death, often it includes a portion for lost wages
- **tort damages re lost wages found to capital in nature b/c they are compensating for loss of earning capacity (Cirella)**
- in *Cirella*, court rejects surrogatum principle for damages relating to lost wages, instead:
 - the amount was **not earned or gained in pursuit of trade or from property** but arose from a damage done to the taxpayer
 - **not of an income character**, merely designated as lost wages b/c of the means of calculation
 - **the amount is a capital amount b/c it is an amount for compensation for loss of earning capacity**

Gratuitous Payments

- often taxpayers argue that gratuitous payments are gifts/windfalls and should not be subject to tax as remuneration for services
- voluntary payments will be taxable if they have the character of income: **if (a) services were performed and (b) there was an intention/understanding that payment would be made** (*Goldman*)
- *Sirie*: monthly payments before b/c professor was denied tenure and lump sum on becoming tenured professor - argued successfully that the monthly payments were a windfall b/c he wasn't an employee at the time (Duff - why didn't CRA argue 6(3)?)

- *Yahominsky Smith*: taxpayer taught at group home, left and pursued education, former employer gave financial assistance to go to school. court said **6(3) applied b/c there was a covenant (agreement) to go to school** and it arose directly after employment. Duff is not too happy about the characterization of covenant.

Strike Pay

- strike pay generally paid by unions for *non performance* of duties rather than performance - taxable - no, not income from a source
- strike pay is paid from a common union fund accumulated from union dues - union dues are deductible for tax purposes so the money has not yet been taxed as income
- pre *Fries*: the strike pay is income b/c the taxpayer is in contract with the union
- post *Fries*: court not convinced strike pay is income from a source, benefit of doubt to TP

Inclusions: Payments on Termination

- *Atkins*: when terminated without notice, that payment cannot be characterized as remuneration from employment

Retiring Allowances

- sub para 56(1)(a)(ii) must include any amount in income on account or in lieu of payment of or in satisfaction of a retiring allowance
- 248(1) def'n retiring allowance: an amount (other than pension or death benefit) received on or after retirement in recognition of service or in respect of loss of office/employment from tribunal order/judgment
- note: 8(1)(b) legal expenses of employee to collect or establish a right to wages owed to the taxpayer deductible
- 60(o.1) legal expenses deductible to establish claim to retirement allowance

RELATIONSHIP TO OFFICE OR EMPLOYMENT

- amount must be in relation to the loss of employment rather than mental distress/other damages *Mendes Roux*
 - PORTION OF THE AMOUNT MIGHT BE TAXABLE & NON TAXABLE
- note: *Merrins, Niles*: 'in respect of' employment is very broad and payments and settlement for grievances, human rights tribunal awards connected to loss of employment are included (pre *Mendes Roux* BROADER TEST)
- *Stolte*: amounts if characterized as damages for mental/physical injuries from hands of employer not in respect of employment

LOSS OF OFFICE OR EMPLOYMENT

- 56(1)(a)(ii) only applies if the taxpayer was in a K of employment *Schwartz*
 - doesn't apply when TP gets settlement before entering the employment relationship, before under any obligation to provide services

Inclusions: General Benefits

- 6(1)(a) includes in income the **value** of any board, lodging and other **benefits received in the course of or by virtue of an office or employment**

6(1)(a) ELEMENTS:

- Characterization of a benefit
 - board and lodging or 'other benefits of any kind whatever' - meant to be very broad
- Connection to office or employment
 - key phrase is 'in respect of' employment b/c it is the broadest

- valuation of the benefit
- some suggest that compulsion affects the characterization, (*Lowe*) others say that regardless of compulsion, question is whether you get something of value (*Dunlap*)

CHARACTERIZATION AS A BENEFIT

- TEST: **'something of value,' 'a material acquisition which confers an economic benefit on the taxpayer,' a 'reward'**
Lowe
 - more than incidental benefit
- when employee is required to go on a trip for business purposes and the business purposes are the primary purpose of the trip, no benefit will be associated *Lowe*
 - the **personal enjoyment** by the taxpayer and his wife was **merely incidental** to the business purpose of the trip

Is there a Material Advantage?

- depends on whether the benefit increases the TP's net value (*Guay*) in comparison with other Canadians (*Gernhart*) or whether the TP is simply being restored to the economic situation before being ordered to incur the expense (*Huffman*) and depends on personal nature of the expenditures (*Pellizzari & Clemis*)

Role of Employer's Business Purpose or Requirement?

- AMBIGUITY: some cases say that things that have a material advantage such as having tax returns prepared by company or going to an expensive party are benefits even though they are unilaterally conferred on the employee (*Cutmore, Dunlap*) whereas some say if the thing is provided for a primarily business reason, they will not be seen as a benefit (*McGoldrick* - meals provided at remote location)
- if the thing is something that the employee clearly does see as an advantage then it may be found to not be a benefit (*Rachfalowski*), generally if it is something that the employee would have paid for if employer had not, then it will be seen as a benefit (*Deitch*)

RELATIONSHIP/CONNECTION TO OFFICE OR EMPLOYMENT

- to be a benefit under 6(1)(a) the benefit must be in the course of, in respect of or by virtue of employment
- **test for relationship to office/employment: whether the benefit is conferred on the taxpayer as an employee or simply as a person** (*Savage*)
 - award for taking courses - yes this is in respect of employment
 - in respect of employment is **very broad, means anything to do with employment**
- *Mindszenty* - relevance of donor's intent - employer deducted the amount of rolex watch as a business expense, was a benefit under 6(1)(a) even though seemed like a gift
- *Phillips* and *Blanchard* (note 5)- benefits from collateral contracts may still be benefits under 6(1)(a)
- *Giffen* (note 6) - employee cashed in air miles points from flying for work - argued that it wasn't in respect of employment, it was in respect of signing up for aeroplane points - (CRA has since issued a position that they will not go after points cashed in for flights but if they are cashed in for money they will be considered taxable.) reasoning: where a benefit is conferred as a result of being an employee along with some other factor like being an aeroplane member, that is unimportant - **still a benefit of employment that was not received in a personal capacity**

VALUATION

- what is meant by 'value'?
 - fair market value - (*Waffle, Giffen, Spence*)
 - cost
 - marginal (administrative exemptions for rail and bus tickets)
 - average (*Detchon* reversed by *Spence*)
 - subjective value
 - resale price (*Wisla*) - ring with employer's corporate logo stamped on it assessed at scrap value
 - discount for rent on apartment which wasn't the first choice of where to live (*Jellus*)
 - rate of return on investment (*Taylor*) - use of yacht assessed at interest rate on the FMV of the yacht

- *Bartley* - \$3,000 higher education award given to kids of employees who go to post secondary by Dow Chemicals - no award b/c employees are not obliged to send their kids to post secondary

Scholarships, Fellowships, Bursaries

- 56(1)(n) requires TP to include amounts received on account of scholarship, fellowship or bursary that exceed the scholarship exemption under 56(3)
 - not including scholarships received in respect of, in the course of or by virtue of employment
- where the scholarship is in connection with elementary, secondary or designated post secondary the full amount is deductible under 56(3)(a)
- where scholarship is to be used to produce a literary, dramatic, musical or artistic work then taxpayer can deduct expenses for that work under 56(3)(b) up to amount of scholarship
- otherwise, general scholarship exemption of \$500
- 56(3.1): amount must be reasonable to support the taxpayer in connection with the program
- TEST: IS IT IN RESPECT OF EMPLOYMENT AND THEREFORE EXCLUDED FROM EXEMPTION?
- in *DiMaria*, scholarship from employer to employee's children not in respect of employment - no obligation to send them and tax system taxes individuals, not family units
 - factors:
 - limited number of scholarships available
 - assessment/selection process
 - objective criteria used in the process
 - money/support awarded based on some merit (doesn't have to be academic criteria)

Inclusions: Allowances and Other Benefits

Allowances

- 6(1)(b): taxpayer must include all amounts (subject to exceptions 6(1)(b)(i) to (ix)) as allowance for personal or living expense or any other purpose
- def'n of allowance from dictionary: money paid to cover special expenses

CHARACTERIZATION

- *MacDonald*: elements of 'allowance':
 1. arbitrary amount - predetermined without specific reference to actual cost
 2. usually will be for a specific purpose
 3. in the discretion of the recipient - recipient need not account for actual use of the allowance
- housing subsidy for increased cost of living in Toronto is an allowance under 6(1)(b) *MacDonald*

For the purpose of para 6(1)(b) the CRA distinguishes among

- An allowance
 - Any periodic or other payment that an employee receives from an employer, in addition to salary and wages without having to account for its use
- A reimbursement
 - Payment by an employer to an employee to repay the employee for amount spent by employee on employer's business
- Accountable advance
 - Amount given by an employer to an employee for expenses to be incurred by the employee on the employer's business and to be accounted for by the production of vouchers and the return of any amount not so spent
- reimbursements & accountable advances generally not taxable unless they are benefits ex. for personal & living expenses

Forgiveness of Debt

- 6(15)(a) deems a benefit UNDER 6(1)(a) at any time an obligation by any debtor is settled or extinguished

- works together with s 80 (in rules for computation of income)
 - amount that is the benefit is the 'forgiven amount'
 - (reverses *Greisinger* where employee was forgiven for a debt on a housing loss when employee was required to move back and forth)
 - note - if you are being forgiven a debt for a housing loss, better to characterize it as compensation for the housing loss rather than debt forgiveness b/c housing loss compensation gets better treatment under ITA
- 6(15.1) determines value of the 'forgiven amount'

CAUSAL CONNECTION TO EMPLOYMENT?

