Taxation 1

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Chapter 1 – The Logic, Policy, and Politics of Tax Law

Terminology

- **NOTE: definitions in the *ITA* at s.248(1)
- Average tax rate: rate of tax applying to taxpayer's income as a whole
- Capital income: the taxable portion of capital gains (i.e. 50% - deductions)
  - Only taxable when realized
- Constitution: Tax requires consent of the governed (so can't tax by royal prerogative)
  - Through 1867 Constitution Act, must start a tax bill in the house of commons (s.53)
- Direct tax: tax is taken directly from the taxpayer (eg income tax – both personal and corporate)
- Division of Powers:
  - Federal: s.91(3) – any mode or system of taxation
  - Provincial: s.92(2) – direct taxation w/in the province to the raising of $ for prov purposes (no indirect taxes)
- Effective tax planning: taking full advantage of tax measure available within compliance with the law
- Effective tax rate: rate of tax that applies once factor in exemptions/deductions/credits
- Fine:
- Fiscal year: April 1-March 31, used for creating federal budget – estimates revenue and expenditure for next fiscal year
- Indirect tax: tax is taken from taxpayer through another (eg gst, hst, excise taxes)
- Interest: Where received on refunds, is taxable. Where charged on balance owing, not tax deductible.
- Marginal rate of tax: highest rate of tax paid by individual
  - e.g. if taxable income higher than 150G, will pay 29% + 14.7% on the last $20G
  - tax planning is done at the marginal rate
  - as raise rates, there is disincentive to work (theoretically)
- Net Worth: assets minus liabilities
- Penalties: not tax deductible s.18(1)(t). Civil penalties ss.162(1)-163.2, criminal fines ss238-239, not deductible.
- Prize:
- Progressive Tax: rate of tax increases (per bracket) as amount of taxable income rises
  - As income rises, ability to pay rises (also, marginal utility decreases, theoretically)
- Refund: Repayment of excesss income tax
- Regressive Tax: rate of tax decreases as taxable income rises (rare)
  - (eg GST, HST, carbon tax, Alberta Proportional Income Tax)
- Royalty:
- Tax: a charge imposed by a government (not a private entity) for the purpose of raising revenue to meet its expenses in providing government services
- Tax avoidance: taking advantage of tax provision in a way not intended by regulation (civil penalties)
- Tax base: the thing being taxed. For income tax, the tax base is "taxable income"
  - tax payable = (tax base (eg taxable income) x tax rate (set by govt)) – tax credits
- Tax evasion: deliberate, wilful taking advantage of the tax act/concealment (criminal prosecution)
- Tax Havens – jurisdiction with no taxes, where no tax treaties with Canada, and authorities won't exchange info w/foreign tax authorities (i.e. banks etc won't disclose information)
- Taxpayer (s248(1)): person beneficially entitled to income (s.2: each person is a taxpayer, as is each corporation, trust, estate
- Tax period: income tax – annually, taxation year is calendar year, April 30 following year is balance due day
- Windfall: found money (gift, lottery) **SEE BELLINGHAM CASE** p89 - damages can be taxable, depends what they are

Theory behind tax:

- Equity fair allocation of tax burden – horizontal/vertical equity, "ability to pay"
- Look for ability to pay to determine:
  - Horizontal: taxpayers with same ability to pay should pay the same tax
  - Vertical equity = taxpayers with different abilities to pay should pay different levels of tax
  - Ability to pay = "income"; families with children; taxpayers with disabilities)
- Income = comprehensive tax base (a buck is a buck is a buck)
  - Regardless of source, if increase in wealth then should pay increase in tax
  - Accretion concept – Bellingham case (any addition to wealth would be included in income regardless of how – windfalls and gifts would be taxable because do add to person's wealth even if not from classical economic conception of increase)

