Class 1

Imposing tax

* Govn’t under constitution can impose any mode or system of taxation; fed can tax people in Canada or even outside Canada. Fed has power to impose extra-territorial taxes.
* Provinces can tax but are limited to direct taxes, within the boundaries of their territory, can only tax people within the borders of their province. The federal tax is applicable to all people, resident or non-resident, wherever they may be in Canada.
* All taxes are statutory and have a statutory basis
* Residents of Canada are taxable on our worldwide income
* If you’re not a resident of Canada, you are nevertheless subject to federal tax on your Canadian tax source

Sources of Income

* The primary source of tax revenue from the personal income tax is employment income.
* business or property income (which is investment income, rent, profits, dividends, interest)
* If you sell the asset or dispose of it for fair market value, capital gains become taxable
* Damages for wrongful dismissal are taxable. Most damages are said not to be taxable
* Spousal support
* Only allowed to have one residence per year for tax purposes.

Class 2

Elements of a tax

* tax base: thing being taxed, the “taxable income” in income tax.
* tax rate: the percentage of the taxable income that becomes the tax payable. Tax rate times the tax base is the tax payable.
* taxpayer: who is going to be liable to pay the tax. Even if they don’t owe any tax, they are still called the taxpayer under the income tax act. Under Canadian tax system every individual is a taxpayer. A person is taxable on income to which they are beneficially entitled. Each one of us is a separate taxpayer. There is no minority, no limit to the age at which govn’t will collect taxes. Trusts and estates are also distinct taxpayers. Companies are also distinct taxpayers. Each corporation is a distinct taxpayer (parent companies and subsidiaries are also distinct taxpayers)

Tax Rate

* The percentage or the tax rate payable depends upon the bracket into which a person falls. Under the Personal Income Tax (PIT), the rate system is progressive. This means the higher your income, the more tax you’ll pay on that income.
* annual tax computed every year, every year taxpayer must work out their taxable income, and the rates combine federal and provincial rates.
* 9 tax brackets in BC. The first bracket is 15% federal tax for anyone with income above 0 up to $42707. 2nd bracket of 22% is people over that, 26%, then 29% for people over $102,406. The rates increase as your income increases
* 5 rates in BC go from 5.6% to 14.7%. 0 to $37,000 you pay 5.6%
* Marginal rate of tax is the highest rate of tax paid by an individual. Somebody with an income of say $150,000 would calculate their tax and the end result would be all of these brackets combined and $150,000 would mean paying tax on their highest dollar. 29% + 14.7%
* If they can get a deduction, they can reduce their income and may be able to actually make more money overall through paying less taxes.
* Gov tries to keep it below 50%. Otherwise, disincentive to work.
* Regressive tax: the higher income earners pay less tax than the lower income owners. Most indirect taxes in Canada like the GST, HST are regressive, not one that rises with income, in fact it hits the lower income tax payers more heavily relative to income. It doesn’t matter whether you’re wealthy or poor, you pay the same rate, so it’s regressive.
* For corporation, it doesn’t really matter how much income they make, it’s always proportional, a neutral or flat system.

Annual Basis

* Imposed annually. Each year is a distinct tax period, figure out taxable income for the tax year. The tax year is the calendar year – Jan. 1 – Dec. 31. (s.249(1)(b))
* April 30: balance due day, when the balance owing by the taxpayer is due – file the return and pay your taxes, by april 30
* Where there’s a dispute over a year’s income tax, the rules applicable are the rules for that year. If taxpayer has problem has problem with their 2010 tax return, you would have to go back and look up the 2010 provisions
* federal house of commons can impose “any mode or system of taxation”
* Provinces have more limited powers of taxation, they can only impose direct taxation within the province for the reason of money for provincial purposes. It must be within the province. Fed can impose on people outside Canada, but provinces cannot.

Direct taxes

* taxpayer charged with the tax is the person who bears the burden for it. For indirect taxes, the initial person is the taxpayer, but that taxpayer then passes that tax on to others to be reimbursed for the tax by passing the taxes on to other people through higher prices or employees to recoup the tax. Thus the tax is paid by someone other than immediate taxpayer. Provinces are not supposed to pass indirect taxes.
* Income tax, whether personal or corporate, is a direct tax for both prov and fed.
* GST, HST, excise taxes, import duties are indirect taxes. For instance, GST, in each stage of production, the tax is charged but gets passed on to the ultimate purchaserInterest is a source of income – what someone pays for borrowing money from someone else

Sources of Income – Things that Are or Are Not Taxable, surrogatum

* Capital – interest or dividends are taxable. Land, natural resources, rent, royalty are all taxable
* Taxable sources are those that result from production/labour of the taxpayer.
* Under source concept of income, certain types of return are not income. This is because they are not from a recognized source. Gifts and inheritances are essentially transfers of wealth from one person to another, not a result of production, not an increase of wealth overall, the deceases/donor loses and the beneficiary gains. They are thus not income, not taxable.
* Death taxes were abolished from the 1970s. However, upon death, their estate is subject to capital gains tax, as all their property is disposed of on fair market value. Similarly, even if it’s given as a gift, it’s given at fair market value and the donor is taxed on the capital gain.
* Capital gains are now only half taxable. Only half the capital gain is brought into income
* Strike pay is not taxable. Taxable income is what you earn, and strike pay is paid for not working, so you didn’t earn it. One half of capital losses are not deductible.
* Windfalls are also not taxable, as they are by chance and not effort, not earned. Lottery/gambling winnings from recreational betting are tax-free. As long as you’re not a professional in gambling.
* Hobby activity that you get money out of is also tax-free. This is because if you’re doing something for fun and not for business, it’s not taxable.
* Damages for personal injuries are tax-free. Money received for loss of earnings as result of injuries, etc, or personal injuries, or wrongful death is tax-free money.
* Bellingham: shows not all damages are tax-free, damage can be taxable depending on what they are for. Personal injury and wrongful death damages are tax free, but damages for other injuries like lost profits ARE taxable. This is the surrogatum principle: if damages are substituted for a sum of money that would’ve been taxable if received in ordinary course, it doesn’t change their ultimate identity and they are taxable. Lost income is exception: compassion for the personal injury overrides surrogatum, but only if the lost income are a result of personal injury.

Class 3

Schwartz (hobbies)

* hobbies are tax-free. Profits from hobbies are accretions to wealth but are not taxable. This is because they are not income from employment, property, or business.

Bellingham

* Windfall: It’s not contractual, not a recognized as a focused, organized effort. The payment was not expected and there is no foreseeable element of recurrence, and it’s not a customary source of income, and it’s not for recognition of service, property, or anything else. You’re getting money but you’re not in a transaction where you gave up anything like services, work, or property. Just doing something for fun (hobby) or pure luck (gambling).
* depends upon the intention of the person: did they go into it with the intention of making money? This can be difference between taxable and whether it’s a hobby or windfall.
* Bellingham: damages/settlements for personal injuries or wrongful death are tax free, but surrogatum applies: if a business gets money that is a substitute for lost income, like a ship forced to wait in the harbour, that is business income and is taxable. Damages for personal injuries are not that type of thing, nor are damages for lost income due to personal injuries

PAYE – Pay as you Earn

* tax deduction at source, the employer withholds a portion of income off the top of every payment of salary to an employee and to remit that to a govn’t.
* Incentive is that the employer will be personally liable if they don’t remit those taxes to the govn’t. Also, non-residents will be held personally liable if they don’t remit. PAYE is simply an interim collection measure that ensures govn’t gets money up front, then the employee can later file a tax return and hopefully get some back.

Federal Collection of All Tax

* fed collects the income tax for both the feds and the provinces. Provinces impose their own taxes but if they follow federal rules, fed collects them on their behalf
* it’s a big incentive for provinces to have the tax collection done by federal govn’t but they must follow the basic federal income tax act and collect income on the same rules as under fed

Tax Equity

* Horizontal equity = taxpayers in same circumstances pay same level of tax.
* Vertical: wealthy taxpayer should pay more tax than the poorer. Rich pay a greater proportion of their income to tax than the poorer.
* Carter Commission says what you should look for the person’s ability to pay, how much can they afford to pay? Horizontal equity says taxpayers with the same ability to pay should pay the same tax. Vertical equity says taxpayers with different abilities to pay should pay different levels of tax. Ability to pay is determined by their income, considering their circumstances
* Carter’s recommendation: Income should be redefined, abandon source concept and we should have one broad definition of income, the “comprehensive tax base”. This means that regardless of source, if you had an increase in your wealth, you should pay tax on that increase.
* Carter goals: said his system was in favour of neutrality (as far as no income sources preferred over any other) and thus efficiency of marketplace decisions. Taxes can modify people’s behaviour like encouraging certain behaviour or can be enacted to deter particular types of activity, should not however unintentionally effect behaviour, however, as then it distorts the marketplace in a way not intended/planned for by legislature.
* Simplicity: system should be easy to enforce and comply with, for govn’t to assess and collect, and understandable and transparent.
* We still have the source concept, as we say no to Carter. It has the negative qualities of inequitable, non-neutral, and not simple. There are different rates and consequences for different sources of income, that distort the tax implications for each. For instance, capital gains, particularly dividends, is much less taxed than employment income.
* If you invest and get dividends that qualify for dividend tax credit, you get much lower rate of tax and can get a tax refund, credit that applies to other taxes.
* In 1980s, damages for wrongful dismissal became taxable.
* 1991: add the GST. Service industry had before not been subject to sales tax, so they introduced Goods and Services Tax. Tax the service sector. Medical services are the only ones exempt. In effect, this was a national sales tax on consumption. Workers pay income tax and the consumers also get taxed. GST on consumption – ultimate tax falls on consumers of goods and services. This achieves greater neutrality between workers and consumers.
* Every spring there’s a federal and provincial budget. Fiscal period for govn’ts is April 1 – March 31. Income tax rules thus change year for year, but not basic rules.

Class 4

Interpretation of Income Tax Statutes

* Primary sources: Income Tax Act, p. 1, Income Tax Application Rules, 1971, Income Tax Regulations, and Tax Conventions
* Look at the text (the words of the provision) in their context and with the regards to the purpose/object of the legislation, words are to be interpreted harmoniously with the rest of the income tax act.
* Income tax case in Canada starts in courts in the CRA and works through the hierarchy there and then if the taxpayer is not satisfied with the outcome within the department, then the starting court is the Tax Court of Canada in Ottawa, then the Federal Court of Appeal. If there’s still dissatisfaction by the taxpayer or minister, you can get leave to the
* Secondary sources (which are not law) include the CRA Publications in taxation field. No legal status, they are just for the guidance of employees of the CRA. Information circulars.

Advance Rulings

* IC-70-6R5: if a taxpayer has some scheme that they want an advance ruling on before taking it to the public and want a tax determination of this scheme, with the guidance of lawyers and accountants, the taxpayer can prepare and submit an application for a ruling.
* If the govn’t will take it on and give a ruling, it is binding on the CRA. This is intended for situations where taxpayer has a specific transaction in mind and this application is made before the transaction occurs
* set out in the ruling application the facts of this proposed transaction and what you think the tax consequences should be and the govn’t has a rulings directorate in CRA which will consider this application and decide whether it’s suitable for a ruling and if they do, they will either agree with your interpretation or disagree, at which point you can withdraw the application and revise it and resubmit it.
* binding on CRA so if the transaction is carried out by the applicant as set out in the app
* You must have a specific transaction that you’re trying to implement, it’s not a general statement of what the provisions of the ITA mean, rather you have a specific transaction and want to know what the tax consequences will be
* Can also ask for a “technical interpretation,” which requires no fees and they won’t give you a binding ruling, but they will send you a letter saying “here’s what we think of provisions of income tax and cases relating to them.” Rulings directorate can issue, upon request of taxpayer, written interpretations on completed transactions (so not advance) and provide over-the-counter advice and assistance on general matters.

Assessment and Dispute Resolution

* self-assessment: taxpayers figure out income and file a tax return, the T1 form.
* If we don’t file a return, we get audited or get an arbitrary assessment.
* Self-assessment is received by the govn’t, Surrey tax centre reviews the return and ensures it matches the tax slips companies are returning. They look for issues and problems and if there are problems, they can then re-assess; they can change the initial numbers filed by the taxpayers and revise them or even add new numbers. I then get a notice of assessment letting me know the outcome of their assessment. And if we don’t like what they’re telling us, we can file an objection. This starts the appeal process through the CRA hierarchy to the appeals office. If we’re not happy there, then our next recourse is the Tax Court of Canada.
* CIBC World Markets: CIBC tried to get their costs following their victory, as CRA was unreasonable in light of outcome in not settling. Court said CRA cannot accept compromise settlements. Cannot compromise their duty to enforce the ITA.
* CRA cannot accept compromise offers like ordinary litigants would depending on their chances of winning in court.

Remission Order

* Alternative to this legal process of appeals.
* If somebody is facing tax or a penalty and they feel the imposition of this tax or penalty would be unreasonable, or unjust, or would not be in the public interest, (not necessarily a legal basis), they can apply to the Treasury Board under the Financial Administration Act s.23(2) and it determines whether the taxpayer has a story to tell to avoid this tax or penalty imposition. They can give relief from taxes or penalties to someone where there is no relief under existing tax law. The outcome of these applications are published in the Gazette federally.
* may work in cases of extreme hardship, incorrect action or advice by the CRA, and financial setback plus extenuating circumstances, and unintended (inequitable) effect of legislation.
* businesses from the US coming in for the Olympic games, wanted remission from income taxes from the goods and services they were supplying in Canada. Remission was given to facilitate the Winter Olympics.
* If the LT gov considers it in the public interest to do so in a case or class of cases where great public inconvenience, great injustice or great hardship to a person has occurred or is likely to occur, the LT may, by a regulation of general application or applicable to a class of persons, or by order related to a specific case, may authorize the remission of any tax, royalty, or fee.

Tax Avoidance and Evasion

* Taxpayers are entitled to select courses of action to minimize their tax liability (Tax avoidance) but must be open, secretive is tax evasion, which is subject to criminal prosecution. Criminal prosecution for tax evasion goes through criminal branch of provincial court system, to BCSC, to CA, to SCC. Criminal prosecution requires proof beyond a reasonable doubt. Mens rea is also required, did the taxpayer have a relevant intent to avoid income taxes.
* Civil penalties: under ITA we also have civil penalties when Crown can’t prove the intent to evade taxes and it’s an inadvertent mistake, that is when you get dinged for civil penalties

Returns and assessment

* We’re looking at our activities from January 1st – December 31st, calendar year, and file a tax return relating to those activities.
* This tax return is due April 30 of the following year. We pay any taxes owing on the balance-due day that day as well s.248(1). Or we can file tax return and arrange to pay the taxes on a future day. File a return even if you can’t pay right then to avoid the penalties for not filing a return, which could lead to charge of criminal tax evasion. If you don’t owe any taxes, don’t need to file
* if you’re self-employed, because individuals with business income, it can be more complicated to prepare your tax return and so you have until June 15th instead of April 30th to file their returnin relation of to their business income. However, they are charged interest on taxes owing if they don’t pay the balance in April
* CRA can demand a return at any time (s.150(2)).
* You have 3 years to amend your return, after it’s due date on April 30.

Penalties for not filing

* if the not filing was with the intent to evade taxes, then there can be fines and imprisonment. Crown must prove there is actus reus and mens rea, these are criminal offences with severe penalties. If there is no criminal intent but there is a violation of the ITA, then civil penalties Repeated failures result in climbing penalties, civil penalties get increasingly severe.
* IC 00-1R: Voluntary disclosures Program: Taxpayers may avoid being penalized or prosecuted if they make a valid disclosure. Come forward with unreported income and the taxpayer can avoid being prosecuted criminally for tax evasion and any penalties related to criminal prosecution won’t be imposed and can avoid civil penalties if they make this disclosure to CRA before the CRA starts to suspect them. Voluntarily discloses the taxes that are owing and pays them plus the basic interest (basic interest on taxes owing is currently 5%).
* It must be voluntary, they must be at least a year overdue, they must be facing penalties, and they must make full disclosure, disclose the undisclosed earnings and pay taxes on them.
* Tax amnesty: amnesty for taxpayer, won’t be prosecuted. As long as they come forward voluntarily and are facing penalties for being more than one year overdue, but come forward with full disclosure. Only have to pay tax in arrears with basic interest, no penalties.