- depends on whether the motivation for forgiveness of the loan was the employment K *McArdle* - TP evidence that the loan was forgiven as a debt REJECTED b/c there was contrary evidence and he was an employee - DIRECT NEXUS btw termination of employment and loan forgiveness

Interest Free and Low Interest Loans

- 6(9) plus 80.4 (rules for computing income)
- 6(9): amount in respect of a loan or debt when deemed by 80.4 to be a benefit,
- 80.4(1): applies where employer gives a direct loan or employer pays interest subsidy to bank, the amount shall be included if the loan/subsidy is **because of or as a consequence of a previous, current or intended employment** of the individual or because of services to be performed by a corporation carrying on a personal services business
 - **formula: (a) + (b) - [(c) + (d)]**
 - (a) interest at the prescribed interest rate (average of gov't of Canada yields on treasury bills)
 - (b) actual interest paid by the employer
 - (c) amount of interest paid on the loan
 - (d) reimbursement to employer for interest that they have paid
 - 80.4(1.1) if terms of the loan would be different but for the employment, loan is deemed to be a loan under 6(9)
- prescribed interest rate - 80.4(7) - reg 450(c)
 - set every quarter - lately has been 1% since second quarter of 2009 b/c of low interest rates

HOME PURCHASE/HOME RELOCATION LOAN:

- 110(1)(j) exempts benefit for a home relocation loan of the amount of: the least of the interest on the loan, interest at the prescribed rate on \$25,000 or the amount added in 80.4
- home purchase loan/home relocation loan (80.4(7)): home purchase loan means a loan to acquire a residence for personal habitation
- 110(1)(j) the amount of prescribed rate shall not exceed the prescribed rate at the time of taking out the loan - works for 5 years (80.4(6)) - balance of loan at 5 years shall be deemed to be a new home purchase loan at the 5 years and then look at the prescribed rate at that time to determine further prescribed rates
 - 248(1) 'home relocation loan': def'd, must be 40 kms closer to the 'new work location'
 - where individual has commenced employment and by reason thereof has moved to the new location, must be 40 kms closer
 - ** must have gotten the job first - look at old case law in the moving expense section

UBC Housing Assistance Plan example:

- two options when buying a house
 - **HOUSING BENEFIT:** give employee \$45,000 to buy a house, forgivable over 5 years (\$9,000/year)
 - tax consequences: 6(15)(1) - \$9,000 inclusion each year
 - **MORTGAGE INTEREST SUBSIDY (80.4, 110(1)(j)):** pay you \$10,000/year mortgage interest subsidy for 5 years
 - assuming a mortgage of \$500K at 2.5%
 - \$2,500 income inclusion
 - if the mortgage is \$500K at 3%, income inclusion is 0
 - increases in mortgage amount means less tax to 0
- 80.4 does not apply if you get the loan at a reasonable rate or the arm's length rate applies when employer is in the ordinary course of business of providing loans

Relocation Assistance

- Relocation Assistance: subsection 6(23)
- in the 1990s, cases held that there was no benefit for a certain higher cost of living subsidies including mortgage subsidy (*Splane*) when employees relocated but there would be a benefit found when there is a monetary subsidy for moving
- 6(23): for greater certainty, an amount paid or the value of assistance provided by any person in respect of, in the course of, or because of office or employment in respect of financing, use of or right to use a residence is a benefit received b/c of office or employment
- note - this doesn't include reimbursement for moving expenses (*Pollesel, Mackiness*) - reimbursement for moving expenses not a benefit

Benefits in Respect of Housing Loss

- 6(19) - (22): **housing loss will be taxable except eligible housing loss will be taxed on half of the amount over \$15,000**
 - must be **in respect of employment** but this is very broad *Thomas* and can be found when leaving employment
- 6(19) housing loss benefit is taxable for full amount under 6(1)(a) except for eligible housing loss
- 6(20) determines amount taxable for eligible housing losses
 - note - can only claim tax preferred treatment on at most one house
 - housing loss (non eligible) value determined by 6(21): different circumstances, have different rules, could be (a) or (b) - (c) or (d)
 - if you are reimbursed for an eligible housing loss you will only be taxed on half of the amount of the benefit over \$15,000
- 6(21) housing loss:
 - amount by which the greater of the cost of the residence at its highest FMV during previous 6 months exceeds lesser of proceeds of disposition or FMV if it is disposed of before end of next taxation year, or FMV
- 6(22) eligible housing loss: move with respect to **eligible relocation**
 - eligible relocation (248(1)): relocated for employment reasons at least 40 km closer to workplace (same as moving expenses - move enabled you to carry on business/work in the new work location)
- *Thomas*: eligible housing loss does not apply if the TP moves and the moves does not 'enable' the TP to carry on work in the new location - evidence that he moved for personal reasons, he was moving b/c he had ties in Ottawa, he eventually started working as a self employed contractor but he didn't move for that reason
- *Ransom*: taxpayer moved and had loss on house he sold that was compensated - no material advantage so not taxable benefit BEFORE THE NEW PROVISIONS

Insurance Benefits

- 6(1)(a)(i) excludes benefits 'derived from the contributions of the taxpayer's employer to or under a ... group sickness or accident insurance plan, a group term life insurance policy, or a private health services plan'
- 6(1)(f) taxpayer to include all amounts that are benefits from insurance plans that the employer paid into - 'wage loss replacement plans'
 - payable on a persistent basis
 - in respect of loss of income from employment
 - pursuant to a wage loss replacement plan
 - to or under which employer has made a contribution
 - not exceeding an amount by which the total of all amounts received by the taxpayer exceeds the amounts paid in by the taxpayer in the year (can offset contributions you make)
- when it is an employer paid plan, payments are deductible, benefits are taxable
- when it is a taxpayer paid plan, payments are not deductible but benefits are not taxable
- *Tsiaprailis*: settlement can be a surrogate to insurance benefits
 - **b/c the taxpayer sued for amounts she said were due under the plan, the settlement was clearly due to the plan via surrogatum principle**
 - **note**: portion of the settlement in relation to present value of future benefits not taxable only the portion in relation to past benefits owing

- distinguish *Armstrong* from *Tsiaparilis*
- *Armstrong*: taxpayer sought to deduct lump sum payment of spousal support payments - not deductible b/c the payment has a capital nature note: lump sum for future obligations re spousal support not taxable or deductible

Options to Acquire Securities

- governed by section 7, 110(1)d, (d.01), (d.1) and ss 110(2.1)
- security: share of the capital of a corporation, unit of a trust
- options: method of compensation, generally issued at FMV, may vest over a period of time
- 7(3) if a particular person has agreed to sell or issue securities to an employee of the person then except as provided by the section, the employee is deemed to have neither received nor enjoyed any benefit under or because of the agreement
 - not under general benefit - only section 7 applies to options
 - *Taylor*: 7(1)(a) applies to directors as well as employees b/c 7(5) refers to 'the employment' which is broader than an employment and includes directorship

ON EXERCISE OF OPTIONS

- 7(1)(a) subject to (1.1) where a corporation or mutual fund has agreed to sell, if the employee acquires the securities, the employee is deemed to have received a benefit deemed to be the FMV shares minus exercise price minus option price

ON TRANSFER OF THE OPTIONS

- 7(1)(b) as modified by 7(1.7) - if you have transferred or otherwise disposed of the rights, there is a deemed benefit
 - 7(1.7) if the amount is received by taxpayer in respect of options that cease to exist, the taxpayer is deemed to have disposed them at FMV
 - amount included is consideration received for the options minus the option price

CCPC DEFERRAL

- 7(1.1) changes the timing of the inclusion (applies only for shares of Canadian Controlled Private Corporations) - the amount of the benefit is deferred until the shares are disposed of
 - note - difficult to find FMV of CCPCs

OTHER NOTES:

- 7(3)(a) ousts other provisions re benefits - see above
- 7(4) if you leave the employment before exercising option, you will be deemed to be an employee for the purposes of 7(1)
- 7(5) nexus test: section 7 does not apply if the benefit conferred by the agreement was not received in respect of, in the course of, or by virtue of the employment
 - *Busby* - taxpayer was nominal director of co and received options for shares - court found they were in respect of her relationship w/ the owner not in respect of employment
- 110(1)(d), (d.1 for CCPCs) deductions in computing taxable benefits half of the amount of the inclusion under 7(1) to make it comparable to taxable capital gains
 - doesn't apply to all options - amount payable under the agreement must be FMV (not 'in the money' options) at the time of the agreement, securities must be issued by an arms length person, must be common shares, shares must be held for at least 2 years

Exceptions, Exclusions and Deductions

Allowances Exceptions

- exceptions from 6(1)(b) found in 6(1)(b)(i) through (ix)
 - (v) reasonable expenses for travel when employee is travelling to negotiate employer Ks
 - (vii) reasonable allowances for travel expenses received by an employee from the employer for travelling away from
 - (A) the municipality where the employer's establishment where the employee ordinarily worked or reported was located and
 - (B) the metropolitan area, if any, where this establishment was located
 - in the performance of the duties of the office or employment

- (vii.1) reasonable allowances for the use of a motor vehicle received by an employee from the employer for travel in the performance of duties of office or employment
 - **not reasonable when the measurement that is not based solely on the basis of kilometres driven