- Neutrality – efficiency of marketplace decisions (p743)
  - o Taxes affect behaviour of individuals and corporations
  - o Intentional encouragement or deterrence of behaviour
- All taxes have 5 components:
  1) **Tax base** – base upon which the tax is levied
  2) **Tax-filing unit** – responsible for paying the tax
  3) **Tax rate** – rate applied to the base in arriving at the amount of tax owing
  4) **Tax period** – period over which the base is measured and the taxes collected
  5) **Tax administration** – administrative arrangements for tax collection
- Direct tax:
  - o Tax demanded from person you want to actually pay
    - *ITA* is direct tax
- Indirect tax:
  - o Tax demanded from person in order to recover tax paid to someone else
  - o Is directed at producer, or seller, who already paid tax to govt, to recoup losses
    - E.g. liquor, customs, GST
- Surtax:
  - o A tax on a tax – instead of raising the price, add a tax (?)

One way to classify tax is by base:
- There are 3 bases upon which a broad-based tax might be levied:

a) Income tax – tax the amount an individual earns

- There is no definition of "base" in the ITA, but in Canada it is usually personal income

- In addition to taxing all income, governments may impose payroll taxes to tax only some aspect of income (ie: wages and salaries)

- Income tax accounts for by far the largest percentage of government revenue

b) Consumption tax – tax the amount an individual spends

- A consumption tax is basically an income tax that exempts the value of the TP's savings
- There are many ways the tax can be imposed and collected: GST, PST, HST, ect…

- Governments often impose excise taxes that are imposed on only selected goods and services such as gasoline, cigarettes, alcohol, luxury goods, etc…

c) Wealth tax – tax the amount represented by an individual's property

- Canada is one of the few industrialized countries that does not have a general tax on wealth

- However, countries can impose estate or inheritance taxes on the value of a person's wealth when they transfer it to some other person by way of gift or upon death

Or can classify tax by rate:
- There are 4 major ways to distinguish between concepts of tax rates:

a) **Statutory rate structure**

- **s.117**: provides a federal tax-rate schedule with 4 marginal rate brackets (from 2005)
  - o 15% **on the first** $42,707 of taxable income, +
  - o 22% **on the next** $42,707 of taxable income (on the portion of taxable income over $42,707 up to $85,414)
  - o 26% **on the next** $46,992 of taxable income (on the portion of taxable income over $85,414 up to $132,406)
  - o 29% of taxable income **over** $132,406.
- BC:
  - o 5.06% on the first $37,013 of taxable income, (total of 20.06%)
  - o 7.7% on the next $37,015, (total: 29.7%)
  - o 10.5% on the next $10,965, (total: 32.5%)
  - o 12.29% on the next $18,212, (under $85,414: 34.29%, over = 38.29%) +
  - o 14.7% on the amount over $103,205 (under $132,406 = total: 40.7, over=43.7%)

- These rates combine with the applicable provincial tax rate, but all are on one tax return

- **Note**: distinguish between these 3 terms:

i) **Marginal tax rate**: rate of tax that applies to each additional dollar a TP earns

ii) **Average tax rate**: rate of tax that applies to the TP's income as a whole

iii) **Effective tax rate**: rate of tax that applies after exemptions, deductions, and tax credits on tax liabilities are imposed

- Therefore, when a TP earns an additional dollar moving them to another bracket, even though it might cause them to move to the higher marginal tax bracket, it can't affect the amount of tax they pay on their income falling in the lower marginal tax bracket

b) Progressive Rate System
- Increased rate of tax with amount of taxable income (ie: Canadian personal income tax)
- Canada has the progressive tax rate because:
i) Individual's capacity to pay tax increases as his/her income rises
ii) Marginal utility of income decreases with total income earned, so the more money one makes, the less money one needs and the less use money has to the individual (apparently)
- S: people will be quiet if the tax level is below 50% (which holds true in every province)

c) Regressive Rate System
- Rate of tax decreases with the amount of taxable income (very rare)
- HST is regressive, as lower income individuals spend more on consumption and pay more in relation to the proportion of their income (gov't tries to correct this with the GST tax credit)

d) Proportional (Flat) Rate System
- Single tax rate is applied on all taxable income for all individuals
- Corporate and *inter vivos* trusts are taxable at a flat rate (and personal taxes in Alberta)