Class 5

Dispute Resolution

* CRA h as 3 years from the original, quick assessment to make additional assessments to the tax payer. If the tax payer takes exception to these documents, he can file a notice of objection, disputing the tax liability from the assessment, reassessment, or additional assessment. This moves the taxpayer’s file from the basic assessing part of the CRA to the appeal part of the bureaucracy and sets a stage for subsequently, if the taxpayer doesn’t get satisfaction from CRA, taking appeal to the courts from TCC to FCA to SCC.
* Alternative dispute resolution has little role to play because the minister is required to comply with the Act and no compromise is permitted under income tax scheme.
* Remission Order: where there’s no legal ground for an appeal, but there is a hardship argument or social/political consideration, personal circumstances. TCC is there to resolve legal disputes and can’t entertain compassion, so route to take is remission order, goes through Treasury Board federally and to the cabinet provincially.

Avoidance vs. Evasion

* Duke of Westminster: taxpayers are entitled to take the most favourable method, most tax-efficient method for entering into a transaction. Entirely legitimate. That is the basis of tax-planning or tax-avoidance, where people get tax advice to minimize the tax consequences.
* Becomes bad if it becomes tax evasion: where the taxpayer is withholding or wants to withhold facts from the CRA. Doing transactions that appear to be doing one thing but doing things under the table not in the agreement.
* Tax avoidance: open attempts to take advantage of the tax laws by arranging a taxpayers affairs to reduce the amount of income tax payable. It’s all open to disclosure.
* Jarvis: Jarvis commited the actus reus of tax evasion by not reporting income but he avoided conviction by establishing that he did not have the mens rea, lacked the intention to commit tax evasion. This failure to disclose income was due to extenuating personal circumstances (grief over death of his wife). Tax prosecutions often fail for this reason: can’t prove mens rea for tax evasion beyond reasonable doubt. In which case, settle for civil penalties.
* SCC says only voluntary part is that the taxpayer files their own self-assessment, they can’t make omissions or fail to file. In other words, self-assessment is a myth – it isn’t up to the individual as they are subject to scrutiny of the CRA.

More on Penalties

* Must pay the taxes plus the amount of the civil penalties. If a taxpayer has repeated failures, the penalties go up, the amount goes up with repeated failure.
* If guilty of tax evasions, you can be charged with both criminal and civil penalties as well as the taxes owing with interest. Govn’t can stack it.
* Interest rate is 3% on refunds. The interest rate charged on late payments is 5%. The charge for arrears of taxes is always 2% more than the rate the government pays you if it owes you money back. Rate charged on arrears taxes starts right on April 30th, whereas interest on tax refunds doesn’t start until 45 days after April 30th.

Principal residence

* Principal residence and the land surrounding the property are all free of tax. Any capital gain on the sale of the principal residence is free of tax, as long as the taxpayer or a family member is living there – the gain on the sale is tax-free.
* Can only have one principle residence per year.
* Cannot claim this if you are not a resident of Canada.

Tax-free Savings Account (TFSA)

* a taxpayer can put up to $5000 a year into this account and can use that money and invest it, and there are no tax consequences on the income or capital gains earned on that money.
* Interest income on term deposits in the TFSA are tax free, investing into bonds, etc, are tax-free. If you want to buy something, take money out of the account, buy whatever you want, and the following year you can put $5000 back in and another $5000 for that year.

Anti-avoidance provisions

* to counteract avoidance and abusive tax planning. Anti-avoidance provisions are that they can lead to civil penalties, which are not tax deductible.
* To maximize adverse impact, these penalties and fines are not tax deductible s.18(1)(t). Interest on taxes in arrears are also not deductible.
* Tax evasion is deliberate, wilful violation of ITA and are subject to criminal prosecution in criminal court and criminal fines are also not tax deductible.

Tax Havens

* countries that do not have tax treaties with Canada; under these treaties, there’s provisions for exchange of info between countries party to them; these countries are outside the tax treaty system and do not disclose information, the banks won’t disclose banking information regarding the transactions of their customers in those countries and are not required to do so

Self-Assessment Process

* Jarvis: we file our return on April 30th of 2013 for 2012, then the minister with all due dispatch is required to assess this return then the minister mails out the original/quick assessment, aka the initial assessment, which gets to you around June, where they calculate info and crosscheck with info slips and such looking for inconsistencies.
* From the date of mailing of this original assessment, 3 years starts to run, this is the basic limit for the taxpayer to amend their return – say, if they find a deduction they miss
* 3 years for a reassessment by the CRA, to include additional assessments and impose new taxes
* we must keep our tax records and documentation for six years. CRA does not keep records
* Refunds: where overpaid taxes or excess employment income tax withheld. Repayment of excess income tax, like if withholding by an employer from 2012, get it back in 2013.
* taxpayer can waive the 3 year limitation period and allow assessment to occur after that period.
* No limitation period if taxpayer made misrepresentation in the tax return that is result of neglect, carelessness, wilful default, or fraud.

Arbitrary/Net Worth Assessment

* For people who don’t file tax returns and are out of the systemor people who file tax returns that govn’t considers a crock, they can simply say let’s start again with a new method
* govn’t can estimate a taxpayer’s income for the year. Networth = your assets minus your liabilities. CRA can simply do it for them if they won’t do it
* CRA just assesses their assets and liabilities to get your net worth as of January 1. Dec. 31 they can make another assessment of the same calculation. The difference is considered the taxpayers’ income (after asking what the taxpayer paid on food, rent, entertainment, etc – this personal expenditure is added back as well).
* This is a rebuttable presumption – it is up to the taxpayer to reduce that figure for taxable income. Increase of net-worth plus personal consumption, and then the taxpayer can rebut.

Class 6

Interest

* Interest starts accruing 45 days after April 30 for overpaid taxes/refunds.
* Interest starts april 30, immediately, for taxes in arrears, even for those that are self-employed

The Fairness Package

* the taxpayer relief provisions. They confer upon the minister discretion to relieve taxpayers from some of the deadlines, interest charges, and penalties under the ITA.
* Minister has discretion to provide refunds to taxpayers beyond the normal limitation period. if the taxpayer going over their tax returns finds they are entitled to a deduction way back when, say 2008 or 2007, and they didn’t claim it, the 3 year limitation period would bar them from making that claim but the taxpayer can make that claim and ask minister to relax the limitation to get a refund. This can be done up to 10 years back.
* Another discretion of the minister is to waive interest.
* Taxpayer may make “elections” after statutory limits up to 10 years. Wiggle rooms for taxpayers to get out of civil penalties, time limits, and interest.
* if your discretion is denied, you can make an objection and get judicial review

Objections and Appeals

* cases start with an objection. An assessment under ITA is presumed valid unless challenged by the taxpayer by disputing it through the procedure of an objection. this is done by sending a written objection to the CRA and this moves the taxpayer’s return and file from the basic procedures of the CRA to a special branch: the Appeals Branch.
* Then we get a decision from the CRA about the objection. If they reject it, taxpayer can appeal further from the appeals branch, take it to the Tax Court of Canada.
* The onus of proof is on taxpayer – has to show a factual error, for instance, in Minister’s assumptions resulting in assessment. The CRA makes assumptions of fact when making re-assessments and it’s up to the taxpayer to rebut and disprove the assumptions of fact in assessing the taxpayer (Johnson).
* you have 1 year from the date of return (April 30) or 90 days from mailing notice of objection, whichever is later.
* Objection is mailed to a specific branch of the CRA, and will move up to the Tax Services Appeals, to the Regional Appeals Office, where 93% are resolved. Then to the Head Office in Ottawa, where lawyers go to make their case to the ministry of the CRA.
* if you don’t hear back from the CRA within 90 days from notice of objection, you can take the appeal to the tax court.
* Tax Court: Idea is that pleadings are minimal and rules of evidence don’t apply and tax payer can represent themselves in this informal procedure. There is however a monetary limit and the amount of taxes in issue cannot exceed $12,000 or the taxpayer’s loss cannot exceed $24,000. Costs won’t be awarded against the taxpayer. Informal procedure and appealable to FCA
* For amounts over that $12,000 limit, you get the general procedure. Here there are legal representation, costs, and also an appeal to FCA possible. One needs a lawyer here and CRA will be represented by DOJ lawyers
* Within 30 days from TCC judgment, taxpayer or CRA can appeal to the FCA.

CRA Procedure in Disputes

* CRA will refund dispute taxes immediately upon the notice of objection or the appeal. You don’t get to keep them: CRA wants them back and will try to prove their claim.
* CRA charges interest at its rate of 5% on those refunded taxes. So if the taxpayer loses the case, those taxes will be payable with that interest.
* CRA will not attempt to enforce collection of the taxes during the objection and appeal process.
* there’s a 10% frivolity penalty by the CRA where there are no reasonable grounds for the appeal. Where the main purpose was just deferral.

Settlements

* the CRA cannot split the difference or knock off part of the amount to settle. They cannot enter into agreements except as permitted by the law. Galway: most go in accordance with the law and not make compromise settlement, confirms principle that the tax settlement has to be on the facts and the law with no room for accepting a compromise just to get the things over with.
* Even if CRA would’ve done better with the settlement, couldn’t accept the settlement as it wasn’t based on facts and law ,just a compromise.
* However, if there’s a dispute on the facts – we think the facts are this, CRA thinks facts are that, it’s a question for the trial court to decide, if there’s a fuzziness on the facts, the compromise settlement can be upheld. Or if the law isn’t clear: cases going one way and other cases going another way, the compromise can be upheld.
* Settlement is not binding on the taxpayer even if circumstances are such that a settlement can be made and was agreed to, Consoltex, the taxpayer can renege

Audit

* desk audit: where they just look at the return and compare to info slips of the different taxpayers that income was paid to taxpayer, compare income slips to the return. Can have audit without taxpayer’s presence (desk audit) or an audit with the taxpayer present (office audit).
* Field audit: entry into business premises and dwellings (with consent or warrant): s.231.1.
* broad powers to demand information and documents in this audit process s.231.2. They can demand from the taxpayer or from his bank.
* Taxpayer is obligated to help
* Can conduct inquiry, put you under oath, at which point you can demand a lawyer
* There is no right to silence, must produce financial records
* The audit can go on without Charter rights until the CRA’s predominant purpose and the inquiry goes from a civil question of what the proper taxes to be paid are, interest, civil penalties, to questions of tax evasions and penal liability, then Charter protections apply.
* Jarvis: After civil investigation, criminal charge of tax evasion against Jarvis. All the documentation collected during the civil audit procedure was offered as evidence by the Crown. Jarvis said that we were now in a criminal proceeding and you’re using evidence that was obtained without my Charter rights.
* SCC ruled against Jarvis: while the audit procedure is going on, the taxpayer has no rights and it is only when crim investigation begins that Charter rights kick in. Here, the crim investigation began when the file went from the audit section of the CRA to the special investigations section. It was then that they were ruled to have gained the “predominant purpose” of pursuing this further of predominant purpose of criminal prosecution of tax evasion. But up until the point where that predominant purpose is reached, we as taxpayers have no Charter rights. Only when the CRA starts thinking it’s tax evasion.
* Evidence from civil audit is admissible in criminal proceeding. No Charter rights violated until CRA’s predominant purpose became criminal prosecution
* When does CRA reach this point? Court was concerned that CRA might drag its feet and not bring the file to special investigations until they’ve gotten loads of evidence. They say it is only when over 50% of the reason is considering crim prosecution that Charter rights kick in.
* Relevant charter rights are s.7 against self-incrimination, s.8 for unreasonable search and seizure, and s.10’s right to counsel.
* Jarvis was acquitted due to lack of mens rea

Collection Powers

* CRA act as a creditor which is owed money by taxpayers and these tax arrears are debts owe
* CRA doesn’t have to go to get money judgment or execution judgment, they just issue a certificate to themselves that debtor owes taxes which is equivalent to a judgment, and they file that certificate with the federal court or BCSC, that takes effect as a judgment of that court.
* no limitation period to collect for CRA. Also, while the money is outstanding, interest accruing.
* Notice of Assessment, April 30th, we have 30 days to pay the taxes, after which point we are subject to collection.
* CRA can seize gifts from their recipients as a means of collection. s.160.
* s.224: “third party demand,” this is the taxpayer having a bank account. CRA files this third party demand on the bank out of the court registry and serve it on the bank, who freeze the account. they remit the bank account proceeds as necessary to satisfy.
* s.225: seizure and sale. CRA can call the collections department, private enforcement. Employ court bailiff services to seize personal property of a tax debtor and sell it to satisfy debt, any balance left is given back to tax payers
* s.223: liens on real property. File the certificate registered with the court on the title of the debtor’s property. This can lead to court ordered sale to settle tax debt.
* If a tax payer is in financial trouble and cannot pay all creditors, Crown has priority

Options for the Indebted Taxpayer

* pay off the debts, either with available cash, selling assets, or even borrowing.
* Work on a repayment plan with CRA – you need a plan that CRA will accept and will fit with your other monthly commitments, this is giving time to pay and the Collections Branch will get taxpayer time to pay, so much a month or so much every two weeks until taxes owing are satisfied. Under CIBC case, these arrangements are not binding on CRA, as this is a settlement/compromise to accept money over time that is owing from the outset.
* Apply for CRA Fairness Package: this govn’t program can reduce the interest and penalties, though not the principal portion (can’t compromise).
* file for personal bankruptcy. Only way CRA can write off these debts and stop harassing debtor. They become an undischarged bankrupt for a while, they eventually they can get discharged and resume their right to own property. While undischarged, the trustee in bankruptcy will get all the income, assets, revenue that the taxpayer earns while an undischarged bankrupt. This can take 9 months where they have no surplus income, then can apply for discharge. if they do have surplus income during the nine months, they can apply for terms of discharge after 21 months.

Class 7

Illegal Business

* still adds to your revenue/income. The expenses of your illegal business are also deductible.
* Eldridge: when it comes to illegal businesses, you compute your income like any legitimate

Damages

* some money is not a compensation for a loss, while others are not compensatory. If some part of the fund is compensatory and some is not, you can’t just say it’s not taxable. You have to break it down and allocate according to the source concept
* Personal injury claims and wrongful death are distinctive and ARE tax-free. Restitution for loss of employment is taxable.
* A person who commits a tort and has to pay damages, but they committed it in the course of employment, it may be deductible. As long as the damages come from something that was in the course of business, it is tax deductible.