MEANING OF TRAVELLING: *Blackman*

- travelling defined as going on a journey - this taxpayer was living away from home in Montreal for various time periods not travelling
 - 240 days of the year is not travelling
- travel vs sojourn - the TP was sojourning in Montreal
 - **travel**: go from one place to another or journey along or through or cover a distance
 - **sojourn**: a temporary stay
 - can't claim travel expenses for sojourning
- intention was to give the same treatment to employees across industries
- if he could deduct the expenses merely b/c he was living away from home, he would be overpaid
- 81(3.1) **travel to part time employment** - exempts a reasonable allowance for reimbursement of travel expenses incurred in respect of part time employment from an employer to which individual was dealing at arm's length, if throughout the period in which the expenses were incurred... the individual had other employment or was carrying on a business or at a designated educational institution... provided the duties of part time employment were performed at a location not less than 80 km away from both the individuals ordinary place of residence and the place of other employment

Statutory Exclusions

- two rules specifically excluding certain benefits or allowances from inclusion under 6(1)

Employment at Special Work Site or Remote Location

- 6(6) excludes value of or a reasonable allowance in respect of expenses incurred by the taxpayer for
 - (a) board and lodging
 - at 'special work site'
 - 6(6)(a)(i) defines special work site: location at which the duties performed were of a temporary nature,
 - (A) the taxpayer maintained at another location a self contained domestic establishment as the taxpayer's principal place of residence
 - (B) that was, throughout the period, available for the taxpayer's occupancy and not rented out by the taxpayer to any other person, and
 - (C) to which, by reason of distance, the taxpayer could not reasonably be expected to return daily
 - *Smith* found a 60 km commute to work reasonable
 - *Charun* found a 60 km commute not reasonable as road was treacherous, TP worked 12 hours a day, 7 days a week
 - **FACTORS**:
 - distance from worksite to principal residence
 - hours of work
 - type of road travelled
 - time of day travelled
 - physical and mental health of taxpayer
 - special work site: compare definition from *Guilbert* to that in *Jaffar*: a work site OTHER THAN employer's place of business, an 'unusual' place to perform work (in this case moving to Rochester, NY for 1 year and 3 months was a special work site)
 - in *Guilbert* temporary work in Quebec City before potential appointment to Ottawa not a special work site b/c work site means 'work site' not just any place of work
 - or 'remote work location'
 - (b) transportation between the taxpayer's principal residence and the special work site or transportation to remote work site from place in Canada or location in the country in which the taxpayer is employed
 - if
 - the period during which the taxpayer was required by the taxpayer's duties to be away from the taxpayer's principal place of residence was not less than 36 hours

- self-contained domestic establishment: def'n 248(1) dwelling-house, apartment or other similar place of residence in which a place a person eats and sleeps

Remote Work Location

- 6(6)(a)(ii) a location at which by virtue of remoteness the taxpayer could not reasonably be expected to establish and maintain a self-contained domestic establishment
- *Dionne*: TP was not in a remote work location b/c it was obvious that he could establish a self contained domestic establishment b/c he lived in the community with his family in a house, there were 400 inhabitants, a school, and a Co-op. MAINTAIN means stable over time

Deductions

- found in section 8:
 - ss 8(2) limits amounts that may be deducted from income/employment to those specifically listed in section 8

Travelling Expenses

- generally include transportation, accommodation, and meals
- 8(1)(h) amounts expended by the taxpayer (other than motor vehicle) for travelling in the course of the office or employment provided that taxpayer
 - was ordinarily required to carry on duties of the office or employment away from the employer's business or in different places and
 - was required under the K of employment to pay the travel expenses incurred
 - except
 - where taxpayer received an allowance under 6(1)(b)(v - vii) not included in the taxpayer's income or
 - where taxpayer claimed a deduction under (e), (f) or (g)
- 8(1)(h.1) amounts expended for motor vehicle expenses incurred for travelling in the course of office or employment where
 - ordinarily req'd carry on business away from place of business/ different places
 - required under the K to pay motor vehicle expenses
 - except
 - taxpayer received an allowance under 6(1)(b) that was not included in income
 - claims a deduction under 8(1)(f)
- 8(1)(j) deduction of interest and CCA from motor vehicle used in course of office or employment or aircraft required for office or employment
- travel to and from work place even if you need to take tools are not travel expenses b/c expenses incurred were before and after not during the course of employment *Luks*
- *Chrapko*: taxpayer travelled to 3 racecourses in course of employment, expenses not deductible for travel to the ones in Toronto but yes to the one in Fort Erie b/c he regularly reported to work at the Toronto locations
- *Merten*: travel between home and workplace other than usual place of work is an acceptable expense
- *Evans*: school psychologist req'd to travel to various schools allowed to expense travel to and from first and last schools of the day b/c she was req'd to transport large amounts of paperwork with her - normally it's only the additional distance from the main location to the other locations but b/c of the paperwork she was allowed the entire thing
- **note: must have a certificate from employer under 8(10) to deduct amounts for travel expenses or motor vehicle travel expenses**

Meals

- for meals during the course of travelling further requirement:
 - 8(4) meal was consumed during a period while taxpayer was required by the taxpayer's duties to be away for a period of not less than 12 hours from the municipality where the employer's establishment to which the taxpayer ordinarily reported for work was located and away from the metropolitan area where it was located

ORDINARILY REPORTING TO WORK

- ordinarily reporting to work = where you normally/usually go *Healy*
 - even if you are ordinarily required to travel to different places for work, expenses are deducted for travel outside of municipality where you usually (majority of the time) report

Other Deductions (Moving Expenses)

- 62(1) taxpayers may deduct amounts paid as or on account of moving expenses incurred in respect of an eligible relocation
 - 62(3) def'n of 'moving expenses' - sets out eligible expenses **NOT EXHAUSTIVE** - INCLUDE:
 - (a) travel costs (including a reasonable amount for meals and lodging) for moving taxpayer and members of the household
 - *Critchley*: dog is a member of the family
 - (b) cost to taxpayer of transporting or storing household effects in the course of moving from old to new residence
 - *Yaeger*: horse lodging and vet bill is not an expense of transporting or storing household effects
 - *Hasan*: amounts must have been paid when a taxpayer physically moves or changes her residence - no to rental payments to store furniture for several months after move
 - (c) cost of meals & lodging near the old or new residence for taxpayer and members of family for a period not exceeding 15 days
 - no 'reasonableness' term - issue of section 67 limitation
 - (NOTE *SHELL CANADA* - CAN'T RELY ON 67 WHEN THERE IS A BUILT IN REASONABLENESS TEST - ambiguity here for 62 about whether reasonableness is built in)
 - (d) cost of cancelling prior lease if taxpayer leased previous residence
 - *Patry*: subletted at a loss, could not deduct difference
 - (e) taxpayer's selling costs
 - (f) where old residence is sold, cost of legal services in respect of the purchase of the new residence and of any tax, fee or duty (other than gst or value added tax) imposed on transfer or registration of title to new residence (not for moving from rental to new property)
 - (g) interest, property taxes, insurance premiums and cost of heating and utilities in respect of old residence, lesser of \$5,000 and total of expenses for the period
 - throughout which the old residence is neither occupied by taxpayer or family or rented to another person and
 - in which reasonable efforts are made to sell the residence - CARRYING COSTS
 - (h) cost of revising legal documents to reflect the address of the taxpayer's new residence (ex. driver's license) and cost of connecting or disconnecting utilities
 - 62(3) moving expenses do not include costs (other than those in paragraph (f)) incurred by the taxpayer in respect of acquisition of the new residence

THREE ELEMENTS to ELIGIBLE RELOCATION

- distance
- purpose of relocation
- ordinary residence

DEFINITION OF MOVING EXPENSES

- **moving expenses: ordinary out-of-pocket expenses incurred by a taxpayer in the course of physically changing his residence** *Storrow*
 - moving expenses: outlays or costs incurred to effect the physical transfer of the taxpayer, his household and their belongings to the new residence only - NOT amounts for acquiring new residence, costs of registration, installing dishwasher, new locks

Eligible Relocation

- 248(1) eligible relocation - relocation of a taxpayer where
 - a. relocation **enables** taxpayer to
 - i. carry on a business or be employed at a location in Canada

- ii. be a student in full time attendance enrolled in a program at a post secondary level
- b. both the residence at which the taxpayer **ordinarily resided** before the relocation and the residence at which the taxpayer ordinarily resided after the relocation are in Canada and
- c. the **distance** between the old residence and the new work location is not less than 40 kms greater than the distance between the new residence and the new work location

PURPOSE OF RELOCATION

- 'enables' taxpayer to carry on business or employment or studies
- not important that he only did the transaction once rather than multiple times, ongoing
- what happens when a taxpayer gets a new job then delays the move
- *Abrahamsen*: under the new legislation, you can move after starting the job
- **ambiguity here: some cases say you need a new work location (*Howlett, Moreland*) whereas others don't even require a change in the work (*Dierckens*) but overall it seems that there must be something related to the move that makes it works related (maybe something in work - *Gelinas*) so that the move 'enables' work, rather than a move for purely personal reasons such as in *Grill***
- *Dierckens*: TP was employed for 10 years before doing the move - note ambiguity b/c she was laid off each year for the summer b/c she was a school bus driver
- *Grill*: moved b/c he split up with his wife, not because he wanted to be closer to work
- *Gelinas*: (1205 note 5) involved a nurse who worked part time in a hospital, got a full time job in the same hospital, moved closer to work b/c it is now full time, - 'new work location' is simply a term defining the words preceding it - should not be elevated to a whole new concept not contained in the operative words - no reference in the operative words to the new work location or new duties - however the move should be linked to something in the work because of the word 'enables'