Sources of Income Tax Law

- Head office of CRA is in Ottawa, then regional offices (Vancouver), and tax services offices and taxation centres (Surrey)
- Primary Sources (law):
  - *Statutes:*
  - Income Tax Act – p1
  - Income Tax Application rules – p1971
  - Income Tax regulations – p2163
    - From CRA, through Ministry of Finance (don't have to go through parliamentary procedures for enactment, passed through administrative procedures
    - Details are in the regulations (often changing, not having to go through ^^ = flexibility)
  - International Tax conventions – plxiii, 2901
    - To avoid double-taxing. Implemented by statute
  - *Statutory Interpretation* (p743 case materials, last para)
    - No strict construction, no special interpretation rule for taxation
    - Bell expressvu
  - *Cases:*
    - DTC (Dominion Tax Cases – CCH), CTC (Carswell), FCR (Federal Court Reports)
    - Tax Court of Canada → Federal Court of Appeal → SCC
    - Decisions binding on CRA (but CRA can amend regulations if don't like outcome)
- Secondary Sources (not law):
  - CRA publications
  - Information Circulars – sets out CRA procedures
  - *Advance Income Tax Rulings* (ATRs):
    - IC 70-6R5 ATRs (2002) – through Income Tax Rulings Directorate (CRA), for specific issue
    - Fee charged, published
    - Result is binding on CRA ($100/hr for first 10 hrs)
    - "is a written statement given by the Rulings Directorate to a taxpayer stating how the CRA will interpret and apply specific provisions of existing Cdn income tax law to a definite transaction which the taxpayer is contemplating." (may be favourable to taxpayer or not – if not, can withdraw before ruling given)
  - *Technical Interpretation*:
    - CRA tax services office considers requests for written interpretations on completed transactions, over-the-counter advice and assistance on general matters
    - Not binding on the CRA
    - No fee charged, anonymous but will be published (this is what's in CCH/Carswell – ATRs too)
  - *Income Tax Dispute*:

Chapter 10 – Dispute Resolution, Statutory Interpretation and Tax Avoidance

- *ITA* s.150 – person must file a tax return if tax is payable or if capital property was disposed of
  - Corporation must file a return regardless
  - Minister/CRA can demand a return at any time (s.150(2), p1587)
    - Person must respond w/in 2 years, or face penalties
  - file by mailing to taxation centre (or efile, or telefile, or netfile), are processed by Tax Data Centre, then may be audited by District Office (generally high-risk taxpayers)
- Taxation year – s.249(1)(b), for individual: January 1-December 31 (p2060), for corporation: fiscal period
  - Due date for tax return - April 30 the following year s.150(1)(d)(i) p 1586
  - Balance due day – the day money is due s.248(1) p1997
  - Should file return even if can't pay. Not filing may → criminal offence (can work out payment schedule)
    - Interest begins to accrue April 30, plus late penalty
  - For self-employed and spouses, tax return due date is June 15 of following year
    - s. 150 (1)(d)(ii) p 1587
    - But balance due date is still april 30, so if owe taxes, will accrue interest from april 30-june15
- Assessment:
  - Starts the clock for statutory limitation period, is the foundation for appeal process
  - Assessment saying no tax payable is not an assessment for appeal process (*Okalta Oils Ltd v MNR* 1955 SCC)
  - Then, nil assessment is an assessment for certain purposes (*Anjulin Farms Limited v. MNR* 1961 Exch)
  - *Okalta* confirmed in *The Queen v. Garry Bowl Limited* 1974 FCA
  - So taxpayer can either wait until next assessment process, or can request a determination under subsection 152(1.1)
- The tax process begins with the filing of a return by the TP and flows as follows:
  - Return
    - s.150 – every individual TP must file and submit a return by April 30 if tax is payable
  - Original assessment
    - Official act of the CRA, who verifies tax return and sends out a Notice of Assessment ("NOA") to the taxpayer by the end of July
  - Further reassessment
    - A NOA is an "initial assessment", as the *CRA* has 3 years to reassess a return, which starts to run when NOA is sent out by the CRA
    - This can be either a reassessment or an additional assessment adding new sources of income
  - Objection
    - TP files a Notice of Objection ("NOO") within a certain time limit that holds payment
    - NOO must state the legal/factual error the claim is based on
  - Appeal
    - If the TP disagrees with CRA's reassessment, they can file a Notice of Appeal with a certain time limit in the Tax Court of Canada ("TCC")
    - Tax Court of Canada first → Federal Court of Appeal → Supreme Court of Canada (with leave)
  - Alternative relief (option)
    - Available to TPs when the law is against them whereby they seek a Remission Order from the Treasury Board
    - A Remission Order is an Order in Council provided by s.23(2) of the *Financial Administration Act*
    - s.23(2) of *FAA*: allows gov't to forego taxes when an individual has no legal grounds of appeal but they believe it is unreasonable, unjust, or against the national interest to pay so much tax
    - TP must make a case for extreme hardship, reliance on bad advice from the CRA, financial setback, or demonstrate an unintended (inequitable) effect of the legislation