Surrogatum principle, damages, and interest

* question of whether a sum of money received (or expended) ought to be taken to be taxable...where it’s compensation for a loss which, had the money been received it would have been income, the compensation is to be treated in the same way as that sum of money would have been had it been received
* Had there not been a loss, would the profit have been taxable? If that profit would have been taxable then compensation for the same loss would be taxable. As insofar as it is compensatory, it is a substitution under surrogatum so it is taxable.
* Fees charged for missed appointments are taxable: they’re substitution for the fee the dentist would have gotten had the patient showed up as was planned
* Contract cancelation fee are liquidated damages and fit in surrogatum
* Damages for personal injuries or wrongful death are tax-free. What if some of the elements of damages are measured by what the person’s income would’ve been? The fact that it’s measured by that loss does not change it’s essential character: it’s still damages for personal injuries and, as such, is tax-free.
* Bellingham: Land was expropriated. Taxpayer received compensation for the value of the land. But the town had undervalued the value of the land, so taxypayer, B, got a top-up in compensation for that. there was interest on delayed payment
* surrogatum principle and have to look at what the money is being paid for and what it’s substituting for.
* compensation for the value of the land –The land having been acquired by B as a business venture, the compensation was included in the taxpayer’s income for a business. The land was in effect an inventory of a speculative business by B and if B had sold the land in the ordinary course of buying and selling property, that amount would have been part of the selling price and income from business and so compensation for not getting that selling price and having to fight for it, that compensation under surrogatum principle is business as well.
* court said that this was interest from business, not capital gain. She was speculating in real estate and this profit was thus income from business, so whole amount had to be included
* Interest that is awarded as compensation for non-payment of a claim (damages) that are awarded under court order interest act or the expropriation act; it’s a type of damages
* Damages take character from the underlying sum: so if the damages are compensation for business/income from business, than the interest is also income from business.
* Make this determination by looking at the motivation or the purpose – why did B buy this property? Did she acquire it to hold it (in which case, an investment) or to flip it, sell it at first opportunity or a profit. court said her motive at the time of buying was to resell it not to hold it, so income from business.
* Even someone who is earning income from something else they can also earn income as a developer or speculator. A person who is a speculator in assets can have an “adventure in the nature of trade.” It can even be a one-off transaction.
* Ordinary interest was also income from business, because any profit from the land was income from business. interest follows the characterization of the underlying claim
* 3rd sum: the additional interest. Court says really a punitive amount. It is tax-free money. Punitive damages are meant to be a deterrent, penalizing the town for excessive delay. if a sum is meant to be a deterrent/penalization and NOT compensatory, it is tax-free

Class 8

Schwartz

* Schwartz was fired, the contract of employment was lost before he had actually started to work.
* Normally, hired, when work starts they get employment income (taxed remuneration for service), then when job ends, we can ding them with another source, the “retiring allowance.”
* SCC: actual employment doesn’t begin until the person actually starts work, that’s when they are considered to have entered service.
* This could not be employment income as he had not yet entered service. Employment income is “while in the service of.” If he’s fired after that point, the source is gone and the contract is terminated so money he gets after that is subject to taxes as a retiring allowance
* retiring allowance is a compensation for loss of employment. But he lost a contract and NOT employment, as he was never employed, was never “in the service of”.
* CRA argued it wasn’t employment insurance or retiring allowance, but it was a lot like those, so should be treated as an unenumerated source, that is simply LIKE income, it just has that income feel to it and should be taxable. (s.3(a)).
* SCC: parliament having specifically enacted the definition of a retiring allowance as specifically limited to someone getting compensation for loss of employment, strictly speaking, Schwartz didn’t fit in that category and his settlement was tax-free, it counts as a wind-fall, this was not caught by any recognized source. It’s up to parliament, not courts, to add sources.
* it is possible to have unrecognized source of income but not when parliament has been so specific in trying to define income of this sort.
* Not surrogatum: This was to compensate for loss of contract of employment and the embarrassment, anxiety, and inconvenience. What they were compensating for was not necessarily for loss of earnings, at least portion of it was like nervous shock or mental distress. CA had tried to apportion between taxable and tax-free parts. SCC said no factual basis on which the CA could make this apportionment. That principle can’t apply and the whole sum is tax-free because there’s no basis on which to separate the heads of damages as distinct from embarrassment/anxiety/inconvenience, nothing in the wording of the contract.
* A unitary sum of money can be allocated by the parties if they are bargaining, that allocation will be accepted by the courts.

More on Damages

* Heads of damages: loss of capital asset/contract or compensation for lost earnings (taxable), punitive/exemplary damages (tax free), mental distress damages (tax-free), defamation (tax-free), discrimination/harassment (tax-free)
* Damages the defendants paid are deductible as an expense regardless of how it’s allocated
* no deductibility for legal costs for Schwartz. The winning party doesn’t get complete indemnity from the losing party and there would be extra legal costs that Schwartz would incur and he could not deduct those from the amount he recovered.
* Defendant: the damages are tax deductible, it reduces their profit for the year.

Surrogatum

* he’s getting money, what is it for – it’s for being out of business for a week.
* Taxable if the sum is substitute for the earnings he’d have been made
* Income for business or property is taxable, surrogatum principle applies.
* Damages for personal injuries is tax-free money, unless a person is getting damages from employer to supplement not being able to work – that will be counted as income from employment.

Losses

* if revenue is taxable than the expenses are deductible. You are taxable on your net income, or their PROFIT if the revenue exceeds the expenses. If the expenses exceed, you have a loss.
* It is possible to get a refund for previous taxes paid (loss carryover) but no refund in current year for a loss.
* Current year losses: can have losses on employment, business, or property (investment). Basic story is that in computing your taxable income for the year you add together your sources of income that are the recognized sources that are positive and subtract from those positive items the negative items/the sources that have losses. Losses are deductible against income from all other sources. This net figure is your total income.
* So one loss can negate two sources that post positives
* The most income can be reduced to is zero. It’s just no income for the year. The excess of red over black becomes a “non capital loss carryover.” This excess can be carried over to other years. You have to reduce to income to zero first, but the excess of what can be deducted against profits is now carried over, meaning it can be deducted against anything in other years.
* you can go forward up to twenty years or go back up to three years with this carryover and deduct the loss on the income in those years. This is for non-capital losses.

Capital losses

* when you’re holding onto something that’s an investment and it drops in value, the paper loss is the accrued loss – it’s not realized, it’s only realized upon sale of the assets.
* Capital gains and losses are calculated upon realization.
* Capital losses are only deductible from capital gains. Realize their losses by selling their losers before years end, must also sell winners to offset the losers to get tax relief on their accrued gains. only ½ of a capital loss is deductible and only ½ of capital gain is taxable. ½ deductible is the allowable capital loss and the ½ taxable is the taxable gain.
* there are net capital loss carryovers, which can be carried over to other years.

Class 9

Losses cont’d

* Loss entitles a taxpayer to no refund in that year.
* We net out losses from ordinary sources, excluding capital gains/losses, limited to the current year. Losses from ordinary sources are deductible from all other sources.
* The losses must be claimed. If you don’t use it, the CRA will not let you use it if it could’ve been used for deduction in the current year (your income wasn’t brought down to 0)
* Losses over what was necessary to reduce your profits the previous year to zero are carried over

Capital Gains/Losses

* A capital property, like land and a building or corporate stock, the calculation of a capital gain on the sale or disposition of property is that you have the proceeds of disposition (selling price) minus the adjusted cost base (the purchase price) plus the selling expenses. If the proceeds are greater than the combination of those two items, it’s a capital gain, if not, it’s a capital loss. ½ of capital gain is the TCG and ½ of the capital loss is the ACL. The TCG and ACL are netted against each other to produce a net capital gain to be taxed, or a net capital loss carryover.

Capital Cost Allowance

* depreciable property? In accounting, assets other than land wear out.
* ITA – instead of depreciation, it’s capital cost allowance, CCA, a deduction allowed in computing business investment income to recognize the obsolescence of assets.
* For tax purposes, we pay sum of money for this building and get to write it off CCA over the profits of the building as an asset used to earn property or business income.
* You can have a capital gain on the sale of a building but you cannot have a capital loss on the sale of depreciable property. We buy this building for $100,000 and can only sell it for $20,000. There’s thus a decline of $80,000 from what we paid. That $80,000 will be claimed over the years as capital cost allowance, that is depreciation over the years, or it will be recognized as terminal loss. There is no capital loss however on the sale of a depreciable asset.
* The land underlying the building, however, is NOT depreciable.
* Bellingham: unitary sums must be allocated over the various components. You must allocate that purchase price over the land and the balance to the cost of the building. Cost of the
* We write the building down through annual deduction, when we bought we allocated $100,000 to the building and over the years we deducted CCA and reduced the “undepreciated capital cost” and claimed $90,000 of the $100,000 purchase price over the years and now we sell it for $25,000 – ITA has allowed us to write down this building for more than actually the amount of its declined in value – we’ve written it down to $10,000 but in reality, it’s only declined $75,000 and the difference between the $25,000 and the $10,000 must be added to income. But there’s no capital gain.
* Vacant land does not qualify for CCA, gets no tax relief and is often regarded as, in Bellingham, speculation and the sale price is thus treated as profit from a business rather than capital gain.

ABIL (Allowable Business Investment Loss)

* ITA gives an incentive that the risk of the loss of the business failing and the loan not be repayed or the stock becoming worthless, this loss would be an ABIL. It would be like a capital loss: only ½ allowable, but unlike capital loss, this is deductible from ALL sources of income
* Restricted Farm Losses: where someone is farming as a side-line business and this farm suffers a loss, these are restricted farm losses. Maximum that can be claimed as a loss in a taxable loss is $8750, the rest is automatically carried over to other years. If it’s an outright hobby farm, that is farming chiefly for pleasure, there is NO loss relief. Not a source of income

Loss Carryover

* excess loss from the year can be carried over to previous years.
* If you carryback to a previous year, you get a refund from the government of the taxes that were paid in that year, though you don’t get any interest on that refund.
* If you carryforward to future years, you’ll reduce your income in those future years. No refund, it just lowers your tax liability in that future year.
* You must claim the loss in the current year as much as possible, but you can go back three years or carry forward up to 20 years, after which the loss expires.
* net capital loss can also get carryover to other years, but only against capital gains. You can carry it back up to three years and you can carry it forward up to the year of death.
* In the year in which the person dies, there’s a more generous tax relief and any excess net allowable capital losses can be deducted from all sources of income in the year of death and the year immediately preceding the year of death s.111(2).

The Taxpayer – liable on income you’re beneficially entitled to

* they can be of any age. A person could be a company or it could be an individual
* each individual family member is a distinct taxpayer.
* The company and each shareholder is also a separate entity. In a corporate group, each company is a separate taxpayer.
* Trustee/beneficiary relationship means trustee has their own tax liabilities, but also responsibility to file tax returns on behalf of the trust or the estate for a deceased person. The beneficiary is also a distinct taxpayer from the trust.
* A person is liable to pay tax on income if they are beneficially entitled to that income, to spend it as they see fit, that’s their income. if it passes through the hands of someone who is not entitled to spend it, they are not personally liable for tax on that income, so a trustee is not personally liable for the taxes of the trust (the beneficiary, who is entitled to its income, is).
* Partners in a partnership are taxable on the income from that partnership with income allocated according to the business partnership agreement. It’s income from business for the partners
* Income from investment is also income from business.

Tax consequences of embezzlement

* CRA takes the position that the embezzler is carrying on a business and the victim should suffer
* Field: Field established an RRSP, a scheme where you contribute a % of your income every year into this plan held by a financial institution and the contributions are tax deductible each year. No taxes paid on the accruing money in that plan until the time it is withdrawn.
* There’s also savings account, the gains accumulate tax free and money can be taken out tax free, but you don’t get tax deduction on way in.
* Field put the money in and got the deduction; they have joint bank account and in breach of fiduciary duty to Field and crime of embezzlement, she made unauthorized withdrawal, took the money out of the RRSP, and put it in their joint account and took the money
* CRA was sympathetic to the taxpayer, Field, and said you are taxable on the withdrawal from your RRSP even though wife took it. CRA argued that Field got a deduction on the way in, the money has been taken out of the plan, therefore Field should have to pay tax on it.
* Court said he’s not taxable on this money because he never received it and so was not beneficially entitled to it – he was in law, but never got it, so can’t say it’s his income.
* sensible thing to do would be for the minister to include the amount of the fraudulently acquired funds into the income of the offending party, make the wife taxable on the withdrawal.
* no nexus between him and this money because he was not the recipient of it and was not beneficially entitled to it insofar as he couldn’t spend it.
* For the wife, this was called business income – she had two lines of business, an investment consultant and her second line of business which was embezzlement.
* Can Mr. Field get loss relief? Problem here is that the victims of embezzlement do not have a source of income, so there’s no tax relief to Field from his losses.

Buckman (illegal practice as income from business)

* CRA said he was taxable on these embezzled funds and he said this wasn’t right – law practice is my business/profession and is taxable, but I’m not really entitled to the money I’m stealing – if they found me, I’d have to give it back, so I shouldn’t be taxable on it.
* Tax Court said Buckman have two lines of business – Buckman is a lawyer, that’s business #1, and embezzlement which has “all the earmarks of a business.” Embezzlement is a second business and the profits of it are taxable.
* Profits of embezzlement are taxable as income from business and repaying the money to the clients is deductible as a loss from the business of embezzlement in the year in which the moneys are repaid.
* Court didn’t accept the argument that he wasn’t beneficially entitled to the money – he was technically correct, he’s not entitled legally, but he behaved as though he was entitled to it, and that’s enough to make it taxable

Class 10

Nexus of Income

* Based on Field and Buckman, the nexus and the taxpayer and the source of income is that the taxpayer receives the money from the source and is beneficially entitled to it/has the benefit
* Court said the joint account was just a conduit to get the money to her, he got no benefit. If he recovered the money from Mrs. Field, then different tax consequence to him. Mr. Field had no nexus and no source, she had taken the source. However, if he did get the embezzled funds back, there’d be different tax consequences. So he got a deduction on his RRSP contributions but on withdrawal, they went to the spouse’s income instead. CRA has said that RRSP is a method for deferring tax, not avoiding. So when you take the money out, it should be taxable. Person who got the deductions will have to include withdrawal in their income.
* you have to receive the money and be beneficially entitled to it in order for there to be a nexus, the person is using it and spending it

The Earmarks of a Business

* Buckman: there is entrepreneurship, repeated transactions (acting as a trader), he has a method (system), he has reward of profit/a risk of loss, and he has a profit motive.
* judge says he’s doesn’t care about GAAP: income and profit are legal concepts, not accounting concepts and the accountants view of what is income, profit, or business is his view, can be a question of fact given to the court, but it is not decisive. Profit is rather a matter of rules of law, ITA, and case law. So here, regardless of what accountants think, this is business in law.

Ponzi Schemes

* early investors into a ponzi scheme get the rewards and the later investors drawn in by the returns to the early investors get nothing. They get the moneys embezzled from them.
* Johnston: Johnston was an up investor, early investor. Judge agrees she doesn’t have a source. Said it was like gambling – her phenomenal return on this ponzi scheme was a windfall and so was tax-free. This leaves the down investors in a bad situation as they are also not considered as having a source, and what applies to the up investors applies to them, so Johnston is tax-free for having no source while the down investors get no tax relief for their losses.
* The embezzlers would give the investors info slips, T4s, saying what their returns were, which were fictitious, as they hadn’t earned a thing. So the victims fight for tax relief, complaining to CRA and asking them to refund the money they paid to them in taxes in regard to these info slips we got that indicated fictitious income. CRA has issued no response.
* Courts are generally saying there is no source here, so no way they can give relief. But there may be a case for hardship, try for remission order from the government.

Income splitting

* Where only one person in the family is an income earner, there is a tax disadvantage, he’d be more heavily taxed, but if he can split the income and transfer it from himself to the other family members then he can get into a lower tax bracket and split the income and tax liability amongst the various members of the family unit (each a distinct taxpayer) while retaining the benefit of the money within the family, since they’re all living under one roof.

Attribution

* rules that attribute the split income back to the original earner. The act contains provisions designed to counteract income splitting, generally attributing income from its legal owner to someone else for tax purposes
* attributes ownership and tax consequences to the original person as opposed to the recipient. Counteracts income splitting, it’s like a boomerang effect: taxpayer gave the money away but the money comes back and the taxes come back.
* Focus is usually on family members/related persons.
* Courts are very reluctant to apply these rules, however.
* enacted the “kiddie tax” which is a tax on certain types of income received by a person under age of 18, that income is taxed at the highest marginal rate (43.7%), which defeats the purpose of splitting an income with a child. Does not apply to employment income or business income received by the kid if the kid earns salary or fees in way of business income.