ORDINARY RESIDENCE BEFORE AND AFTER RELOCATION

- under the definition of eligible relocation under 248(1) essential to determine not only the purpose of the move but where the taxpayer 'ordinarily resided' before and after the relocation
- questions:
 - where do you ordinarily reside?
 - where did you ordinarily reside before the relocation
- *Rennie*: you can be resident in more than one place at a time but **you cannot be ordinarily resident in two places at one time**
 - note: where you declare yourself ordinarily resident may impact whether or not you can claim the deduction
 - in this case, TP claimed moving expenses to Victoria when he moved to an apartment there, then claimed them again when he moved to a house and sold his prior home in Montreal
 - **maybe he should have waited and claimed them all at once as part of the process of moving**
- *Neville*: taxpayer moved to Winnipeg, lived there for two years before selling house in former city, court found that he was ordinarily resident in the prior location for those **2 years**
- *Pitchford*: moved from place to place until settling in Saskatoon - waits until finally settled to claim moving expenses, yes this is okay
- *Dalisay*: taxpayer moves from St. John's to near Edmonton, spends 7 weeks in Regina in between - 7 weeks in Regina is not ordinarily resident
- *Ringham*: taxpayer moves to Hungary for a while, moves to Thornhill - **not necessarily ordinarily resident in a place even if you sell your prior residence and move your mailing address** - can still be a temporary sojourn based on facts: these places in between are '**way stations**'
- *Jaschinski*: in between places are '**stop-overs**'

DISTANCE OF RELOCATION

- 40 km measurement test: **shortest normal route** - prevent taxpayer from having to use neglected/unpaved road but not limited to the route that the taxpayer prefers *Giannakopoulos*

- *Nagy*: court rejected MNR's proposed route as unreasonable, requiring almost 40 turns, rural roads & congested areas - it is the shortest **realistic** route
- *Lund*: taxpayer argued his route was shorter by time, whereas CRA route was below 40 kms but took longer - court rejected this argument - it is the shortest (by distance) normal route, not the shortest normal route by time

Limitations on Deductibility

- 62(1)(a) moving expenses not deductible to the extent they were paid for in respect of, in the course of or because of the taxpayer's office or employment
- 62(1)(c) limits the amount that may be deducted to the income for the year from the new work location or scholarships from new school
- 62(1)(b) may deduct non deductible eligible moving expenses in the following year(s)
- *Hippola*: moving expenses not deductible b/c he was intending to set up a consulting business and instead was hired by a company - reason for moving determinative of deductibility
 - the taxpayer did not earn any business income from consulting which was the reason for moving back to Ottawa
 - the job was offered to him after the move
 - purpose of the move was to start the business
 - taxpayer must have already been found the employment or planned the business before moving in order to benefit from the benefit under 62
 - **UNSURE IF THIS CASE STILL APPLIES - STATUTORY LANGUAGE HAS CHANGED TO 'THE BUSINESS OR EMPLOYMENT' TO A BUSINESS OR AN EMPLOYMENT**
- *James*: taxpayer moves to a new location, is required to do the employment through a business, takes his income out as dividends from his corporation - deduction disallowed b/c the dividends were considered **property income and not employment/business income** as required by the eligible relocation

Income or Loss from a Business or Property and Other Income

- 3(a) identifies 'business' and 'property' as sources of income
- 3(d) permits deductions for losses from business or property

Subdivision B: sections 9 - 37

- 9(1) income from business or property is 'profit'
- 9(2) defines loss
- 9(3) income or loss from business or property does not include capital gains or losses
- 10 - 11 timing issues
- 12 - 17 Inclusions
- 18 - 21 Deductions

Business - Meaning

- encompasses both ordinary and extended meaning

ORDINARY MEANING *Smith v Andersen*: two parts of the meaning

- subjective: profit purpose
- objective: organized activity, time, labour etc
- *Smith v Andersen* - 'anything which occupies the time and attention and labour of a man for the purpose of profit is business'
- TEST: did you arrange your affairs to make it a business, or was it a hobby
 - test for gambling: what is the dominant object - **to conduct an enterprise of commercial character or primarily to entertain oneself**
 - **must have the expectation that you can actually win**

EXTENDED MEANING OF BUSINESS

- 248(1): business means business and includes 'a profession, calling, trade, manufacture or undertaking of any kind whatever and ... an adventure or concern in the nature of trade' but does not include an office or employment
- profession - (dictionary) a vocation in which a professed knowledge is used in its application to the affairs of others or in the practice of an art founded upon it
- calling - business, occupation, profession, trade
- trade - twofold: practice of some occupation, business or profession habitually carried on esp when practiced as a means of livelihood or gain or buying and selling or exchange of commodities for profit
- manufacture: making of articles by physical labour or machinery, especially on a large scale
- undertaking: enterprise or activity or a proposal, plan or program, **must involve a risk** (not a focus of many court proceedings)
- adventure or concern in nature of trade - enterprise, commercial speculation with characteristics of a trading enterprise

TEST for **adventure/concern in nature of trade**: **manner of dealing** - did the TP deal with the asset as a trader would?

- dealt with the lead exactly as a dealer in imported lead would have done - bought it overseas and sold it to a user of lead in Canada *MNR v Taylor*
 - **nature and quantity of the subject matter may stamp it as being of a trading nature** -- 22 carloads of lead, excluded possibility that it was of an investment nature or a capital nature
 - no intention to invest in lead - reason for purchasing the lead was to sell it to make a profit
 - **not important that he only did the transaction once rather than multiple times, ongoing**
 - whether something is an adventure in the nature of trade depends on the **character and surrounding circumstances of the transaction**, no single test
- intention as another factor in other case law, secondary intention in *Regal Heights*

Business - Reasonable Expectation of Profit

- subjective profit making test
- historically was a general rule used to deny losses when they were ongoing especially when used to offset other income?
- 18(1)(a) no deductions except for income earning purpose
- 18(1)(h) no personal or living expenses deductions
- allowances 20(1)(c)(i) interest on borrowed money used to earn income

Stewart REJECTS the reasonable expectation of profit test as the primary test instead adopts this test:

SOURCE OF INCOME: (recommended approach for business or property income)

1. is activity undertaken in pursuit of profit or for partially personal reasons
 - i. if it is clearly commercial (no personal element) - no need to inquire further - active income is business, passive income is property
2. when there is a personal element look to the factors to determine whether it is commercial or personal/hobby like
 - factors that may be looked at - not exhaustive (factors from *Moldowan*)
 1. profit and loss experience in the past years
 2. taxpayer's training
 3. taxpayer's intended course of action
 4. capability of the venture to show a profit (after deducting interest)

Inclusions: Business Income and Other Income

- inclusions: profit from business or property
- profit: income less reasonable expenses for gaining that income

Gains from Illegal Activities

- **immaterial whether income comes from a legal or illegal source** so long as it is a source and therefore tax liable *No 275*

- wouldn't want to give tax advantage to these activities
- should be estopped to pleading your own illegality to avoid tax

Damages and Other Compensation

- surrogatum principle used *Canada v Manley*: if the TP is engaged in an adventure in the nature of trade and is then compensated for it via damages then that is business income, especially if the amount compensated is the same amount as they would have gotten if the payment had been made
 - *London & Thames Haven Oil Wharves v Attwool 1967 HL*
 - **damages included in income if:**
 - **received pursuant to a legal right**
 - **amount in respect of which damages are received would have been included as income**
 - compensation will take the form for income tax purposes of the thing it is replacing
- *Donald Hart Limited* - taxpayer sued for infringement of trademark and passing off - court said it had the character of income as it was made for the purpose of filling a hole in the taxpayer's profits - nature of income for use of trademarks

CAPITAL

- *HA Roberts Ltd* - taxpayer had long term contract that was cancelled, damages for cancellation of the K - this has the character of capital b/c a separate mortgage business ceased to exist and the Ks were capital assets of an enduring nature
- *damaged lobster traps: compensation for loss of traps is capital, compensation for loss of lobsters in income

ISSUE - UNDERLYING NATURE OF THE PROPERTY RIGHT BEING COMPENSATED ESP IN RELATION TO THE TAXPAYER: **DEPENDS ON SIZE OF BUSINESS**

- *Pe Ben Industries* (note 10 pg 541): taxpayer had a K to transport supplies & equipment from Fort McMurray to an oil plant that was terminated. compensation was given. court said this was a separate business and an enduring K for the taxpayer so on capital account b/c the K was central to the company
 - *Canadian National Rail Company* - exactly the same kind of contract as above but the compensation was seen as income b/c the company is so large with multiple Ks and compensation was given for loss of business, but this would be expected on the ordinary course of business

PUNITIVE DAMAGES

- *Bellingham*: expropriated property, compensation was adjusted to a higher amount by the courts, got additional damages. court said the additional damages were a form of punishment for the expropriation body. that is a windfall.

<u>Income</u>	<u>Capital</u>	<u>Windfall</u>
surrogatum	loss of business loss of contract of an enduring nature	punitive damages

Voluntary Payments

- **if payment is unlikely to ever occur again and did not result directly or indirectly from any business action then it is likely a windfall** *Federal Farms* - in this case the taxpayer did nothing to get the money, had no legal right to it, it was a charitable donation in response to hurricane farm losses
- not compensation or income
- distinguished from insurance income b/c **taxpayer did nothing to get the money** - taxpayer had absolutely no legal right to the amount

WINDFALL CASES - Duff: most of these cases, the court is just confused

- *McMillan*: taxpayer had long term K with insurance broker, it was cancelled, he got compensated by somebody else who was requested to pay it by the broker. court says this is a windfall.
- *Cranswick*: taxpayer was minority shareholder of a company, majority shareholder made payment to the taxpayer in the hope of avoiding controversy and potential litigation which may have arisen - offer to buy the shares above value or pay

them a small amount per share - court says this is a windfall - no organized effort, not sought after by the taxpayer, no foreseeable recurrence

- subsequently in *Mohawk* this was reversed
- *Frank Beban Logging* - gov't compensation to logging contractor after federal & provincial gov'ts established national park - windfall
- Non competition payment cases: reversed by 56.4(2)

SERVICES

- note *Campbell* 1982: pro swimmer attempted the crossing of Lake Ontario in anticipation of award offered by newspaper. despite failing she was compensated for attempting. characterized as income from a business b/c it appeared that the newspaper felt obligated to pay her b/c of the K.