How to split income

* If employee earns employment income, very hard to split income. If the family member is qualified, it is possible to split income with them by asking employer to amend the contract of employment to allow an assistant or substitute, who I will pay a salary out of my salary. Result is that I reduce my employment income because it is a deductible expense.
* Income from business: For this, the taxpayer must make a contract of service that makes the family member his employee. s.67 is a general rule that the expense must be reasonable in amount to be tax deductible. It’s not so much the purpose of the expense but rather the amount relating to the value of the services rendered by the employee.
* Boutillier: it must be scrupiously documented so it conforms with the transaction. Boutillier didn’t handle the paperwork at all. So in this context of this employee, he was trying to split income by hiring a family member as an assistant, but this requires documentation in his contract of service with the employer, and then he must have a contract of service with the family member, all of which must be documented paper-wise.
* Partnership: taxpayer is a partner with family member and in the arrangement they have an agreement for how the income will be split between them. There’s a partnership contract between them that details this. Split according to partnership agreement and each partner pays tax on their share of the income. So income can be split so long as it’s documented and the provision of income follows the partnership agreement, then it will pass the CRA’s scrutiny.

Splitting Through Incorporation

* Incorporate a corporation: enter into a contract of service with that corporation, which is a legal entity, and the lawyer incorporating the law corporation is another separate person and there can be a contract of service between the lawyer with their law corporation, and family members can meanwhile be shareholders of that corporation. They can have non-voting shares in the corporation under Legal Profession Act. This is used to split income – the law corporation will pay the lawyer a salary as an employee, which is a deductible expense when computing the income of the corporation, and the corporation will pay tax on its income that would be its revenue minus its expenses
* Neuman: It is possible to split income with family members through dividends, and incorporating a company and having family members be shareholders and splitting income from the employee through the company to the shareholders.
* can also income split through family trust

Class 11

Non-Arms Length

* s.67: taxpayer and a family member making a transaction together, something that is a non-arms length transaction because it’s between family members means it’s apt to be scrutinized by the CRA. Transactions between spouse and common law partner is open to scrutiny and transactions with child or grandchild under 18 is also open to scrutiny.
* easiest way to split income is if family member wishes to become actively involved in the work of the taxpayer. If they want to work, the taxpayer can pay a deductible remuneration) or the individual family member could be hired as an independent contractor, meaning this taxpayer is paying someone business or professional fees for some kind of service.
* Other possibility is the family members becoming partners in a business, they can divide the profits according to the partnership agreement.

Family Company

* Neuman: taxpayer can incorporate a “family company” with the family members as the shareholders. The company would earn the income and the taxpayer could be an employee of the company getting a salary from it, reducing the company’s profit by the amount of that salary, and then the company would pay taxes on its income and the after-tax profit of the company could be paid out to the family members as a dividend.
* Neuman rule is that the company and the shareholders are distinct taxpayers – the company’s earnings are its own earnings. A company is thus taxable on its own earnings and the after-tax profits are available either for retention by the company (retained earnings) or they can be distributed through a dividend, becoming income for the shareholders, who are taxable on it
* Paying dividends is not deductible, it’s just a distribution of wealth/profit.
* You can receive $30,000 in dividends tax free and the rates on dividends are much lower due to dividend tax credit. The shareholder and the company are integrated so the tax paid by the company is credited to the shareholder as if the shareholder had paid it, who then computes this tax credit and gets a break.

Family Trust

* a trust and the beneficiaries of it are the family members.
* In Boutilier’s failed argument, he put the shares of the family company into the family trust and the idea was settlor becomes the trustee of the shares in the family company and the idea was that the trustee in the family trust has a discretion to sprinkle dividends over the various family members/beneficiaries. Discretionary power. The family member thus becomes a trust beneficiary and the money earned by the business goes to the trust and the trustee would decide how to distribute those dividends through the trust as income for the beneficiaries.
* So trust beneficiaries receiving income instead of as shareholders. Trustee can also decide not to give income to bad kids, can show favouritism, discretion allows them to divvy up money.
* remember kiddie tax: if the trust beneficiary or shareholder is a related kid under 18 (parent resident in Canada), kiddie tax applies.

Indirect receipt

* Requirements for this to apply: 1) The payment must be to a person other than the reassessed taxpayer. 2) The allocation must be at the direction/concurrence of the reassessed taxpayer. 3) The payment must be for the benefit of the reassessed taxpayer or for the benefit of another person whom the reassessed taxpayer wishes to benefit (like to a family member – keeps the income under one roof). 4) the payment would’ve been included in the reassessed taxpayer’s income had it been received by him or her.
* If all these elements are met, attribution rule would say that income that the person received would be attributed back to the payor under s.56(2)
* if you transfer money to someone to another person to benefit yourself or to benefit the other person in a way you wanted to benefit them, this is money is still included in your income, doesn’t disappear/become a loss
* In other words, if someone directs a payment to someone else, and it would've been income, it is attributed back to the original person who was supposed to receive it ie: barber asks customer to write a cheque to his kid rather than himself

Dividends

* if there are different classes of shares, directors are entitled to give one class preferential treatment to another, sprinkle dividends among classes at their discretion. However, if just one class, has to be equal between shareholders.
* each shareholder must buy their shares with their own money, pay for their shares with their own personal funds. (otherwise indirect receipt)
* Neuman: there must be a contribution to the company by the shareholder. Court says a shareholder need not contribute anything more than capital to the company, all that’s needed to be a valid shareholder is to contribute capital for purchase of the shares – they don’t need to work in the business or anything like that.
* Can’t say that the dividends, if not paid, would have been income of the original taxpayer, it would instead remain the retained earnings of the company. As such, test failed on 4th req.

Class 12

Boutilier

* when you split income, have to pay attention to the legal form to insure that the legal rights it’s creating are in fact created. If the form is not properly carried out than the CRA will reassess
* Salespeople can be either employees or self-employed with income from business. Self-employed commission salesperson of mutual funds so his income is income from business, giving him opportunity to split income.
* Plan: get the trailer fees income paid to the family holding company and then the family holding company would distribute it by dividends to the family trust (which was its shareholder), who would then sprinkle it at trustee’s discretion to the various family members.
* Basic story was that Boutilier failed to get through s.56(4), one of the attribution rules. This says that first requirement is that there is a “transfer of a right to income.” He says he didn’t transfer right to income, just an opportunity to family holding company to earn trailer fees. But he didn’t have proper documentation for what he was transferring to the company
* The transfer must also be to a non-arms length person. Here Boutilier was person earning the income and he had control of the family holding company, family, so it was non-arm’s length.
* Third thing was that it would have been transferor’s income. Boutilier tried to argue he never would have earned the income, it was the company’s. Boutilier dealt with the customer following the sale though and kept them in the fund, the company did nothing; the company incurred no expenses; Boutillier took all expenses personally and deducted them from his income, not through company. He also did not have a written contract of employment with the company, so again his documentation fails him.
* Documentation did not support idea that the company was earning these trailer fees, Boutillier was and the company was just a passive receptacle. There was no beneficial entitlement in the company to the fees, they were all boutiller’s
* “unless property also transferred.” Company, however, had no assets whatsoever.

s.56(4) as laid out in Boutilier: income will be attributed and income splitting fails if

1. an amount has been transferred and assigned by the taxpayer
2. that amount has been transferred/assigned to a non-arms length person (the FAMILY holding company)
3. the right to that amount, had it not been transferred/assigned, would’ve been in the taxpayer’s income
4. the income is NOT attributed if the income comes from property that the taxpayer has ALSO transferred/assigned

Loans and Income-Splitting

* A loan is not a “transfer.”
* As such, parents would lend money to their children or spouses to each other and not charge interest, or a very low rate of interest, and the spouse recipient would use that money to earn income and the question is whether that income would be attributed and the courts held that when statute only referred to transfers, no attributions, as they were loans and not transfers.
* CRA amended to capture both loans and transfers by referring to both. So if a parent makes a low interest/interest-free loan and the recipient invests this money, as long as they’re not at arm’s length, the income earned on this borrowed money is attributed back to the lender s.56(4.1). Attributes back income in a family type transaction.
* applies where it’s non-arm’s length and low interest on the loan
* If I transfer property my *child* (under 18) and that property generates income, like I transfer building to child and it makes rental income, it would be attributed to the parent who made the transfer to a child. Must be property/ investment type asset where there can be income or loss, If you just give money to them on which no income is earned, there is no attribution.
* Principle residence is exempt from tax however, so parent’s own home can be given to the child tax-free. No capital gains are payable on a principle residence.

Spousal Transfers and Rollover

* Transfer or loan to a spouse or common law partner: If a spouse or future spouse transfers property, investment type property like real estate or stocks/bonds, there is attribution back of the income earned by that property, same as with a child under 18.
* if it’s a spouse, the property transfers tax-free to the spouse (spousal rollover) but when the spouse sells the property, the capital gain is attributed back to the transferor spouse. So there is a tax deferral between spouses.
* if the spouses are estranged, there is no attribution at that point.

Transfers to a trust

* if you transfer it to a trust for the benefit of the non-arms length minor or spouse - there will be attribution of the trust income of the beneficiary/trust is attributed back to the settlor. So if you transfer indirectly to the trust to the child, there’s attribution of that minor beneficiary’s income
* Similarly, if you transfer to a corporation and the shareholder is the minor child or the spouse, there could be attribution of the income earned by the child under 18 or the spouse
* when trust sells a property, there will be attribution of the capital gain back.

Resident Status

* Benefit theory: discussed in Thompson case. If you’re a resident of Canada, you get the benefit of the government of Canada and what it provides, so you should pay tax.
* Obligation is on residents to make sure non-residents pay their taxes.
* Residents of income are taxable on their world
* residents of Canada must report investments outside Canada if total cost > $100,000. As a Canadian resident, you have to report your income from all sources both inside and outside Canada, but because the difficulty of enforcing this, many Canadians don’t disclose
* If you’re resident in Canada in the year, you are considered resident for the entire year, unless you can split your year, as it’s called, “part time residence.” The idea is that you are actually going to enter Canada to reside here permanently, then you acquire residence during the yea.
* A person who emigrates Canada with intention of permanently discontinuing their relationship with Canada causes them to become non-resident.
* In situations of entering or leaving Canada permanently, you have a split-year, a part where you’re resident and a part where you’re non-resident. You’ve divided your residence.

Gaining Resident Status

* Resident status is determined for each tax year
* First is “factual resident,” people who are resident under the ordinary, dictionary meaning of “resident.” Do you live in Canada? Physically reside here? If yes, you’re a resident.
* “ordinarily resident.” You retain residence if you’re not physically present here but you are ordinarily resident here. Like if you’re on an extended vacation, but your home is in Canada. This is where you return to. So someone could be an astronaut circling in space for the year, but still be resident because although not physically here, they are ordinarily here, so when they land, they are coming back to Canada. People who ordinarily live here but are physically absent
* Deemed resident: this is to sojourn in Canada for a 183 days or more. If someone is here temporarily, but if you stay for 183 days or more, you are a deemed resident for the entire year. It’s a total of all the days in the year.

Residential Ties

* Thompson: guy had a house available to him here in Canada and he was held to be resident here because he had a house here, a significant residential tie. if you have a dwelling house in Canada that is available for occupation for you, you are a resident.
* Another factor was that he had a spouse here in Canada.
* Also, if you have a dependency, like children, in Canada, you are a resident.
* significant ties: having a home available to you here, having a spouse/common law partner here, having a child/dependents here.
* secondary ties: personal property here, social ties here, economic ties here, hospitalization and medical insurance here, driver license, seasonal dwelling, burial plot, pet (Lee), Canadian passport, membership in Canadian union – any of these things can make someone residential if combined with a significant tie. There must be a significant tie to make you resident, secondary ties can embellish. Two significant ties or one significant ties with secondary ties.

Class 13

Ordinarily Resident

* Reeder: was outside of Canada and argued he wasn’t resident as a result. Court said no, you have residential ties and you are ordinarily resident here
* Physical absence from Canada for “several months or years” will not disconnect a person’s residence in Canada, as they can continue as ordinarily resident here.
* Reeder: everybody must be resident somewhere. Can be dual/multiple countries of residence. People who are resident of Canada in view of CRA will continue to be resident here unless we sever our residential ties with Canada and take up a residence somewhere else.

Sojourning

* person who comes into Canada for 183 days or more, Jan.1-Dec31.
* a temporary stay in Canada for a temporary purpose is sojourning.
* Part of a day is equal to a whole day. It is the aggregate of days of actual physical presence, temporary residence or residence for a temporary purpose.
* This only applies to people who are not coming from a tax treaty country. Treaty country retain residence of their country of origin.
* If sojourner is caught, they are considered resident for the entire year, subject to tax from January, not from when they started their sojourn. Splitting year, like a part-time resident, is not possible for the sojourner.
* cross-border commuters: people living in the US and coming up to Canada to work. Here, the CRA says that if you come in here to work, you are not sojourning. Sojourn = establishing a temporary residence. People who live in the States and cross border to work, then go back at night, they do not acquire Canadian resident status becausethey return home every nightm just for work, they don’t have a temporary residence.
* It’s 183 days in the calendar year. Like if they came in Sept 2011 and they left in April 2012, they’d be here for a total of 244 days, but this must be broken down into taxation years, Jan-Dec
* It’s an aggregate of days of actual physical presence for a temporary purpose. A person is not automatically considered sojourning for every day they are in Canada, the nature of the stay must be determined: it must be temporary purpose with a temporary habitation. For instance, commuters are not caught as sojourners.

Thompson (treaties/tie-breakers)

* Court rules he’s resident: he had a house here and he had secondary ties like social relationships and family in Canada, so he was taxable on his worldwide income after house built. He was also taxable in the US for his worldwide income, he was subject to two country’s taxation on his worldwide income.
* we have Canada/US tax treaty, purpose of which is to relieve against double taxation
* tax treaties have tie-breaker rules, a method of reaching a conclusion that only one country is country of taxation, solving problem of double-taxation.
* Tiebreaker questions: Where did he have a permanent home or centre of vital interests (here, both)? Then where was his habitual abode (again, both)? Then we look at what his citizenship is? (here, this was the tiebreaker, he was a citizen of Canada, not US or Bermuda). Just look for the one that one country has and not the other.
* government looks at the regularity and length of his visits to Canada.
* next question is whether he had a dwelling place available in Canada

Cutting Residential Ties

* To leave Canada you must sever all significant residential ties and almost all secondary ties within Canada. Can still have a few family ties and such, but cut them down as much as possible. But NO significant ties.
* One way out of dwelling house problem is to rent it out on a long-term lease. CRA will let people, in a down real estate market, to rent it out. Of course, they will be subject to tax on the rental income as a source in Canada. It’s a house, but not available to them for occupation.
* Can get a certificate from CRA, Form NR73 for Determination of Residency Status (Leaving Canada). To successfully break ties with Canada, you need to go to CRA and tell them you’re going to leave and reckon up outstanding tax liabilities and to really secure your position as a non-resident, you apply for a determination of residency status through this form from the CRA, that you’re no longer a resident if you do what you say you’ll do on this form.

Reed

* becomes resident by marriage and dwelling house. Marriage was in June of 1981, so he’s resident from June to December and a non-resident from Jan-May. This is part-time resident, only resident for the portion of the year following acquisition of Canadian resident status. Only subject to tax worldwide for the part of the year where they are determined to be resident.
* He argued that he wasn’t eligible for EI or healthcare and immigration wouldn’t let him stay but CRA said you can be resident for tax purposes but non-resident for all other kinds of purposes/govn’t agencies, as the concept of resident varies from legislation to legislation.
* Can also apply for FormNR74, a determination of residency status (entering Canada). Determination of residency status upon entering Canada.
* his intention of not establishing residence was not enough to overcome the significant residential ties and so he was caught as a resident of Canada.

Part-time resident

* person leaves with intention of severing ties with Canada or enters with the purpose of establishing residence. In this case the date of arrival if one is immigrating or the date of departure if emigrating. Unlike sojourner, can split your tax year, becoming resident upon date of arrival to the end of the year, before that, non-resident
* deemed to acquire capital property at fair market value at the date of arrival/becoming a resident, establishes the cost base for future capital gains of losses

Departure Tax

* At the time of leaving Canada, you get hit with the departure tax. You have to pay capital gains tax on gains you accrued on investments while resident in Canada, based on a deemed disposition at fair market value of capital property immediately before emigrating.

Class 14

Resident Status for Corporations

* subject to same basic concepts as individual: if resident in Canada, corp is taxable on its worldwide income and if it’s non-resident, it’s taxable on Canadian sources of income.
* deemed residence for corporations – if the corp is incorporated in Canada after 1965 it is deemed by statute to be resident of Canada irrespective of where central management and control is, it is a resident of Canada forever after unless it goes through a process called “continuation” which is where it changes its place of incorporation to another jurisdiction. Not like individuals, whose residence is determined for every tax year.
* if the company is not incorporated in Canada, it can still become resident in Canada if its central management and control actually abides somewhere in Canada – this is the “case law principle”
* If the corp is not incorporated in Canada and doesn’t have central management and control in Canada but carries on business in Canada will be taxable on profits from those Canadian sources only, taxed as a non-resident.
* Residency is determined for each company in a corporate group, each of which is a separate taxpayer/individual.
* companies incorporated prior to 1965 are not caught by the rule of incorporation in Canada. However, if those companies ever have a director’s meeting in Canada or carry on business Canada, they will have sufficient elements to be taxable in Canada forever after.

The Case Law Principle

* Case law principle:. Basic test in the case law is applicable to foreign companies like De Beers. The company had its business operations in South Africa, its board of directors had some meetings there, shareholders met there, and its business operations were there. However, the critical thing was that all the big decisions, important decisions for this company were made by board of directors in their meetings in London. So the test is “where central management and control ACTUALLY abides,” here the REAL decisions were made in London
* where are the important/big decisions made? A company resides for purposes income tax where it’s real business is carried on, which is where the central management and control actually abides. This means where the top level decisions being made, the ultimate control.
* if the directors are just rubberstamping things that means someone else is really making the decisions. That can make the country resident where that de facto power is exercised and NOT where the head honchos/directors are meeting.
* If the shareholders are calling the shots with the directors doing small stuff, it’s the location of the shareholders that determines the location of central management and control

Residences of trusts and estates

* prior to Fundy Settlement case, a trust was resident where the trustees were resident.
* Fundy Settlement: Legal title is held by the trustee, and hence the control, and the equitable title, benefit, goes to beneficiary. Trustee makes the management decisions, albeit in the beneficiary’s best interests.
* In this case, however, the beneficiaries in Canada were actually calling the shots, they were telling the trustee what assets to sell and buy and when, so the high level decisions in this trust were actually being made by someone other than the trustee (as it would normally be).
* SCC held that a trust should be resident where its central management and control actually abide should apply, similar to what applies to companies if the controlling shareholder is the one calling the shots
* Trust is normally resident in location of the trustee....unless there’s a departure from the norm and the beneficiaries are actually calling the shots.

Double taxation

* Canadian tax plus foreign tax, like if we’re taxable as residents of Canada and we have a foreign source of income.
* For sources of income outside Canada, you get a dollar for dollar credit for the taxes paid to the foreign source country which you can apply to reduce your Canadian income tax. You still pay according to the Canadian tax rate, just whatever you’re taxes are based on assessment of your worldwide income is reduced by what you paid in taxes on that foreign source in that country.
* There are also provisions in tax treaties to relieve against double taxation through exemption and/or credit, but you always get this foreign tax credit based on ITA.

Taxing Non-Residents

* federal income tax on taxable income – this is net income from employment in Canada, net income from carrying on business in Canada, or taxable capital gains on disposing taxable Canadian property. So non-residents file tax returns on April 30th of the following year and report their income from employment, business, or taxable capital gains in Canada
* If a non-resident is selling property, the resident buyer of that property has to make sure that the non-resident vendor gets a clearance certificate from the federal govn’t before the sale goes through as a method of pre-payment of tax and then the non-resident vendor must file a tax return on April 30th to get their money back.
* if the Canadian resident doesn’t carry out, they’re personally liable for the taxes
* Canadian resident payor is to deduct 25% off the top of every payment.
* Canadian resident payor, like a non-resident who owns timberlands and is deriving royalty income from Canada and the payor of the rents or the royalties is required by Canadian tax law to withhold, or take off of the top every payment
* Resident payor must do this or face personal liability. The money withheld also cannot be recovered from the non-resident payee from the payor.
* Withholding is a final tax – the non-resident payee does not need to file a tax return.
* non-resident taxpayer is taxable on the gross amount and is not able to deduct expenses under this Part XIII withholding, though deductions are permissible by the first net income method.
* Rental income of non-resident landlords can elect to be taxed on net income (first method), otherwise they will be taxed by the withholding tax. Employment and Income from business will be under the first method, while dividends, pensions and such will be the second.

Class 15

Non-Resident Employee

* based on contract of service between the resident employer and the non-resident employee.
* Every employer is required to deduct from the paycheque of the employee whether they are resident or not, deduct sums of money for the employees income tax, EI, and Canadian pension contributions. withholding applies to the employer and if they don’t do it, CRA make them liable to make up for the deductions they fail to make.
* Have to pro-rate the time of the individual over the calendar year, , say 1/3 of the year working for the employer, so 1/3 of their salary is considered income earned in Canada. So their Canadian income is based on performing duties in Canada.
* Employer withholds during those months that the employee is working in Canada, then employee files a tax return by April 30th of the next year, reporting that employee income in Canada, but not any other income because theyaare only taxable on Canadian sources.
* Usually, the employer will withhold more than is necessary so that the employee will get a tax refund upon submission of their tax return.

Non-Resident Income from Business (Granger)

* subject to Canadian income tax if their activities come within the definition of “carrying on” (repeated transactions) and “business (actively pursuing profit with the hallmarks of business – taking risks with the aim of making profit with an organization/scheme of profit-making, it’s actively pursuing profit, as opposed to something like passive investment income, which is subject to part 13 tax instead)
* Granger/Goff draws distinction between businesses which are dealing with Canada as opposed to dealing within Canada, the latter are taxable as carrying on business in Canada.
* The basic test is where the contract was made, which is deemed to be the place of acceptance. Where the sales contracts were made, that is the place of acceptance. Here, the contracts were accepted in France, so Grainger escaped british tax liability.

The Broadening of the Granger Rule, The Role of Agency/Soliciting in the Granger Rule

* s.253(a) broadens this, says the place of making contract isn’t conclusive – someone non-resident is carrying on business if they “produce, grow, mine, creates, manufacture, fabricate, improve, pack, preserve, or construct anything in Canada” whether or not sold before export. So it doesn’t matter if the contract and delivery were made outside Canada: if these activities were conducted in Canada, then the business is being carried on in Canada.
* ITA tries to get around Grainger case by saying that extended meaning of carrying on business includes soliciting orders or offers by a servant or agent of the non-resident in Canada. But Grainger does not have the authority to bind the principal and that authority to make a binding contract was not conferred on him so the agency element is missing and Grainger was an independent contractor, not a servant/employee either.
* Soliciting of orders according to Sudden Valley, must be done by someone who was an agent or servant. So attempt by statute to overcome Grainger fails. Soliciting must be binding on the non-resident, which it only is if the salesperson was an agent or employee, not contractor.

Smith v. Greenwood (further broadening Granger rule)

* in addition to looking at location of the acceptance, also look at where the operations takes place from which the profits of substance arise.
* Greenwood says profit can be apportioned, if reasonable, among multiple countries where there are profit-making operations in different countries. Profit making operations can be apportioned among different countries, can have more than one place of business

Distinction Between Passive Income and Business Income for Non-Residents

* GLS Leasco: Court draws the line between passive rental income (landlord doesn’t have any involvement in earning) as opposed to rental income where the taxpayer is actively involved in earning the rental income, which could be business. No clear line between the two.
* Court must look at GLS’ activities and see how extensive they were, if extensive enough to fall under Part 1, in which case apply Greenwood test, if the operations where profits in substance arise are in Canada, in which case it’s revenue, business – could get loss carryover
* Greenwood test: look at place of activity – in GLS, there was an office that was used in Canada, a Canadian bank account, contracts for the purchase of the trucks were in Canada (Grainger idea of where the contracts relating to the business were made), but they had no employees in Canada, just visited. But court in GLS said this was sufficient. It’s enough substance in Canada to make it the place of business for GLS

Sudden Valley – “substance” in attaching a business to Canada, interest exemptions

* question for Canadian courts is whether interest income here was passive income or could be active income as moneylending business.
* SV was held to be taxable under part 13 and therefore the purchaser should have been deducting and withholding 25%m non relief from the expenses under its Canadian income
* SV tried to put itself under extended meaning of business, but court said that there have to be soliciting orders or making offers in Canada through a servant or an agent, but the sales pitches didn’t start until brought the prospective buyers into the US, were soliciting in the US, and the sales staff who were in Canada didn’t have authority to make binding contracts, just lure to US
* Court says there’s no Canadian income from this business undertaking and the payment of interest based on its US real estate business is too remote from its Canadian activity. They said there wasn’t enough substance – GLS had enough *substance* to have an active business in Canada and be taxed in Part 1 while SV didn’t.
* gov has since decided to exempt interest payments made by borrowers in Canada to lenders abroad. If it’s an arms length relationship between lender and borrower, a dealing between two independent parties in Canadian buyer and non-resident seller, that interest is now exempt.
* Mortgage held by non-resident is also not subject to Canadian income tax. This is only for real property situate outside Canada and interest on the mortgage being paid by a Canadian
* Canada/US Tax Treaty takes it a step further, saying that even between non-arms length parties, Canadian and US borrowers/lender exempt from tax on interest payments.

Non-Residents Selling Real Estate

* CRA dings them when they dispose of those properties, at which point they are subject to capital gains tax in Canada on those sales.
* to enforce this tax, the government makes the Canadian purchaser collect a downpayment of tax towards the final tax liability on this property and if they don’t, the purchaser is personally liable for the tax the non-resident vendor should have paid.
* the interim agreement will thus have a clause that says the vendor will not now or at time of closing be a non-resident of Canada for which the vendor can tick of a yes box or a no box. If resident of Canada, no further need to worry, but if they tick no and say they are a non-resident, the purchaser is obliged to ensure that the vendor has a clearance certificate from the CRA before the closing of the transaction
* If no clearance certificate and the vendor receives the full purchase price from the purchaser, the purchaser will be liable to pay what should have been paid to the gov in the first place, that being 25% of the purchase price/capital gain.
* Checking boxes is considered a reasonable inquiry and purchaser is not liable if vendor lies.
* Purchaser only knows what the sale price is, they don’t know what the cost base is for the vendor, so if the vendor doesn’t get a clearance certificate, the purchaser is required to withhold 25% of the purchase price.

Class 16

Withholding on Sale of Property

* It’s the tax on the gross amount without deductions for expenses, unlike tax under part 1 which would let you deduct expenses.
* Rent from Canadian Real Estate, can elect to be taxed on net basis with deduction for expenses.
* Capital Cost Allowance: if you have a building, not just bare land, it’s depreciable property. Non-Resident property owner can deduct/depreciate in computing rental income, just like a resident landlord could.
* If the non-resident landlord elects to go with part 1 tax, then the non-resident has to file a T1 return on April 30th, so that deductions can be examined.
* In net basis for rent to non-residents, the payor still withholds, but it’s just 25% of the PROFIT instead of the gross amount. So if income is $1000 with $800 of expenses for profit of $200, under NR6 form, the tenant just withholds 25% of that $200: $50
* If taxed for rent on net income basis, this withholding gives a dollar for dollar tax credit to the landlord for whatever he is assessed for based on his T-1
* Treaties can reduce withholding rates for income from Canadian source for non-resident.

Defining Employment

* The big issue is the distinction between the employee and the independent contractor/self-employed person/consultant, which is instead income from business.
* Employee has a contract OF service in a master-servant relationship. While a business contract FOR service would be principal to agent. The legal relationship is different.
* So there’s a difference between a contract of service and contract for services – the former involves the employee rendering service exclusively to the employer, just one contract. The self-employed person has the freedom to work for other people
* Definition: “employment is by an individual” (company can’t earn employment income).
* “Individual in the service of some other person.” “In the service” gives us this concept of the contract of service, where the employee renders services exclusively to the employer, which isn’t strictly required but is the general idea.
* Tax implication of this distinction between income from employment and business: The government has a self-evaluation document called RC4110(E)
* Can also get a ruling request to ask the government what they think you are....they tend to find people to be employees because it compels the employer to withhold and remit

Method of Taxing the Employee

* Employment: an employer must withhold and remit a certain amount from every payment made to an employee
* Employee on this scheme is taxable on remuneration and taxable benefits. Employer can deduct the remuneration and benefits as business expenses.
* For self-employed, hirer doesn’t pay, self-employed pays their own quarterly instalments of income taxes and have to contribute to the Canada pension plan and, if they want to, employment insurance. Their income is reported on accrual basis, remuneration earned and expenses deductible on the year in which were incurred. And it’s the calendar year.
* It’s Jan-Dec for both the employee and self employed. But for employee, it’s cash basis, just includes cash received and benefits enjoyed during that year and deducts expenses.
* Scope of deductions: an employee may deduct the limited set of expenses from s.8 while self-employed business person has a much wider array of deductions.
* A self-employed person could deduct technology, processes, resources, staff, services, while employee could only deduct the specific stuff from s.8, which is exhaustive.

Classifying Employed or Independent Contractor: the 4-in-1 Test

* first element was Nature and degree of control: the power of selection, payment of wages, control over method of work, and the master’s right of suspension and dismissal.
* Wiebe Door: courts looked at control test and said it isn’t sufficient, now four factors: control, the ownership of tools, the chance of profit, and the risk of loss.
* Control = employer has the right to tell the employee how to do the work, while independent contractor has autonomy over how to get the work done provided they get the result, employee cannot bring in a substitute to do the work for them.
* tools: tools are laid out and provided by the employer, self-employed person would provide their own equipment (providing the financial risk for paying for it all themselves)
* chance of profit: for employee/employer, employer is indifferent for how productive the employee is, same remuneration, while the self-employed person, if they work efficiently and work well, they earn more money
* Risk of loss: if they don’t work efficiently or a mishap/delay occurs, they may lose money. Employee does not have this risk, he gets his income regardless of the success or failure
* CA rejected the integration/organization test, preferring the four-in-one test. It’s still a valid test, but it is subordinate to the 4-in-1 test. As a consideration, though integration test must be applied from the POV of the worker, not the superior. The employee’s work is integral part of the employer’s business while the self-employed person’s work is only an accessory to it. But this is examined from the worker’s POV and whether the worker thinks they are part of someone else’s business or in business for themselves (own business that, in its function, is an accessory to the business).
* Common intention has now been added to the four in one test
* Job of the court is to balance all these considerations
* Control test isn’t about actual control, but about whether the employer has the RIGHT to control what the employee does, the what, where, when, and how….not just the result.
* Crucial question “whose business is it?”
* Ultimately, the employee will get a salary or piece-work wages and other remuneration while self-employed/independent contractor has profit from business, so the revenue minus expenses, having taken financial risks employee doesn’t

Class 17

More on the Tests for Employee vs. Independent Contractor

* Specific result test: where someone is just hired to do a specific job, as opposed to control. Short term engagement can be self-employment while someone with an ongoing employment without any limitation on the term is more likely to be an employee.
* Wiebe Door case did not leave much room for the intention of the parties to factor in. .
* More recent cases have backed off of that, saying it does matter what the parties think their relationship is – common intention (what relationship the parties thought they were in) should be considered in addition to the 4 in 1 test, a balancing of considerations.

Cavanagh

* had employment related expenses that he couldn’t deduct as an employee, but he argued that he was self-employed.
* Cavanagh succeeded: Not under control: He worked at home and if he set up tutorials with his group, he could pick his own place and he provided his own tools and he had the chance of profit (he was paid per student who completed), risk of loss (if he lost students, loss).
* Court also addressed integration test, looking at it from his POV, he thought he was self-employed. He was also only paid once at the end of the term, not on a continuing contract, it was just reviewed based on how he did.