Prizes and Awards

- prizes from lucky draws won by **pure chance** not taxable even if there is some connection to work; the element of luck breaks the connection to the work (*Abraham, Poirier*)
- prizes from competitions **MAY** be taxable as business income (*Rother, Watts*)
 - *Rother & Watts*: cases where architects won prizes for competing in a design competitions - first case not taxable since it was a gratuitous prize, next case characterized the competition as a contractual relationship - led to statutory reform in 56(1)(n) - prize for field of endeavour, \$500 exemption

PRIZE: Steps

- is it received in respect of business or office or employment? - if yes, fully taxed under 6(1)(a) or 9(1)(b) as employment or business income
- is it for achievement in a field of endeavour ordinarily carried on? - yes then 56(1)(n) and taxable over \$500 (if no then not taxable as prize - *Rumack*)
- is it a prescribed prize? - if yes then not taxable

PRIZE def'd: anything to be striven for, doesn't have to be a competition, reward for passing difficult exam is a prize/award
Savage

CASH FOR LIFE?: lotteries in the form of annuity payments are taxable on the interest portion of the lottery b/c if the TP had won the amount as a lump sum and invested it, then they would have been taxed on the interest *Rumack*

Prize for Achievement

- section 56(1)(n) scholarships, bursaries etc - 56(3) exempts scholarships
- taxpayer required to include amounts received as or on account of a prize for achievement in a field of endeavour ordinarily carried on by the taxpayer other than prescribed prize
- prize for achievement
- field of endeavour ordinarily carried on by taxpayer
- other than prescribed prize
- * exceeds the scholarship exemption for prizes (\$500) under subsection 3
- ** not amounts received in the course of business or in respect of office or employment
- achievement in a field of endeavour ordinarily carried on by taxpayer rules out prizes won by chance, costume party prize *Savage*
- *Turcotte*: field of endeavour ordinarily carried on does not include knowledge of the 'vast field of culture'

Prescribed Prize

- section 56(1)(n) excludes prescribed prize from business income as set out in Regulation 7700
- prescribed prize (7700): any prize that is
 - recognized by the general public and that is
 - awarded for meritorious achievement in the arts, the sciences or service to the public
 - NOT including any amount that can reasonably be regarded as having been received as compensation for services

- *Foulds*: band winning prizes for winning competition is a prescribed prize b/c
 - meritorious achievement in the arts
 - recognized by the general public
 - not compensation for services
 - not business income - Duff thinks this argument is not super persuasive
- *Labelle*: accounting case writing prize - recognized by general public - requires an element of evaluation or appreciation

Non - Competition Payments

- when former employee receives consideration for entering non compete agreement with former employer, generally deemed to be remuneration under ss 6(3) and taxable as income from office or employment

FOR NON COMPETITION PAYMENTS THAT DON'T FIT 6(3) - CONTRADICTIONARY CASE LAW

- *Fortino*: court rejected Minister's argument that non competition payments not subject to the deeming rule in ss 6(3) should be characterized as income from an unenumerated source
- *Manrell*: payments were proceeds from disposition of property right - taxable as capital gains

Inclusions: Property Income

4 MAIN categories of PROPERTY INCOME: (passive income): INTEREST 12(1)(c), DIVIDENDS 12(1)(j) and (k), RENTS 9(1), ROYALTIES 12(1)(g)

Interest

- 12(1)(c) specifically includes any amount received or receivable by the taxpayer in the year as, on account of, in lieu of payment of or in satisfaction of, interest to the extent that the interest was not included in computing the taxpayer's income for a preceding taxation year
- three contexts for characterization:
 - where revenue department or the taxpayer seeks to characterize an amount 'as, on account of, in lieu of payment of or in satisfaction of interest'
 - where taxpayer disposes of a capital property for an amount part of which is payable in one or more taxation years
 - where taxpayer realizes a gain on a debt obligation acquired at a discount or disposed of at a premium or on which a bonus is payable at maturity
- Interest (dictionary): money paid for the use of money lent or for not exacting repayment of debt

"Legal Interest" three ELEMENTS:

- compensation for the use or retention of a principal sum
- referable to the principal sum
- day to day accrual
- AMOUNTS THAT ARE REFERABLE TO A PRINCIPAL SUM ARE INTEREST even if the amount is contingent upon future events such as the amount of income earned by the company that is sold *Perini Estate*
 - court says the interest is referable to the payment price as a contingent liability with retroactive effect
- *Sherway Center*: financed by 9.75% interest plus 15% of operating income over 2.9 Million - court found this was deductible b/c it was referable to the principal sum of the debt - THIS DECISION EXPANDED THE DEF'N OF LEGAL INTEREST TO INCLUDE AMOUNTS THAT MIGHT NOT BE DIRECTLY RELATED TO THE PRINCIPAL AMOUNT BUT ARE CLEARLY RELATED TO IT
- additional interest in compensation payments was a punitive amount and therefore a windfall *Bellingham*: just because you call something interest doesn't make it interest

Payments of Interest and Capital Combined

- 16(1)(a) applies where, under a K or other arrangement, an amount can reasonably be regarded as being in part interest and in part capital in nature
 - anti avoidance provision for courts to characterize amounts as interest if appropriate
 - irrespective of legal form or effect of the K an amount may be deemed interest
- **Groulx**: when interest is waived on sale price that is payable over a period of time in instalments, court can deem interest
 - factors:
 - taxpayer's knowledge of real estate transactions
 - taxpayer proposed the non payment of interest
 - weakness of the reasons motivating this gesture
 - **payment price was more than FMV**
 - purchaser probably wouldn't have paid that much if he wasn't exonerated from interest
- **Vanvest Logging** applied **Groulx**: factors looked at were **(1) terms of the agreement (2) course of the negotiations, (3) relationship of the price paid to apparent FMV, (4) common practice w/respect to interest in these transactions**. no evidence that interest was considered or negotiated on, no change to purchase price, no evidence of FMV difference, no deemed interest - **section cannot be applied whenever purchase price is payed in a number of instalments over time, must be some evidence to support the conclusion that deeming interest is reasonable**

Deductions: Illegal Payments, Damage Payments, Fines and Penalties, Legal Defence

TESTS For Deductibility of Expenses:

- a. **Income Nature (not Capital)**
 - i. section 9(1)
 - ii. 18(1)(b): expressly prohibits outlays in respect of capital except as expressly permitted
- b. **Reasonable Amounts**
 - i. section 67: cannot deduct for expenses if they are not 'reasonable in the circumstances'
- c. **Incurred to Gain/Produce Income**
 - i. 18(1)(a): no deduction except to the extent made or incurred by taxpayer for the purpose of gaining or producing income
 - ii. not egregious or repulsive
- d. **Not Personal**
 - i. 18(1)(h): cannot deduct personal or living expenses (except travel when in the course of business)
- e. **No GAAR (section 245)**

OLD WAY OF LOOKING AT EXPENSES:

- FIRST STEP for ALLOWING deductibility: whether they were made or incurred by the taxpayer in accordance with ordinary principles of commercial trading or well accepted principles of business practice *Imperial Oil, Royal Trust Co* (note: 65302 ignores this part of the test, skips to 18(1)(a)) (OBJECTIVE TEST)
 - note: 9(1) has an implicit limitation as expenses are only allowed in the pursuit of profit
 - 9(1) taxpayer's income for a taxation year from a business or property is taxpayer's **profit** from that business or property for the year
 - 9(2) loss from business or property is amount of loss from computing taxpayer's income under the rules of the Act
- SECOND STEP: Income Earning Purpose Test (does not allow the expense, LIMITS deductibility in some situations)
 - 18(1)(a): disallows deduction of any outlay or expense **except to the extent that it was made or incurred by the taxpayer for the purpose of gaining or producing income** from the business or property
 - 65302: subjective income earning purpose test
 - unless expense is so egregious or repulsive that subsequent expenses cannot be justified
- OTHER limitations:
 - 67.5 Illegal payments relating to bribes, conspiracy
 - 67.6 fines and penalties

- 18(1)(l) recreational facilities and club dues
- 67.1 meals and entertainment (50% disallowed)
- 18(9) home office expenses
- 20(1)(c) interest expenses

Illegal Payments

- many of these cases have involved bribes
- *Muller Meats*: under the table payments to bribe people to buy the meat - didn't have receipts, no evidence: no deduction
- *Eldridge*: expenses such as bribing law enforcement & civic officials - no evidence, not deductible
- *United Colour & Chemicals Ltd*: kickbacks that were accepted by TJ, secret rebate arrangements - TJ accepted that they were necessary for gaining or producing income: yes deductible
- in response gov't enacted 67.5: non deductibility of illegal payments
- TAINT OF ILLEGALITY **NOT RELEVANT** TO DEDUCTIBILITY OF EXPENSES: not relevant that the wages 'bear the taint of illegality' b/c of tax evasion scheme *Espie*
- *Neub*: drug dealer could not deduct expense of drugs that were seized by cops b/c amount had not been established and to allow the deduction would be contrary to public policy (BEFORE 65302)
- *Burnett*: seizure of a van under *Narcotics Control Act* not deductible b/c contrary to public policy (BEFORE 65302)