How to Avoid Characterization as Employment

* Interpose a contract for personal services: employee terminates their work due to retirement or resignation and after a decent interval (at least a month), comes back to work under the same person under a new contract, a contract for services. Common intention is that he finishes up as an employee and for the balance of the taxation year and for future years, is hired as a consultant/self-employed contractor.
* Retire/rehire: genuine retirement, don’t work for a month or so, then they come back to work for the same person as an independent contractor and get self-employment income from that point on. should be at least one month’s lapse. Court will examin if it is same or different service? Same or different remuneration?
* 2. Interposing a Corporation or Trust (of which the taxpayer and his family are beneficiaries, or are owners of the corporation). Employer has a contract of service with employee. Employee goes to employer and asks him to accept employee’s resignation and then you can hire my company to provide my services – I have a contract of employment with my company
* corporation cannot earn employee income because while a person, it isn’t an individual. So payment to the corporation would be counted as income for business.
* CRA has amended the ITA to remove the benefits otherwise present: corporation doesn’t get favourable tax rate, doesn’t get small business deduction, taxed at higher rate. Corporation also can’t deduct the normal expenses that a business would: corp can only deduct the salary they pay to the employee, but other expenses are not deductible.
* the employee has to be a 10% shareholder in the corporation.
* Can also try to interpose a trust. Employer and employee, but I get the employer to employ my family trust, and have the family members as beneficiaries of the trust and sprinkle income among them. I am an employee of the trust, whose business is to provide my services.
* Problem is that inter vivos personal trusts are taxed on their income at the highest marginal rate (43.5%), so you can’t accumulate income this way at a favourable rate of tax. Other problem is the attribution rules, which would attribute the income from the trust back to the employee.

Capitalization of the Employment Benefit (third method)

* Try to say that the employment contract is the employee’s capital asset. (Schwartz) Source of income doesn’t begin until he enters employment/starts the work
* Same for end: tax-free money: following termination of the contract of employment, there’s no more source, contract terminated, so any money received by the person who formally had that contract has no source
* Old practice: when you first hire an employee, pay a huge hiring bonus because it’s tax free, because it’s in the Schwartz space: money being paid to the person before the work, and hence the source, begins. Or another way to get tax-free money is to have them enter into a covenant with the employer that says that when their contract ends, they won’t work for a competitor, then we give them a sum of money for doing that. That’s tax-free money as well, as they’re giving away a capital right (working elsewhere) and it’s after employment/source ends.\
* s.6(3) amends all of this, says if you pay the employee a hiring bonus, that is taxable as income from employment and if you take a non-competition covenant and pay the employee a sum of money for that covenant, it’s also taxable as income from employment.
* sums of money paid by employer to employee is rebuttably presumed to be remuneration for services, and thus taxable income for employment. However it is irrebuttably presumed to be income from employment if it was an inducement (hiring-on bonus), if it was remuneration, or for payment for a non-competition agreement (where you’re giving up a capital right to work for whoever you want for a sum of money)

Curran

* to avoid being caught under s.6, instead of Home Oil paying the bonus to Curran, arrangement was made that the principal shareholder would pay the bonus to Curran, so wouldn’t come from the employer and would escape s.6(3). Brown was the third person, and he’d pay it before employment started, and that payment would be for the giving up his contractual rights.
* Said not caught by s.6(3) and it’s in relation to capital assets, not payment related to employment: it’s not coming from my employer and I haven’t started work yet, and it’s not an inducement, it’s for compensating the loss of my prior job.
* SCC didn’t buy it: said this was an advance on salary. *Substance of the matter was the acquisition of services*, regardless of how they worded it. FP wanted Curran’s services and the consideration was paid so those services would be made available, it was like advance on salary and fact it didn’t come from employer, but a third person, didn’t matter, as it was based on intention to pay Curran money to work for FP.
* SCC said it was remuneration for future service by a third person, so was caught as “remuneration” under s.6.

Class 18

Retiring Allowance

* When somebody was fired from their job, they in effect lost a capital right, lost their contract, the source was gone, so what they got were payments after the source was over and was thus tax-free. This continued to be law until 1980s until minister of finance created a new source of income called “retiring allowance.” When someone voluntarily leaves their job.
* Damages for wrongful dismissal are included in this too, so “retiring” is misleading, as payments after involuntarily leaving are also taxable.
* upon termination, the former employer gives money to former employee, this is taxable as retiring allowance. Termination, Resignation, Retirement, and Dismissal with or without just cause. If without just cause, they get a reasonable period of notice and if no period of notice, they have claim against their employer for losses in “severance pay.”
* Severance: one month’s pay for each year of service up to a max of 24 service when terminated without cause or notice. This is now taxable as income. As far as the compensation is for loss of the job, that is taxable as a retiring allowance.
* Often when an employee is terminated, there may also be income from employment resulting from these types of compensation: back pay (considered remuneration), working notice (where employee continues to work during notice period and receive salary and benefits), bonuses, commissions, overtime, and unused vacation credits are all subject to tax as income from employment. Back pay or vacation pay = fired before the income comes, so it’s still employment income.
* Lawyers advising terminated employees in assisting them to recover this stuff, the client can deduct the lawyer’s bill
* Retiring allowance is subject to rollover.

Retiring Allowance Cont’d – Breaking Down Heads of Damages

* Initially it was limited to a payment “in recognition of long service.”
* Added to retiring allowance is also “in respect of a loss of office or employment,” so if an employee is fired without just cause or notice they get a sum of money from employer as compensation for breach of contract of employee, that’s also retiring allowance.
* Legal fees in connection with this damages settlement for breach of employment contract are deductible from the amount awarded.
* Just as they would withhold on employment income, the former employer must withhold on retirement allowance. Retiring allowance IS NOT the same source as employment income.
* Higginson: made the workplace miserable, made it so shitty that Higginson quit, but he came back, then they fired him without any compensation or damages for wrongful dismissal.
* Apply Bellingham to break award down into his damages into components: $236,000 was for wrongful dismissal, the retiring allowance portion of his damages, while $573,000 were for punitive damages for the manner in which they’d attempted to get rid of him.
* Higginson can’t say this whole amount is taxable as retiring allowance; he can break it down into types of damages. If he DID treat it all as income from retiring allowance, the former employer would take 30% withholding off the top – he’d only get $560,000, and then the next year, he’d be taxable in the year on his income (basically, another 13% that he’d have to chuck up in April)
* To prevent this, we can roll over, defer tax on the retiring allowance portion of the payment he’s receiving. it’s $3500 a year up to 1989, then $2000 rollover for 1989-1996, then after 1996, no more rollover (fully taxable for all the years from 1996 onward).
* No 30% withholding on the rollover amount.
* Punitive damages award is tax free. It’s not compensatory.

Meredith Boucher

* Again, punitive damages from wrongful dismissal were tax free.
* Counseling is a tax-free benefit. So a dismissed employee can demand counselling from the former employer to give non-taxable payments to pay for re-employment counselling.

Employee Benefits

* taxable benefit or tax-free privilege?
* The employer gets a deduction for the benefit, but the employee isn’t taxable on it if it’s considered a tax-free privilege.
* if it’s not a cash payment to an employee, but a service, like a paid vacation, have to put a value on that, which is something that boils down to the cost to the employer or the fair market value
* Purpose of benefits is not remuneration for services. They often are to offset the risks of human condition and encourage employee retention and make employer competitive with other employers offering such arrangements. Some will also use the benefits more than others

Taxable Benefit or Tax-Free Privilege – the Test

* Tennant: bank employee was retired to live on the bank premises and lived there rent-free.
* HoL said it was not taxable because it is not convertible into money – a person is only taxable on what is money or what is convertible into money. This is however not Canadian law. In Canada, a person is subject to tax on benefits “of any kind whatever” and that is held to mean non-cash benefits, benefits that can’t be converted to cash are still taxable in Canada
* Basic point of the case is that the primary benefit went to the employer rather than to the employee. The employee got rent-free accommodation, but that was only a secondary consideration/reason for the benefit, the main reason for the benefit was that the employer insisted that someone be on the premises at all times to deal with customers.
* if benefit is to the employer rather than to the employee, it is tax-free benefit. The financial advantage must be to the employee: if it’s to the employer, than not taxable.
* doesn’t matter whether it’s taxable on the employee or not, it’s always deductible for employer.
* Sorin: Tennant principle is applied: idea that this arrangement was primarily for the employer’s benefit – Sorin showed that he hated the arrangement, the facility was far from ideal – court said primarily no benefit to Sorin, primarily benefit go to employer, part of the requirements of the job so it’s tax-free.

Class 19

Valuation

* Benefits can be in cash or it can be in chattels or non-cash benefits.
* Largely the responsibility of the employer to keep informed on govn’t rules and to decide whether it’s taxable or tax-free and if it’s taxable and in kind, not cash, how to value it.
* Value is usually FMV or cost, if you can’t determine FMV, use what it cost the employer to provide that benefit.
* Purpose of these benefits is not remuneration. Prior to Savage, they figured that if it was not subject to remuneration, it’s tax-free.
* Sorin: If the benefit goes PRIMARILY to the employer, tax-free.

Savage (the two requirements for a benefit to be taxable – economic benefit & by virtue of employ)

* upgrading one’s skills/continuing education where firm sends the associate who is an employee to take a course to improve their skills, paying the tuition for that type of course is for the primary benefit of the employer in getting a more skilled employee. Incidental benefit to employee doesn’t count.
* the incentive plan to the employee to take the course, THAT was taxable, but just paying the tuition was not taxable. Creating an incentive to take it was taxable.
* benefit must be in respect of, in the course of, or by virtue of an office or employment. Prior to this case, SCC followed Canada and took this phrase as meaning the benefit must be remuneration for services to be taxable.
* In this case, employer wanted employees to upgrade skills so paid Savage to take courses on insurance business. It was ruled there was thus some benefit to her, because there was some “material acquisition which confers an economic benefit”. Here, she did get a material acquisition – the money for each class completed. Clear economic benefit.
* Was it in relation employment though? SCC said that it was in relation to the employment because it was only open to employees to get this benefit and it was upgrading her skills as an employee. It was thus counted as remuneration and taxable.
* Thus, Savage puts down two requirements: It has to be a material acquisition which confers an economic benefit that is gained in the respect of or by virtue of employment. D
* Govn’t changed their policy after Savage: an employer can now give an employee a gift or an award (like Savage’s incentives) if it’s non-cash and the total amount of the gifts and awards does not exceed $500. They are tax-free, while employer can deduct it.
* Scholarships, fellowships, and bursaries tenable at university are also not taxable by statute.

Laidler (gifts from employer)

* employer started giving employees gift cards every Christmas.
* Employees said it wasn’t taxable because it was a personal gift – cases where the employer gives employee a personal gift, like a gift in recognition of their personal qualities or financial hardship, it is tax-free. Gifts received are not income to the recipient (Bellingham) and are still tax-free and can be given from employer to employee without tax consequences. This falls in line with new provision that allows for non-cash gifts or awards of up to $500.
* Courts say it depends upon employer’s intention, have to look at it from employer’s point of view – the employees think the employer loves them and is recognizing them, but that doesn’t matter, it’s what the employer has in mind with the gift. This company here was giving this gift to the employees to motivate them to work harder and to promote loyalty and good relations with employees, so there was a monetary motive.
* These were not personal gifts, but thus rather closer to being incentives, like Savage, have to look at purpose.
* Critical factor: does the employer deduct the so-called gift as a business expense because if they did, it’s an indication that it’s hard business reality that is motivating the employer
* Gifts are however a deductible expense by employer
* Waffle: The gift does not have to be from the employer to employee to be taxable. It can come from a third party. Was taxed on his portion of an incentive cruise and his wife’s, even though she wasn’t an employee

Business Trips and Vacations (Lowe)

* if the employer orders the employee and spouse to take the trip for business purpose, the benefit is primarily to the employer and it’s not taxable.
* Court said there is a source, it was related to the employment, but there was no benefit. There must be a benefit to the employee. Because the employer required the employee and the spouse to attend this conference the benefit was primarily to the employer.
* Having the spouse there was also because the employee had ordered it, so again not a taxable benefit. Whether the spouse’s presence at request of employer was primarily to serve the employer’s business. Any personal enjoyment to employer or spouse was merely incidental from the command of the employer to bring spouse along as business expense.
* If court is satisfied that pleasure/business is equally split, then they can say half the value is taxable and the other half is not. In this case, the preponderance or the primary thing was work. Allocation is such that it’s either 50/50, or one or the other.

Huffman (work clothes - reimbursement)

* expenses for the suit were work-type expense, employer required it, this was a tax-free reimbursement. Employee is paid that $500 to reimburse for work-type expense, with employee responsible for submitting receipt so employer can verify that the money was spent as it was supposed to be, for that expense. Employee gets no personal benefit out of this, as it’s not for a personal suit that he can wear off duty, it’s one that can only be worn on-duty
* There is a connotation of material acquisition (like Savage) but a reimbursement is idea that they were required to lay out this money and employer is just paying them back, so there’s no net gain, so no material acquisition by the employee, it’s just money in and money out.
* If it’s an allowance though, like if the police had said “here’s $500, due whatever you like with it, can get a new suit but if you want to use an old suit and keep the money,” that is a taxable

Ransom (relocation reimbursement), Allowances

* It must be a work-related expense as opposed to a personal expense.
* The employer can give the employee an advance, instead of requiring the employee to incur the expense and submit receipts, so long as employee is required to submit receipt and show that the expense was paid or to repay any excess (prevents it from being an allowance)
* Allowance is a pre-determined amount paid in advance to employee and the employee is not accountable for its expenditure, it can be taken personally so it is taxable as a possible concealed remuneration.
* can have a reasonable allowances for employment-related expenses of remployees that are tax-free. Question is what a reasonable figure is.
* Company had policy of compensating for losses if the house was sold below cost to employee. Court held that this was a reimbursement of an expense that the employer *required* the employee to incur as part of his job, so the benefit of the expense went to the company (they got relocation of their employees) and the payment to Dupont was just a reimbursement, just break even, no real material acquisition. Wasn’t an allowance because it wasn’t an arbitrary amount – he had to show what he lost/his expense to the company

**Class 20**

Eligible Housing Loss

* money from the employer is presumed to be remuneration, but it is a rebuttable presumption, provided it’s not a hiring bonus or restrictive covenant. Can rebut by showing reimbursement and not allowance (Ransom) - accountable to employer and show proof of amount
* capital gains on principle residence is not taxable.
* s.6(19): reimbursement of a housing loss is a taxable benefit, fully included in income if the payment is not for an eligible housing loss.
* a short move is not eligible. It must be 40km or more. It must also be a required relocation.
* Eligible housing loss: first $15,000 are tax-free. Anything beyond that $15,000 is half taxable.
* Other moving expenses on relocation can be reimbursed and can be a tax-free benefit if reasonable. (like hiring moving trucks)

Commuting Expenses

* traveling to and from work is a personal expense, no tax relief from that whatsoever.
* if I were required to have my car at work and use it at work, that could be a claim of employment expense.
* tax incentive: transit pass tax credit, you can deduct your transit passes if you take public transit

Moving Expenses

* s.62: the moving expenses a person incurs if they are moving by way of relocating in connection with a job and the new employer won’t reimburse you, you will get a tax deduction for those moving expenses, but if the new employer does reimburse and you can provide receipts, you get tax-free money.
* must be a move that moves you 40km closer to your new place of work or study
* to be deductible, must be for the purpose for moving to commence work or study, to commence work at new location, moving expenses are then deductible from income earned at new work location in the year of the move and/or carried forward to the next year only.
* deductible moving expenses include: travel costs, costs for household goods, meals and lodging for 15 days, costs of lease cancellation, selling costs of old residence, legal fees and taxes to register title to new home
* not deductible: loss on sale of old home, pre move expenses, and fixing up old home to sell.
* Phillips: any reimbursement from employer for higher cost of living and higher cost of housing in this new place is a fully taxable benefit. Here, employer gave $10,000 compensation for higher cost of housing in city he’s moving to. Arbitrary amount. Court found this to be taxable.
* That $10,000 was a material benefit and not a reimbursement of a loss.
* So between Ransom and Phillps, the loss suffered from having to sell your house is compensable (reimbursement IS ½ taxable if >$15K), but the cost of buying a more expensive one is not.
* Home relocation loan: employer can loan up to $25,000 interest free for five years; normally that free interest would be a taxable benefit.
* Cost of living adjustment: Compensation for buying chattels in a place with higher living costs = taxable benefit. Compensation for moving to a higher cost jurisdiction = taxable benefit. Exception is if you’re going north to a remote area.

Valuating Taxable Benefits and Further Examples of Taxable Benefits

* Method of valuation is fair market value – what it would cost employee to buy same benefit for themselves or, if you can’t figure that out, the cost to the employer.
* Employer-paid parking is a taxable benefit unless you need the car for work
* membership to clubs – tax-free if employer requires it and gets the primary benefit (requiring you to join a social club to hang with clients, or annual bar fees for lawyers)
* s.6(1)(b) says allowances are taxable, with some exceptions. Get sum of money
* allowable deductions for employees must be listed in s.8(1)

Allowances

* Campbell: nurse got a flat sum no matter how much she spent, was taxable on that sum even though she was able to show that she had made those expenses.
* Since Campbell: an employer can pay a “reasonable allowance” to an employee for the use of their car at work, but it needs to be required by the employment (Campbell was voluntary, not part of her ordinary duties). Also, no reasonable allowance for personal use.
* Reasonable automobile allowance: $0.53 per kilometre up to 50000 km + $0.47 per additional km, with a logbook keeping track of gas bills and mileage.
* Tax exempt reasonable allowances for business travel: traveling for the employer, if you are required by your employer to keep track of lodging, meals, and airplane travel, can be paid for at fixed figures, so long as it’s a reasonable amount
* for overtime (> 2 hours, not more than 3 nights per weak), there can be a reasonable allowance for meal ($17/meal) and reasonable commuting allowance

Specific Deductions for Employees

* Specific deductions permitted from s.8 as well as moving expenses under s.62 and child care expenses within limits of s.63 are deductible.
* Deductible expenses for employees: those REQUIRED by employment contract (Campbell was voluntary) for purpose of earing employment income. If the expenses, like the car, are also used for personal use and employment use, have to be able to apportion
* s.67: general rule against unreasonable expenses, disallows the unreasonable portion of legitimate expenses.
* Expenses of entertaining people, food/beverage whatever, are only half deductible
* Specific deductions permitted: travelling expenses for railway employees and traveling commission sales employees, for other employees, they can deduct travelling expenses if they are required to travel in course of their duties and are required to pay these expenses yourself (no reimbursement) then you can deduct. Employer must sign form T2200 that says that employment requires incurring these travel costs.
* Commuting to and from work is a personal expense, no tax relief. If you’re required to travel while at work, use car while at work, those commuting costs can be deducted.
* Legal expenses: an employee who is not being paid, maybe owing backpay or insolvent employer, legal expenses from recovering that owing pay are deductible. Also legal feels for recovering retiring allowances/damages for wrongful dismissal.
* Professional and Union dues are tax deductible as well under s.8, professional dues in a statutory body like a law society and the job has a connection to this statutory membership, therefore the membership fees are tax deductible. Or tax-free if reimbursed.
* S.8: home office: can make an arrangement whereby employer requires them to have a home office, if they will sign off on form T2200, establishing that employee requires an office at home to complete the work, can’t all be done at work; this permits deduction of home office expenses
* Can only deduct these home office expenses if you can fulfill one of two conditions: either the home office is your principle place of work (spend >50% of your time there) or this area is for exclusive use for employment and is a regular/continuous basis for meeting customers/clients.
* If meet requirements, can apportion expenses for home use between personal expenses and employment expenses –do ratio of the square feet of the home office to total square feet of the entire house, that percentage of household expense (rent, maintenance, telephone, property tax) are deductible. If 25% of home is office, 25% of household expenses are deductible
* You can also make traveling costs from home office to work office deductible

**Class 21**

Income from Business

* s.9: taxpayer’s income from business or property is the taxpayer’s profit from that business or property for the year. Revenue – expenses.
* Not just s.8(1), all kinds of deductions permissible and if the revenue exceeds the expenses we have a profit, otherwise loss, and loss can be carried on to other years, to all sources.
* GAAP is followed except where the Act or the cases say no.
* s.9(3) excludes from computation capital gains or losses in connection with the business or property. Distinct source. Circulating capital = what the company trades in, whereas fixed = the assets that the business uses year in and year out to operate the business. There are capital gains/losses and depreciation/CCA consequences to those fixed assets while the circulating capital gives rise to income from business. Fixed = business premises and tools, while circulating = the goods business deal in/sell on a daily basis.

What constitutes a business

* s.248(1): a profession, calling, trade, manufacture, undertaking of any kind, adventure or concern in the nature of trade. Excludes windfall gains and hobbies. Distinguishes from activities that are purely person in nature, distinction between activities with a view to making a profit, for-profit activities, as opposed to recreational or personal activities, things done for fun that are not profit-making. If it’s a personal activity, like a hobby, that yields money, that’s not taxable nor are the losses deductible.
* Business: an activity (organized activity, being busy, not passive income/investment) that the taxpayer intends to carry out FOR PROFIT (don’t have to make profit, only that taxpayer has to be motivated to make a profit) and there is EVIDENCE to support that intention
* Stewart: the first stage of test: does the taxpayer intend to carry on an activity for profit (there’s the intention to make a profit, it doesn’t have to be result of profit or even a reasonable expectation of profit) and second stage, is there evidence to support that intention.

Is it a Business? (the earmarks of a business)

* first, it has to be an activity, you have to actually be doing something, not just passive income.
* Graham: it’s an organized activity, purposeful in its purpose of making a profit, that it has a “scheme” or a “system”. If a person just took odds they were given and bets, that’s not business, they don’t have a scheme, but if they have some way of cheating or trimming the odds in their favour, like a casino or bookmaker, that’s a system
* risk/reward, profit motive: Distinguishes between the hobbyist doing something for fun and someone doing it for a profit. If you’re losing year after year, recurring losses, this could be evidence that you do not have a profit motive. Thus recurring losses can bet aken as evidence against reasonable expectation of profit..
* Stewart: SCC cut back the reasonable expectation rule, just has to be some EVIDENCE to support the subjective intention of the taxpayer to make a profit, to support that they’re doing it for profit, doesn’t have to be a reasonable expectation, just that they’re trying to profit.

Lines Between a Windfall and a Business (Organized Activity; Gambling)

* Must be an organized activity: Graham – the bookmaker has a system while windfall gains are not organized, just laying random bets. Graham didn’t have an angle, he’s just taking the odds and betting on them, he doesn’t have enough of a scheme or system, and as such, they are outside a source, they are not income from business..
* he just takes the odds that he’s given. He’s not organized in the same way as the bookmaker – he’s taking a chance and he could win or lose, and just happens that overall he wins. He’s skilful or very lucky, but he also isn’t doing for a profit motive – he’s just addicted to gambling. Didn’t matter that it was his livelihood and how he made a living.
* established the principle that gambling or lottery winnings are tax-free unless it’s a very extreme case where have such an organized activity or angle that you’re taxable. Bookie makes the odds, so he has a system, and he has an office and staff, business-like, he is organized, offers a service on considerable scale, and he has a trade that he does for profit. Bettor just accepts the odds and tries to beat them with more luck than skill, counted as windfall gains.
* Walker: line between windfall and business. Guy was betting, but he also raced his own horses, insider info from jockeys and such about probable outcomes. Not like Graham, who just took odds, Walker had inside info, shaped the odds for him. So he was considered to have a business on his gambling, systematic attendance and scale.
* Morden: changed his status, a source can start and it can stop. He had his own horses so had insider info like Walker – his gambling was thus a business. Got rid of horses but continued gambling: court said he’d given up the source and was gambling on odds like everyone else.
* Leblanc: limits to how much an individual can bet. These guys thus hired people to place bets in their own names as nominees, betting on a huge scale. Their “system” was that they were able to look at the odds given by the lotteries on these sports things and the oddsmakers were all dufuses and gave very favourable odds and the LeBlanc’s secrets was to bet, taking the long odds that were actually favourable. Had huge losses but ended up $5.5 mill in profit. Court decided that while there was a LOT of money and there was a certain level of organization, hiring people to place bets, still tax-free, not enough of a scheme, just taking odds as given.
* Ultimately the Distinction is between the better just taking the odds they’re given and the gambler who has a system of organization for reducing their risk.

Pursuit of profit

* losses on hobby farm were not deductible as they didn’t relate to activity with a profit motive.
* Dickson (Moldaven) lays out criteria: the profit/loss experience in past years, is the taxpayer trained or an amateur without background in the field, the taxpayer’s intended course of action (what is he trying to accomplish, is there business plan), is this business capable of ever showing profit. This is the reasonable expectation criteria. Recurring losses also negate.
* Stewart: no personal element whatsoever, it was an “exclusively commercial intention” and CRA was wrong to try to add a reasonable expectation of profit test to someone like Stewart where his activity is purely commercial with no recreational or fun aspect to it
* SCC rejects the reasonable expectation of profit in his case: if you’re conducting a commercial activity, and you’re trying to make a profit, and there’s evidence here (tax reduction, capital gains motivations, charging market rent, and arms length tenants), then you can count it as business and deduct the losses.
* Start-Up: can have losses for a few years and reasonable expectation test would lead the CRA to snuff a business in its early years. Concern is not the validity of the reasonable expectation test but rather its overuse on taxpayers suffering recurring losses.

The Three Types of motivations and Reasonable Expectation

* where the activity is exclusively commercial with no personal element (need not show reasonable expectation to deduct losses)
* you can have the hobby type of situation where it’s purely pleasurable (there, it’s conclusive due to nature of activity that it’s not commercial and hence not deductible)
* middle ground: mix of commercial and personal motivation, and here the reasonable expectation of profit concept CAN be used as one of several factors to decide whether it qualifies for tax deduction. In that middle ground, look for the *predominant intention* of the tax payer. It’s a blended motivation, and the taxpayer must establish the > 50% intention is to make a profit from the activity: can do this through establishing reasonable expectation of profit via the Moldaven factors. Thought that’s still just one factor.
* If the predominant motive is profit, losses are deductible. Otherwise, no.

**Class 22**

Stewart Test For Finding Profit Motive

* in order to have a source of income (from business or property) the taxpayer must have/show a profit or if they can’t, a reasonable expectation of profit. Objective evidence of circumstances from which you can say yes, this person, although they’re having losses, they are trying for profit
* Stewart was taking these recurring losses to shelter his other income, reducing his taxes overall by claiming these losses against his other income.
* SCC: if you have a commercial activity, that you are seeking to make profits, and there’s no hobby element (gambling, a form of activity done for recreation, which renting units isn’t) and if he had a profit motive, didn’t need to show reasonable expectation of profit.
* Losses are deductible as income from business as long as the taxpayer has a profit motive for what they’re doing. Don’t need reasonable expectation.
* Also borrowing money or investment can be business – he was earning current income from the renters and he planned on selling later on for capital gain (shows a commercial purpose even though capital gains are a distinct source from business), court accepted seeking capital gains and tax reduction were commercial purposes
* Stewart test: it’s a commercial activity and he was trying for a profit, don’t have to actually make a profit nor show a reasonable expectation of making one. If it’s a mixed motive, then reasonable expectation can be considered to establish predominant purpose.

Adventures in Trade

* Bellingham: A single speculation in land is taxable as an adventure or concern in the nature of trade (s.248(1)), counts as income from business. Someone who flips real estate, buying fixing up and selling it for a quick buck is the hallmark of a speculator.
* buying and holding is characteristic of investor while buying to resell is hallmark of speculator. The latter is income from business while the former is capital gain. Short-term versus long-term

Business Income Distinguished from other Sources

* Employment: 4-in-1 test plus common intention to distinguish employment from self-employed (business), look at the situation holistically and all the factors and make an overall assessment.
* Speculator versus investor (above).
* Income from Property (investment or speculation?) Test to be applied: buying and holding units (Stewart), not providing services to the tenants like a hotel would. Just passive income: use of his capital to earn rental income, little activity or time, effort or organization.
* Income from property: “ordinary income”= interest, rents, and royalties
* Capital gains are excluded from income from business.

Investment Income – Interest Income

* interest income is compensation for the use of the taxpayer’s money, referable to the principle amount, and it accrues daily. If you borrow just for personal expenditure, the interest expense is not deductible. If it was borrowed for investment or for earning purposes, then it is.
* Interest = Principle (capital) ($1000) x Rate (5%) = $50 income. Principle, the loan, is tax-free money: receiving money that you’re obliged to repay isn’t income. But the interest rate payable to the lender is interest income (minus the expenses associated with the lending/borrowing)
* Bonuses: if instead of saying I charge you $50 bonus instead of saying a percentage of interest, this counts as a capital gain, so only half is taxable as income. Eg: if I charge you 5% interest on the $100 I loan you, that $5 would be taxable as income, but instead of giving an interest rate, I just say “pay me back $105,” that $5 is a capital gain.
* payment of the loan back to the lender is on a periodical basis, like monthly payments on your mortgage, each of which contains two elements: part payment of the principal and interest (a blended payment). As more payments are made, the amount of the principle outstanding falls and as payments reduce the principle, they become larger and larger comprised of interest.

Guards against Hidden Interest

* s.16(1): if you have a blended payment of what is both interest and principal, you have to separate the interest element out for the benefit of the borrower who may be able to deduct that if it’s used for a productive purpose and lender will have to report it as income.
* Groulx: Purchaser needed time to pay so negotiations ended up with the price of $395,000 but Groulx had to give purchaser five years to pay it. After downpayment, $310,000 payable over six and a half years without interest. Expressly provided that there would be no interest. Court concluded that the difference between the $395,000 and the $350,000 (the price purchaser originally offered) was hidden interest. Groulx was held to be taxable on this sum.
* vendor said I’ll give you time to pay, you don’t have to pay me any interest, but for that interest-free accommodation, you’ll pay a higher price. This was found to be hidden interest.
* The three factors that make a bonus “hidden interest”: Invariable practice to charge interest (if you’re getting instalment payments for purchase price, it is usual for the lender or the person making the accommodation to demand interest)
* the price was sold at higher than its fair market value (he paid higher to get “interest free”),
* raised this issue and was part of the negotiation – he wants to get tax-free money as capital. The taxpayer bargained interest versus a higher price without interest.
* lifetime capital gains exemption of $750,000 for shares in family businesses, family farms, or family fishing businesses, leads to great temptation to hide interest in those cases.

**Class 23**

Income from property

* term deposits, interest, rental income for a landlord who’s simply a passive landlord and not providing services, royalties, dividends. It’s all passive income, as opposed to active income (which would be income from business).
* Does NOT include capital gains, which is its own separate source.

Court ordered interest

* monetary claims carry a court order or pre-judgment interest, with interest charge from time claim arose to the time of judgment or settling the case: pre-judgment interest.
* If the person doesn’t pay after judgment, you get further interest – post-judgment interest, which is ordinary interest while pre-interest is a head of damages.
* post is 3% while pre-judgment is just 1%.
* pre-judgment interest is a head of damages and takes its character from the underlying damages being awarded. Interest follows the underlying claim, whether pre or post judgment so, for interest, interest on damages for wrongful death/personal injury would be tax-free.
* Damages can be set up to be paid in an annuity that’s less than 21 years.

Reporting Interest Income

* s.12(1)(c): interest is taxable
* taxpayer has a choice about year in which they report interest: it’s in the year received (report the interest in the year you got it from the bank or the company paying you bond interest or whatever) - the cash method, or you can be taxed on the receivable method (report it in the year in which you’re entitled to it regardless of the year in which it is actually received. )
* Accrual method: if you have interest income that can be worked out on an annual basis, you can be taxed on the year in which the interest income is earned even if you won’t actually receive it that year, that’s what the receivable method does, accrual demands that you are taxed on whatever you EARNED in the year, regardless of whether you received it as well in that year. Won’t be taxed again once you’ve actually received it.