Damage Payments

- **deductibility of expenses is to be determined according to the ordinary principles of commercial trading or well accepted principles of business and accounting practice (absent a specific exclusionary rule) *Imperial Oil***
 - if damage payments are incurred b/c of actions in the course of business then they are deductible
 - negligence on the part of the employees in running the ship is a **normal and ordinary risk of the business**
 - yes damages arising from negligent employee conduct are deductible
 - **process of earning income** - connection to the operation, part of the process of earning income
- after 65302 avoidability and public policy are likely not relevant and remoteness questioned unless the expense payments are 'egregious': this likely applies to damage payments
- *Davis* (note 4, 624): pig farmer driving over to his brothers house to inspect two boars got into a car accident, sought to deduct the accident costs - court: too remote - if the business he was involved in was a transportation business then yes but this **expense was too remote**

CRA's view on damage payments (summing up):

- Outlay must have been made for purpose of gaining or producing income 18(1)(a)
- Outlay must not be of a capital nature 18(1)(b)
- Outlay must not have been made for purpose of producing exempt income 18(1)(c)
- Outlay must not be a personal expense 18(1)(h)
- Outlay must be reasonable in the circumstances 67

Fines and Penalties

- NOT deductible: 67.6 - no deduction in respect of any fine or penalty (other than a prescribed fine or penalty) imposed under a law of a country or of a political subdivision of a country

PRIOR CASE LAW TO 65302 and 67.6

- two fold test: *Amway v Canada*
 - was the expense incurred for the purpose of gaining or producing income
 - would its deduction be contrary to public policy
- ARGUABLY THE FOLLOWING CASE APPLIES TO OTHER EXPENSES

65302:

- court uses the subjective income producing purpose test (ignores the 9(1) test of ordinary business practice which might have worked to deny the deduction)
 - court may still find an expense **egregious** or repulsive so contrary to public policy
 - fines and penalties are deductible if they were made for the purpose of earning income
 - DO NOT read incidental to business test into the Act
 - REJECTED REMOTENESS TEST, PUBLIC POLICY
- L'HD (concurring): fines/penalties should be deductible if they are meant to be compensatory, not deductible if they are intended to be penal
- Bastarache (dissent): must determine public policy allowing deduction of fines/penalties on case by case basis

Legal Defence Costs

- lawful legal fees and costs incurred or made in defending business practices are for the purpose of earning income and deductible *Rolland Paper*
 - even after conviction
 - company charged with unlawfully conspiring to reduce/prevent corruption
- part and parcel of the business
- tax evasion defence costs - **not part and parcel of the business**
- not deductible for expenses that are personal or not connected with the business (*Neeb, Cormier, Sommers, Thiele Drywall*)
- use subjective income producing test from 65302 although you can argue that it is egregious or repulsive

Deductions: Recreation, Meal, Entertainment, Clothing, Home Office and Travel

- 18(1)(h): prohibits deduction of **personal or living expenses** other than travel expenses incurred while away from home in the course of carrying on the taxpayer's business

Recreation, Meal and Entertainment Expenses

- 18(1)(l): no deduction for expense relating to the use of recreational facilities and club dues
 - (i) for the use or maintenance of a property that is a yacht, a camp, a lodge or a golf course or facility unless in the ordinary course of the taxpayer's business of providing the property for hire or reward
 - (ii) as membership fees or dues in any club the main purpose of which is to provide dining, recreational and sporting facilities for its members
 - *Siemack Pipelines*: **anything incidental to the use of this type of property** even meals, transportation, fishing, canning of fish, licences, etc. disallowed
 - no need to own the property
 - *Hewlett Packard*: 18(1)(l)(i) does not apply to hotels expenses
 - 'yacht' - tug boat? no, yacht rented to go take photographs? no not entertainment purpose
 - boat used for purposes of taking photographs, research purposes not a yacht - look to use made of the boat *John Barnard Photographers*
 - *MNR v CIP*: converted tugboat used for entertainment purposes not a yacht even though purpose is a yacht

Royal Trust TEST for Expenses

- **9(1) is where you go first for authorization for the deduction**
- note: don't defer to accountants re ordinary and well accepted business practices b/c accountants are interested in keeping income estimates low
- **test:**
 1. **is the expense in accordance with the ordinary principles of commercial trading or well accepted principles of business and accounting practice to fall under 9(1)?**
 2. **does it come within one of the exclusionary rules of section (18), in particular 18(1)(a)**
- in this case expenses for social clubs were allowed b/c it was considered good practice, the policy did result in business and income was produced from it - OVERRIDDEN BY 18(1)(l)(ii)

MEALS AND ENTERTAINMENT

- 67.1 limits amount otherwise deductible to 50% of the lesser of the amount paid for meals and entertainment or an amount that would be reasonable in the circumstances
 - note - moving meals expense not subject to the limitation
 - 67.1(2) lists exceptions to the 50% rule
- **Stapley**: expenses for food & entertainment, even if they are in respect of producing income from a business, if they are also 'in respect of human consumption of food or beverages or the enjoyment of entertainment' then they are caught by 67.1(1)
- FOOD AS FUEL: **Scott** - bike courier, allowed for the additional marginal cost of food, court analogized this to couriers using cars deducting fuel as expense

PARTIES

- **Adaskin**: party for cast members after end of show, after paying actors **not** deductible - not for the purpose of gaining or producing income
- other cases of parties, the deductibility depends on the way of inviting the people; if the guests don't necessarily know that they are guests of the company rather than guests for social reasons then the expenses are not deductible (**Roebuck, Fingold**) but if the invitations are sent on company letterhead, identify company on all correspondence sent through the company then the expense will be deductible for those guests (**Grunbaum**): lawyer invited clients to daughter's bat mitzvah: not deductible, purely for social reasons

Clothing Expenses

- clothing may also provide a personal benefit, could be caught by 18(1)(h)
- if clothing is worn outside of work then it will not be deductible - this is a personal or living expense (**No 360 v MNR**)

Home Office Expenses

- expenses incurred on home office may also provide a personal benefit
- 18(12) limitation on home office in self contained domestic establishment
 - limits the amount you can deduct - cannot use home office expense to create a loss but expenses on home office can be carried forward
 - limits work space deduction to work space in the home that is either the individual's
 1. **principal place of business** or
 2. **used exclusively for the purpose of earning income on a regular and continuous basis**
- note: before getting to 18(12), first look at 9(1), 18(1)(a) and 18(1)(h)
- 18(1)(h) no deduction for personal/living expense

HOME OFFICE: **Locke**

- **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 the family living quarters?
 - was an appreciable amount of business transacted in the said room or was it just used for convenience?
 - was his house partially municipally assessed for business purpose?
 - was his telephone ordered for business purpose?
 - was there a sign on his house announcing the business to the general public
 - if taxpayer already has another office, was the home office essentially a second branch
- in **Locke** a solicitor was denied the home office deduction b/c the home office was principally for his own convenience, nothing unusual about lawyers receiving clients in their homes, he also had an office in town, approximately met 2 clients per week in home, made and received phone calls, read and worked from home, did not hang a sign or put his number in the yellow pages
- in **Logan**, court allowed deduction of home office expenses for doctor after he proved that:
 - purchased this particular house b/c there was an extra room to do work in
 - room was separate from the house

- he had a business phone & dictaphone
- 5-8 doctors came weekly to discuss patients
- he used the office for report writing and consultation w/ other doctors
- compare to *Mallouh* where doctor was denied home office expense: he did not treat or receive patients, had no business phone, no signage, did not purchase home w/ primary purpose of establishing medical office

Vanka: you can meet your clients **on the phone** - he met one client per week there and had about 7 phone calls a day w/ clients that were seen as 'meeting patients'

- is work space part of taxpayer's self contained domestic establishment?
 - generally if the office is connected to the home based on factors such as physical attachment, shared utilities and accessibility it will be part of the SCDE *Ellis, Dufour* - things such as studios over the garage, garage office
 - for bed & breakfast/Inn, it depends on integration: if your home is an independent apartment separate from the B&B or Inn *Sudbrack*, then it will be seen as separate but if the B&B is part of the home w/out separation then it will be a part of the SCDE *Maitland*

Travel Expenses

- 18(1)(h) travel expenses deductible against business/property income if incurred by the taxpayer
 - while away from home
 - in the course of carrying on the taxpayer's business

TEST from *Cumming*

- if taxpayer has a **base of operations in their home and travels to workplace throughout day, this is travel for work purposes**
 - review of law that says when a person lives away from office and travels to work that is personal and living expense
 - taxpayer's base was his home
 - if there is a base of operations in the home then any travel away from the home for work is travel in the course of business
 - home was close enough to the hospital to not have personal or living expense quality to the travel

X REFERENCE TO TRAVEL/SOJOURNING CASES IN EMPLOYMENT CONTEXT

- also cross reference to 67.1 50% limitation on meals expenses
- *Henry*: taxpayer was anaesthetist, travel to hospital denied b/c he also had an independent office where he kept records
- *Cork*: expense allowed for drafter with office in one room of his home - had 'base of operations' in home and travelled to draft tables w/equipment etc

COMMUTING

- commuting may be found deductible as business expense **if TP has a base of operations in the home** even if the home is quite far away, work done in the home is very little and TP likely 'chose' to have base of operations in home, so long as the base of operation is found in the home *Forestell*: in this case, court allowed expenses for apartment, meals and travel SEEMS QUESTIONABLE but court will not allow deduction of travel expenses incurred for PERSONAL REASONS
Brown: taxpayer was independent contractor in Toronto, had travel expenses to visit family in Sault Ste Marie - no this is not travel expenses b/c not sufficiently connected to business

TRAVEL BETWEEN BUSINESSES

- travel in business or between different locations in the business will be seen as deductible if related to a single business operation with several locations (*Randall, Wasserman*) but not for or travelling between separate businesses
 - *Ozvegy*: taxpayer allowed travel expense deduction for apartment rental for apartment near hospital where he worked 2 1/2 days per week - allowed b/c similar to cost of renting hotel for that time

Travel for BUSINESS & PLEASURE - 18(1)(h) may apply or CAPITAL

- *A-1 Steel and Iron Foundry*: where travel involves both business and pleasure, a portion of the expense may be non deductible
- **note travel expenses may be seen as capital if taxpayer was travelling to conventions that give lasting advantage

Reasonableness

- section 67: no deduction in respect of an outlay or expense otherwise deductible except to the extent that the outlay or expense was reasonable in the circumstances
- courts have generally been reluctant to apply this rule
- *Cipollone*: expenses are unreasonable if they are simply way too much for the amount of income being earned in aggregate and seem unreasonable: claimed were significantly in excess of income and the types of expenses - automobile, clothing, travel, promotion etc should be somewhat proportionate to revenue
 - **in aggregate the expenses were seen as too much**
- **subsequent cases have said that aggregate test of expenses maybe not a good test**
 - *Mohammed*: no second guessing the deductions as too high just because they are too high - must point to another test such as super high interest rates etc
- things like clothing, home office, travel that have personal elements may come under 67
- *Ammar*: taxpayer had immigration/consulting business for students in the middle east, rented an extremely expensive apartment in Cairo - not a reasonable expense, it was excessive

Deductions: Interest and Other Financing Expenses

Interest

- 20(1)(c) permits deduction for interest on borrowed money used for the purpose of earning income from a business or property **or a reasonable amount in respect thereof**, whichever is lower, (that is wholly applicable or partly applicable) other than exempt income
 - *Shell*: four elements
 - amount must be payable in the year or be payable in the year sought to be deducted
 - amount must be paid pursuant to a legal obligation to pay interest on borrowed money
 - borrowed money must be **used for the purpose of earning (non exempt) income from a business or property**
 - amount must be reasonable
 - ****Shell**: general reasonableness limitation in 67 probably doesn't apply when the provision has a built in reasonableness component
- 20(3) specifies 'for greater certainty' that borrowed money used to repay money that was previously borrowed is deemed to be used for the same purpose as the previous indebtedness
- 20.1: grants the deduction for income if you have actually lost the source of the income
 - *Sinha* (note 21): taxpayer deducted interest on student loans b/c he invested the funds - it is the **USE** of the funds not the original purpose of borrowing the funds

Bronfman distinguishes between direct use and indirect use of the funds - these funds were used for the direct purpose of making a distribution

- **direct use for business purpose is necessary for deductibility - STILL RELEVANT**
- distinguished from *Trans Prairie* b/c no bona fide business purpose - there was very little income produced by the trust - it was primarily capital gains that were made - return fell grossly short of the interest expense
- if we allowed wealthy people to deduct interest for personal loans b/c they had other money invested but did not allow poor people to deduct interest for personal loans b/c they had no money invested that would make a mockery of the tax system (CONSEQUENTIAL ANALYSIS)
- aimed at borrowed funds that are directly used for business purpose, not remotely or indirectly

PURPOSE CASES:

- if the money is borrowed for a reason other than to earn income, it is not deductible (*Mark Resources*: real purpose of borrowing money was to import losses into Canada, *Robitaille*: **real purpose was to buy a house, not to contribute to the law firm**)
- consistent w/*Bronfman* but uses 'real purpose' test instead of 'sham'

BRONFMAN IS REVERSED BY *Ludco* and *Singleton*

- *Ludco Enterprises* SCC 2001: co has borrowed funds, paying \$6M interest to earn \$600K of dividends - ultimately sold shares at a capital gain of \$9.24M (taxable capital gain of \$4.61M), \$6M was deducted as interest expense. **income means gross income not net income - direct use test. income does not mean profit.** Duff thinks we should apply the GAAR notwithstanding this case esp if it is extreme.
- *Singleton* SCC 2001: unclear facts, taxpayer bought a home, also reinvested money into firm and that was seen as for the purpose of earning income. **nothing in 21(c) that allows you to look at the series of transactions** - (reversal of *Bronfman*) note: GAAR still allows you to look at a series of transactions so it may be used to prevent this type of thing but Duff thinks *Singleton* could withstand the GAAR

Timing Issues: Capital Expenses, Running Expenses, Prepaid Expense

TIMING ISSUES

- general rule: start from generally accepted accounting principles

Capital Expenses

- 18(1)(b) prohibits deduction in respect of 'an outlay, loss or replacement of capital, a payment of capital or allowance in respect of depreciation, obsolescence or depletion except as expressly permitted
- amounts characterized as capital expenditures as expense are not deductible in the year of expense - CCA rules apply
- CATEGORIES OF CAPITAL property:
 - depreciable property
 - financing expense
 - goodwill - eligible capital property
 - non depreciable capital property

TESTS FOR WHETHER AN OUTLAY IS EXPENSE OR CAPITAL OUTLAY

- expense incurred once and for all **with a view to bringing into existence an asset or advantage for the enduring benefit of trade** (*British Insulated and Helsby Cables, John Mansville*)
- whether the amount was expended on **establishing the structure within which profits are earned or in the process of earning income** (*BP Australia, Sun Newspapers, Hallstrom's*)

Johns Mansville allowed the TP to deduct expenses for land b/c the expense was **periodic, annual, recurring and no enduring value**

- Court looks to Australian case (see BP Australia on pg. 792... and other cases)
 - Structure = capital (setting up the structure of the business) "**means of production**" (set up cost) versus
 - Part of making money = deductible (operating cost)
- court looked at a three part test
 - **character of the advantage sought** - current operations or long term
 - **manner in which the practice is incorporated into the business** - manner in which the asset is to be used, relied upon or enjoyed
 - **means adopted to obtain**
 - periodic outlay of funds? or lump sum payment
 - **interpretive ambiguity would be resolved in favour of taxpayer b/c of lack of relief for taxpayer in the alternative (NO CCA FOR LAND)**

OTHER FACTORS:

- purpose of expenditures from practical and business outlook
- were expenditures incurred yearly as integral to operations
- easily discernible element of production
- not acquired for intrinsic value but by reason of location
- incurred annually
- will not produce an asset for the company
- expenditures to prevent halt of operations
- expenditures relative to business are small

CASES IN WHICH THE BRITISH INSULATED TEST WAS APPLIED

- increasing the value of your capital assets is a capital expense if made once and for all to create a benefit of an enduring nature: *BC Electric Railway*: payments of \$220K to municipalities to change from rail service to bus service, *Haddon Hall Realty*: cost to landlord to replace appliances in rental units a capital nature due to the fact that the expenditure was made once and for all to create a benefit of an enduring nature
- HOWEVER, if the benefit is not of an enduring nature then it will be expensable in the current year: *Damon Developments*: hotel expenses to replace furniture and appliances allowed as income expenditures. distinguished from *Haddon Hall* b/c in a hotel such items have a much shorter life, *Canada Starch*: payment to be allowed to partially infringe trademark is an expense b/c it takes its value from its relation to the ongoing business
- REMOTENESS: *Algoma Central Railway*: railway had a major survey done of all its lands to try to spark resource & development interest & increase traffic, court said the chance of an enduring benefit resulting was too remote to be classified as capital nature, instead it was analogous to an advertising expense
- *Oxford Shopping Centres*: payment by mall owner to city of Calgary to construct road interchange is an income expenditure; not enough connection to benefit to business to be capital

CASES IN WHICH THE STRUCTURE TEST (BP AUSTRALIA) WAS APPLIED

YES CAPITAL: establishing structure of business is a capital expense, including increasing your personal capital (*Cormack*: travel expenses incurred to research similar businesses to improve own business is capital, *Young*: subscriptions to investment publications if you don't have an ongoing business of investing), researching potential targets for acquisition *Firestone* while putting a business together EVEN IF YOU DON'T WIND UP DOING THE BUSINESS (*Bancroft*), fees paid to initialize new capital projects, draw up plans are capital (*Park Royal*)

- NOT CAPITAL: *Bowater*: expenses undertaken to assess potential of generating additional power from watersheds were of an income nature b/c they were incurred when the taxpayer was operating and were part of the cost of the business
- *Kruger Pulp & Paper*: consulting services and legal fees incurred by taxpayer to acquire timber cutting rights and investigating a site for a plan allowed as deductible expenses in the operation of business

ACQUISITION AND MAINTENANCE/REPAIR OF TANGIBLE PROPERTY

- SEVERABLE ASSET: if a severable asset as part of a bigger asset is replaced, this may be capital: (*Canada Steamship Lines*: boilers are a severable capital asset *Thompson Construction, Vancouver Tugboat*: engines are a capital asset)
- *Canaport Ltd*: installing fibreglass liner to prevent leakage and extend life of pipeline for carrying crude oil - this was found to be deductible as an expense, comparable to repairing cargo carrying holds - inconsistency??
- *Reynolds*: new liners for pots to produce aluminum found to be capital in nature - reached the ability to extend the life by 7 - 9 years
- ISSUE: repairs/capital improvements
 - *Shabro*: generally, replacement of worn or damaged parts will be repairs and are contrasted with changes designed to create an enduring addition or improvement to the structure, in this case, taxpayer's floor fell apart b/c of existing defects in structure therefore although taxpayer was repairing the floor, it was a 'capital' expense b/c taxpayer made improvement to it rather than just replacing floor to same condition, repairs mad on account of defects in original structure, not wear and tear or aging
 - *Goldbar*: **depends on the purpose of the repair**, distinction between improvement/repair, in this case replacing a bad wall was a 'repair' because the purpose was to fix the wall, not to get a better wall
 - *Marklib*: repairs to apartment complexes in order to comply with work orders issued by municipal gov't was income expense b/c of **purpose of the repair**: purpose was to restore buildings to original condition and comply with municipal work orders, not to improve the buildings