Rent and Royalties

* where landlord owns a building and provides only minimal cleaning and maintenance, that’s considered passive income and hence income from property, not from business.
* Person who is receiving the rent (business or property) expenses: interest, property taxes, maintenance, management fees, or capital cost allowance.
* CCA allows you to write the cost of the building off over the years, but not the land: question is one of allocation of purchase price between the land and the building, try to maximize the allocation to the building for tax purposes, because it allows a bigger deduction for CCA.
* Declining Method of CCA: you get bigger deductions in early years and smaller deductions in later years. It’s always 10%, so less value deducted every year. ($100, to $90, to $81)
* Better to own property personally and not through a company: Corporations would be taxed higher rate, and if losses are in the company, it’s a separate tax payer and there’s no way of getting those losses out of the hands of the company into the hands of the shareholder and unless it had other sources of income, nothing to offset it against
* Royalties: sums that are paid on a formula, things like 10% per unit sold

Earn-Out Clauses

* On the sale of a capital asset like land or building, if the price can’t be negotiated as a fixed price between vendor and purchaser, may go for a price based on future profitability of the asset, a purchase price payable based on formula on how the earnings from this asset turn out in the future. Payments under this earn-out clause count as income to the vendor, not capital gain
* Spooner: ranch purchased for $5000, 25K shares, and 10% of oil production. Privy Council held that this was a capital transaction and the royalty was tax free. Govn’t reversed outcome with enactment of s.12(1)(g), saying that this 10% was a payment based on use or production is now income, earn-out clause.
* If a property is bought for $90,000 plus “earn-out” based on future sales/output, that component is taxable as income. Adverse consequence to vendor: a fixed price would have been a straight capital receipt and the whole amount only ½ taxable income.

Dividends

* Corporation cannot deduct dividends as an expense when computing profit.
* “Integration”: tax has already been paid by the company: dividend is just a distribution of a profit (already taxed when corporation was assessed) to shareholder, and so favourable tax rate is given on them to avoid double-taxation.
* Must be Canadian dividends to be eligible dividends. If eligible, you can run up to $50,000 in tax-free dividends when you add up personal credits and dividend credits (dividends must be sole source of income to get this tax-free money)

Profit/Loss

* s.9 talks about profit and s.9(2) about loss: say that it’s profit or loss according to general account principles, then adjust that to take into account ITA, regulations, and case law.
* First inquiry is whether the deduction is permissible according to GAAP, then go to business purpose test: was the income earned with the purpose of earning income.

**Class 24**

ITA Deductions

* s.18(1)(a): apply the business purpose test: in computing income of taxpayer from a business or property, no deduction that is not for the purpose of earning income
* 18(1)(b): Capital outlays: these are expenses that benefit the business for more than one year, so not accurate to deduct it all from one year, should be spread out over those future years.
* s.18(1)(h) expressly disallows personal or living expenses from being deducted
* s.20 permits deduction of CCA, but again, this is written off over the years.
* interest expense is also deductible, provided the money that is borrowed is used for the purpose of earning income - if the money is used to buy something for personal use, the interest will not be deductible
* s.67: with non-arms length expenses, govn’t scrutinizes them to ensure that it’s a reasonable amount that is being deducted.
* s.67.5: bribes are not deductible and under s.67.6 statutory fines and penalties also cannot be deducted. This is not out of public policy considerations: expenses from illegal activities ARE deductible if those activities qualify as a business.
* Campbell: deductions require accounting records, which is obviously a problem for criminal

Business Purpose Test s.18(1)(a) examined

* what is the mental state of the person incurring the expense, the proprietor or investor, are they doing it for a productive purpose/earning income? They don’t have to show that it actually resulted in income, cause/effect (Imperial Oil), it’s the purpose not the result.
* “to the extent” is a recognition that expenses can have dual purpose, partly purpose and partly business – like a computer can be used for business and for personal use, the person could apportion the computer and deduct the business portion of the cost.
* “made or incurred” relates to timing of the deduction: “made” has connotation of a cash based taxpayer (like investor): people who are earning income from property use a simplified method of accounting – “cash in (what did they receive in the year) and cash out (what expenses have they made in the year) while the business tax-payer, they would use the accrual method of accounting, “incurred”: this means liability for the expense that has arisen, you claim the expense in the year the liability arises rather than in the year you actually pay it (so in Imperial Oil, the deduction for damages was when the judgment was delivered, not date of payment)
* Practically speaking, accrual means revenue is reported sooner, as are expenses.
* Businesses use the accrual method (it’s the year where you have the legal commitment to pay or be paid, it’s when the liability arises), investors use the cash method (simpler), you can elect under s.35 of ITA to report on receivable method.

Imperial Oil (losses incidental to the trade = s.18(1)(a))

* Accident due to IO negligence occurred in 1927, US Steel negotiated settlement and arrived at settlement in 1930 under which IO was obliged to pay $500,000.
* goes through the steps: first step, GAAP, what do accountants say: they say it should be deductible for financial statement purposes to disclose to shareholders where the money went.
* step 2: s.18(1)(a) legal question of whether this expense was made or incurred for purpose of earning income. Judge says that what is meant by “for purpose of earning income” is that the expense is meant to cover a loss that is incidental to the trade.
* Business purpose is synonymous with “part of the process of earning income”, whether the activity responsible for the loss was inevitably part of the process of earning process.
* also refers to it as an “operating expense,” as it is related to the transportation of oil. The activity and collision arose as part of their profit-earning process, as it’s an accident is an inevitable incident that’s going to happen at some point in that process.
* As long as the expense is made or incurred for the purpose of earning income, it is deducted from that year, regardless of whether there was income in that year that was the result of that expense or if there would ever be. This kills GAAP’s matching principle.
* s.18(1)(a): “to the extent that”: this permits apportionment of expenses.

Fines and Penalties

* if the expense of a fine or penalty is deductible, then deterrent effect is reduced
* there is no such public policy issue for civil damages, which are compensatory to the plaintiff and so do not have the deterrent goal of criminal or quasi-criminal fines and penalties. Civil damages are thus deductible while statutory fines and penalties are not
* has to be a *statutory* fine to be not deductible under s.18(1), must be imposed under law
* the exception are the civil/regulatory fines for non-reporting of income, which are not deductible. Interest on taxes in arrears are also not deductible.

Royal Trust (determining whether something is a capital outlay; club membership fees)

* don’t have to match revenues with expenses, don’t have to show that result of smoozing that club member led to business from that person, don’t need cause/effect, sufficient to show that the expense was for the purpose of earning income, regardless of whether it did so or not.
* CRA tried to argue initial, initiation fees were capital outlays. A capital outlay is an expense that is infrequently incurred, “once and for all” expense, not recurring. But court said you have to look at this from point of few of Royal Trust, who is bringing these employees into the business and sending them to these clubs on a regular basis, so from perspective of RT, initiation fee is a recurring expense due to all the different people being employed in this way.
* Capital outlay must create an asset or advantage that you can see on the balance sheet. Nothing was created here that appeared on RT’s balance sheet on basis of this expense. They got no land, buildings, or anything of permanent nature.
* Also, no lasting or enduring benefit (if employee quit, there’s no benefit)
* This was not a capital outlay: it was recurring, produced no balance sheet asset or off-balance sheet asset as it’s all very temporary, and no lasting or enduring benefit
* Since this case: s.18(1)(l) now disallows deduction of club dues, reversing RT outcome. That said, RT’s principles are sound. Also can no longer deduct “playing fees” like for playing golf. However, smoozing of potential customers by buying them lunch is still a deductible expense: only 50% deductible (50% of entertainment or meal expenses for business purposes)
* s.18(1)(l): main purpose of these clubs must be dining, recreational, and sporting for it to be non-deductible – things like membership fees to professional associations are deductible

Personal Living Expenses

* s.18(1)(H): personal and living expenses are not deductible except for business travel reasons.
* s.62: permits the deduction of moving expenses, even despite the personal aspect: to encourage student and employee mobility, they are deductible.
* Medical and educational are personal expenses, but they get tax credits.

Deductions for Personal Caregivers?

* Benton: cannot deduct expenses from paycheques to a personal caregiver. Benton had a farm and on that farm he had a domestic who worked part-time on the farm and part-time attending to Benton, tending his household. So her paycheques were an apportionable expense between the personal side (not deductible) and the business side (deductible). Allocated based on how many hours a day she spent doing each. The apportionment must be on a reasonable basis.
* Parliament has since given a little slack: Can deduct disability support under s.64 or just attendant care expenses can get a tax credit under concept of medical expenses.

Leduc (deductions for legal expenses?)

* Leduc, who was the lawyer for church pedo ring and had been facilitating settlements ended up charged with being a pedo too. Eventually the charge was stayed.
* Tried to deduct the legal bills he incurred defending himself.
* Court: not incidental to the practice of law to defend yourself against charges of pedophilia, it is not part of the operation of a law business, this is personal/relates to activities of the individual.
* Whether legal expenses are deductible depends on if it relates to operations of the business. Hard for criminal activity to be within the scope of business. Similarly, divorce legal fees or legal fees from will claims or conveyancing fees from buying a house are also likely non-deductible.

**Class 25**

Child Care Expenses

* Originally excluded as they are not for purpose of earning income. Personal expenses.
* Symes: Her argument was that the expenses of the nanny should be deductible as a business expense in computing the income of her partnership because they permitted her to go to work.
* SCC: whether it’s income from business or employment at issue, these childcare expenses are deductible within limits of s.63.
* Despite her income being much higher than the average taxpayer, she is subject to the same limitations: the lesser of 2/3s earned income of spouse with lower income or $7000 for each child under 7 years, $4000 for each child between 7 and 16, and $10,000 for disabled children of any age. These are the deductions you get, regardless of the nature of your work.
* These expenses include nannycare, day care, private schools, summer camps, and day camps.
* spouse includes common law – it’s the lower income of the two spouses that sets the limits of childcare expenses. If one spouse makes 100 and the other makes 50, 2/3s of the 50 is the upper limit, which is $33,000. That’s the most you can possibly deduct across all your kids, regardless of what you’d get at $7000 per kid.
* if one spouse has NO income, then you cannot deduct childcare expenses. For single-parents, it’d just be that parent’s income that is considered.
* If spouse is in prison, deduct childcare expenses from the other spouse as the sole provider.

Scott (situation where food and drink is deductible)

* argued that couriers burn up more calories so should be able to deduct extra food and drink to just as a courier who couriers through truck gets to deduct fuel costs. FCA accepted this argument: ordinarily food and drink is a personal expense but here, it is a necessity of the self-employed courier to keep their energy up, so the expenses are deductible.
* just for the extra food above normal consumption, which is of course pretty uncertain line.
* CRA allows a standard deduction: $17.50 a day for self-employed rickshaw drivers or foot and bicycle couriers for extra food or beverages, just keep a log that shows you worked those days. If they want to claim more than this, they have to prove it with log books showing days & hours
* Employees required to work overtime: can get $17 per meal as a tax-free allowance.

Commuting expenses

* the cost of commuting from home to work, and associated parking, is considered a personal expense. Exception is where the employee is required to have their car available at work by their employment, in which case that commuting cost is deductible.
* if they have a home office and that home office is the base of their practice, than like Cumming, traveling from home office (you have no office anywhere else) to jobs, is deductible; it is effectively traveling from one workplace to another workplace, not between home and workplace, so that’s deductible.

Auto Expenses (where deductible for the reasons above)

* can claim capital cost allowance on the vehicle, as well as interest expenses and leasing costs.
* The max capital cost is $30,000. Didn’t like seeing self-employed people driving luxury cars and deducting them, so limited the figure used for capital cost allowance: figure is $30,000.
* CCA is also allocated between use and standing time, like Cumming, they said it was 50% standing time, so only 50% deductible.
* Cumming: CCA rate is 30% on max cost of $30,000. So cumming could claim 30% of the $15,000 (use time allocation) each year under CCA
* interest on payments can be deducted: $300 per month on interest payments if he borrowed money to buy the car
* If he leased the car: maximum leasing cost that’s deductible is $800 a month.

Home office expenses

* Same restrictions as employees: to claim home office expenses, the office must be their principal place of business (must be there at least 50% of the time – Cumming didn’t have office anyplace else, so it was his) OR if you have another office too, the home office must be exclusively used for regular and continuous meetings. Must log meetings with clients in the office and prove that you are using the place exclusively (must be set aside, can’t be used for personal use) and there must be regular and continuous meetings with clients.
* you can also claim CCA on the house at rate of 10% of wood building and 4% if its stone, but if CRA sees this, won’t allow the principal residence exemption to the extent of the CCA. Like household expenses, this is based on what percent of the square footage of your house is your home office space: if home office is 20% of total square footage, you’d get 20% of the CCA of your house.

Expenses of criminal activity and Net Worth Assessments

* If a crime is a business you report your income for it and it’s the net, so you can also deduct. Everything that applies to legal businesses applies to illegal as well.
* Exceptions: s.67.5 – bribes to public officials are not deductible and s.67.6 prohibits the deductions of statutory fines and penalties.
* Eldridge: income on criminal activity is taxable and losses are deductible. Because she didn’t have financial records though, the CRA did a net worth assessment: an arbitrary assessment under s.152(7) where people don’t submit returns.
* Net Worth Assessment: put a value on her assets and then figure out what her assets are minus her liabilities on Jan. 1 and then figure that out on Dec. 31, and the increase in net worth between those two dates is the income. She would then have to estimate her living costs between those two days, which would be added back as not tax deductible (CRA assumption).
* Net worth: increase in net worth + non-deductible expenditures – non-taxable receipts.
* she challenges the assumption that all her expenses were personal – argued some of that was deductible business expense. However, to be deductible but there must be PROOF that they were incurred, not enough for her to say they were incurred, she had to provide receipts.

Statutory Fines reviewed

* S.67.6 says that statutory fines or penalties are not deductible. s.18(1)(t) says that interest on tax arrears and penalties are not deductible. Other fines though, like disciplinary fines from a non-statutory body like the NHL or whatever or contractual fines are deductible.
* To be non-deductible, it must be imposed via statute

Interest Expense (direct versus indirect use of the borrowed funds)

* the charge for borrowing money is deductible if the purpose of borrowing the money is for the purpose of earning income from business and property or for purpose of employee’s vehicle required for work. If purpose of borrowing is toacquire property for purpose of earning income, it’s deductible. It’s money borrowed for purpose of earning income, not personal.
* Borrowing money on a credit card leads to interest that is not deductible, nor is the interest from borrowing money to buy a house or car for personal use. Borrowing money for personal expenditure – interest is not tax-deductible. Borrowing money to contribute to RRSPs and TFSAs – interest on that is also not deductible. It must be to earn income.
* Bronfman Trust: Trustee borrowed money because beneficiary wanted to be paid out of the trust, have her interest extinguished. Bronfman trustees said market sucked, was inopportune time to sell the assets, so decided to hold onto them and paid out with borrowed money. SCC said they had not used the borrowed money for productive purpose: they just distributed it.
* Bronfman: It’s not the INDIRECT use of the funds that count, it’s the direct use of the count (the direct use of the borrowed funds was just to pay someone – not income generating act. While the indirect use = paying the money to hold onto the assets and make money by selling them at a better time). SCC said direct use is the one that matters in determining whether the interest on those funds is tax-deductible.
* Singleton: drew out of his partnership capital account and used the funds to purchase a home (personal), then he got a bank loan for the $300,000, and put the loan to replenish his partnership account. The SCC said that unlike Bronfman, this sequence allowed interest expenses to be deducted. The borrowed money was going in to replenish the partnership account, and that account earns income for the lawyer, so the direct use is thus for the purpose of earning income for the lawyer. If he used the loan to buy the house directly, non-deductible.

Requirement of reasonableness

* the expenses must be reasonable in amount
* even if it’s for a legitimate purpose, the CRA can disallow an unreasonable amount; the unreasonable portion of a legitimate business expense would be disallowed.