Running Expenses

- expenses that cannot be easily matched with specific revenues may be deducted in the year incurred, even if that may distort taxpayer's income for the year and you don't get an asset out of the expense
- if the expense is not referable to any particular line item of revenue and difficult to determine the effect if any and over what time period it has an impact then it is deductible in current term *Oxford Shopping Centres*, but it is possible that TP has the choice to extend its deductibility *MNR v Tower Investment*
- *Oxford Shopping Centres*: tax uses different rules than accounting, no need to follow matching principle even if the TP's financial statements match the expense over a number of years to increases in revenues

ADVERTISING EXPENSE: unless referable to a specific line item of income that is in future years, it is deductible as an ongoing expense of business

- Tenant Inducement: *Candereel*: large amount paid to get a new tenants, not clear where the expense should be allocated, deductible as current running expense - SCC found that depending on the facts the tenant inducement payments were not in fact referable to an income item, other incidental benefits played a role
- *MNR v Tower Investment*: taxpayer was entitled to amortize advertising expenses for inducing tenants - choice
- note: 18(9) came after this case:
 - can't deduct payments for
 - services to be rendered after the end of the year
 - interest, taxes, rents or royalties in respect of a period after the end of the year, or
 - insurance in respect of a period after the end of the year OR
 - deduct portions of expenses in years reasonably considered to relate

Prepaid Expense

- 18(9): requires taxpayers to defer deduction of prepaid expenses, can be deducted in subsequent years to which they can 'reasonably be considered to relate'
- *Urbandale Realty Corp v MNR*: ss 18(9) does not require amortization of a regional development charge levied by the Municipality on the grounds that the one time tax did not relate to a 'period' as indicated in 18(9)(a)(ii) and was not imposed in respect of a period 'after the end of the year'

Timing Issues: Deductions of CCA

- 20(1): may deduct any amounts as are wholly applicable to the source or such part of the following amounts as may reasonably be regarded as applicable thereto:
 - Capital cost of Property:
- 20(1)(a) allows deduction for capital expenses which qualify through CCA
 - generally use the declining balance
 - assets are assigned to a class, percentage of decline is assigned by the class of capital
 - deduction of CCA is optional
 - where taxpayer finds it advantageous, may maintain UCC by forgoing current deductions and deferring tax value of these deductions to subsequent accounting periods
- **13(1) for capital recapture - capital amounts that are deducted in CCA in previous years, that are then made up for on sale are recaptured in full in income for the year**
- **20(16) terminal loss - when you sell depreciable property for less than the UCC in the class**
- **note: if you dispose of depreciable capital property for above the amount you paid for it, that is a capital gain**

Depreciable Property

- 13(21): depreciable property: property acquired by the taxpayer in respect of which the taxpayer has been allowed, or would, if be entitled to a deduction under 20(1)(a)
- requirements:
 - acquired by the taxpayer
 - property for which a deduction is allowed
- note 13(7): deemed disposal & acquisition at FMV for property going from income earning purpose to some other purpose or vice versa

Regulation 1100(1)(a) sets out the various CCA rates applicable to specific classes of depreciable property (under s 20(1)(a)),
PROMINENT CLASSES:

- class 1 - most buildings 4%
- class 3 - building acquired before 5%
- class 6 - frame building or frame used for farming or fishing 10%
- class 10 - automotive equipment or general purpose electronic data processing equipment 30%
- class 44 - patent or a right to use patented information 25%

EXCLUSIONS FROM CCA

- Regulation 1102(1):
 - (a) amounts already deductible in computing income
 - (b) property acquired or manufactured for sale (inventory)
 - (c) even if something is listed in the schedule and included in a class, it will not be subject to CCA if it is not purchased for the purpose of earning income
 - essentially the same test as 18(1)(a) and 20(1)(c)
- 1102(2): land is not depreciable property**

UCC

Definition of UCC is in 13(21) - note: $UCC = (A + B) - (E + F)$ (chronologically: $A - E - F + B$)

- A: total of capital cost of any asset of this class
- B: recaptured amounts from 13(1)
- E: total depreciation (amounts under 20(1)(a) and 20(16)) - CCA + TL
- F: lesser of proceeds of disposition or capital cost

Other Notes

- note: 1100(11) - (14): CCA for rental properties **not to exceed net income from renting**
- 1100(15) - (17): CCA for leasing properties **not to exceed income from leasing**
- **note: 1101: separate CCA classes for property that is acquired for gaining or producing income for different businesses/properties**
- note 1101(1ac): rental properties that cost >\$50,000 are deemed to be in separate classes
- **courts have held that leasing property is acquisition of property by lessee so lessee rather than lessor can deduct CCA

Exclusions:

Ben's Ltd: 1102(1)(c)

- **the purchase of the buildings were not for the purpose of gaining or producing income, simply bought them to facilitate expansion of the bakery, not a capital asset**
- *Hickman Motors* (consistent with *Ludco Ent*): qualifies this decision in that if you earn some income you **are using the property for the purpose of earning income** - in *Ben's* TP earned a very small amount of rental income so might qualify under this test. the case involved a taxpayer that was a car & truck dealership w/a subsidiary that leased automobiles. sub was losing money. parent took all of the leased vehicles, reorganized them and sold them off. vehicles were in the hands of the parent for 5 days, earned a bit of rental income, about \$20,000. the parent deducted CCA on all the vehicles, CCA amounted to over \$2 million.

Capital Gains and Losses: Characterization and Computation

- 3(b) includes in income net taxable capital gain
 - taxable capital gains + taxable net gain for the year from dispositions of listed personal property (3(b)(i)) - allowable capital losses
 - *taxable & allowable are one half of the total amount of capital gains or losses under Section 38
- 39(1)(a): taxpayer's capital gain/loss from disposition def'd - gain or loss from selling property that wouldn't be taken into account in business income

GAIN AND LOSS: section 40

- gain: proceeds - ACB (and transactions costs)
- loss: ACB - proceeds
- section 54: Adjusted Cost Base - in the case of depreciable property, ACB is the original cost base
 - cannot have a loss for depreciable property - this is b/c it is a separate world, terminal loss applies
- 248(1) property: property of any kind whatever whether real or personal or corporeal or incorporeal

PROPERTY can be INVENTORY or CAPITAL PROPERTY

CAPITAL PROPERTY can be PERSONAL or INVESTMENT

INVESTMENT PROPERTY can be DEPRECIABLE or NON DEPRECIABLE (land and others)

Real Property

ISSUE INVENTORY or NON DEPRECIABLE CAPITAL PROPERTY:

- in *Regal Heights*, TPs had plan to buy property to turn into a shopping centre, this plan did not work out, ended up selling the property, SCC found that it was inventory b/c the **(secondary plan) was an adventure in the nature of trade: speculation in vacant land**
 - DISSENT: sale of the land was a gain on capital when original plans fell through

SECONDARY INTENT TEST: would you have bought the property **but for** the ability to resell for a profit

- most of the cases where it is vacant land being bought and sold then for the most part it will be inventory
- cases where there is something on the land to earn income from such as rental property, farming, then it is more likely to be capital property

LAND - factors from the notes for characterization:

- holding period (short suggests inventory)
- circumstances responsible for the disposition ex. whether you have sought a buyer, if buyer comes to you might be capital property
 - ie. are you dealing with the property the way a trader would
- manner of financing the purchase
 - if you borrow heavily, the interest might be too much to expect you to earn income from the property
- other activities
 - are you generally in the business of buying and selling property? or are you generally in the business of buying property and renting it?
 - *Lemieux v Canada* (1973): land held for primarily personal reasons that is then sold for a gain is considered capital
- what if you change the purpose from inventory to investment or vice versa: notional disposition at the time you change the use

Section 68

PROVISION TO RE ALLOCATE PURCHASE PRICES

- BUYER PREFERS TO ALLOCATE TO vehicles first, then building then land
- VENDOR PREFERS land if you have claimed CCA, if not doesn't matter
- section 68: where an amount received by someone can be **reasonably regarded** as in part consideration for the disposition of a particular piece of property then it will be deemed so regardless of the form or effect

CHARACTERIZATION: *Golden*

- courts will generally show deference to an agreement between parties when agreed to between arms length persons and there was hard bargaining including bargaining over allocation
- *for the most part courts defer to the agreement unless there was a sham, non arms length, no bargaining
- in *Golden* there was bargaining between the parties, allocation was found not to be unreasonable, even though the purchasers initially suggested a different allocation

- courts will use the same argument to prevent taxpayers from using 68 to change allocation
- *TransAlta*: reasonableness test is similar to the reasonableness test in 67 - what is reasonable for a business person to do

- where the allocation is **substantially different from FMV (unreasonable) and there was no hard bargaining over allocation, courts apply the rule and ignore the allocation of parties** *Peterson, Leonard*
 - *Peterson* involved amount allocated for goodwill when it was substantially clear that the company's good will was nil
 - *Leonard* involved a **taxpayer wishing to change the value** of livestock and a milk quota in the purchase of a farm - court determined there might not have been hard bargaining b/c apportionment was only provided at the last minute and the amounts allocated appeared unreasonable in comparison with auction prices