Tax Planning:

- Taxpayers are entitled to select courses of action or enter into transactions that will minimize their tax liability (*Duke of Westminster*)
- Tax avoidance is only bad where it becomes tax evasion
  - Where taxpayer withholding facts from CRA, or transaction appears to do one thing but really does another
- Penalties: not tax deductible s18(1)(t).
  - As imposed by the *ITA*. For deductibility of civil/criminal penalties in general, see below (*Eldridge* etc)
  - Civil: Failure to file, repeated failure to file, false statements, 3rd party assistance penalties – ss162(1)-163.2,
  - Criminal: failure to file, false/deceptive statements, destroying books – ss238-239,
- Interest:

- S.161 – if tax outstanding, interest charged to TP at prescribed rate
- Interest set quarterly by regulation (ppxxvii, reg 4300, p2452) (charged is always 2% higher than given)
- Interest given on refunds – 3% as of Sept 30, 2012
- Interest rate charged on late payments – 5%, not deductible (s.18(1)(t))

- Assessments:
  - Initial, original or quick assessment must be done "with all due dispatch" – s.152(1) p1589
    - Notice of Assessment (refund if applicable) s.152(2) – p1592
  - 3 year limit for amending a previous return from CRA mailing of notice of initial assessment – s.152(3.1)(b) p 1592
    - beginning at notice of assessment from CRA
  - subject to a possible extension of up to 10yrs (fairness package)
  - 3 year limit for CRA reassessment as well
  - individual is required to keep records and documentation for 6 years s.230(1)-(4) p 1930
  - IC 78-10R5 – Books and Records Retention/Destruction
- Reassessment:
  - Normal Reassessment Period: s.152(4) – Minister may reassess individual or Cdn-controlled corporation w/in 3 years from day of assessment
    - other corporations – 4 years
  - Outside of normal reassessment period, can only reassess if
    - A) taxpayer made a misrepresentation attributable to neglect, carelessness or wilful default or has committed fraud, or
    - B) taxpayer filed a waiver within the normal limitation period
- Net Worth: (assets minus liabilities)
  - CRA can force taxpayer to report net worth, or will estimate it for them (can do it Jan 1 and again dec 31 to see growth)
  - Assessment not dependent on return, CRA may make arbitrary/net worth assessment, not bound by info from TP
  - Any increase in net worth creates rebuttable presumption that it is taxable income (*Eldridge)*
  - Where estimated by CRA, is "arbitrary" because is assumed, not self-reported
  - Increase in net worth + personal consumption = taxable income
- TP must keep records for 6 years – s.230(1)

Audit and Investigation (p744)

- Income Tax Act ss.238-239 (pli-lii, civil penalties – ppliii-lvi)
- Penalties for not filing:
  - Criminal fines, imprisonment, requires AR+MR (offences – ITA ss238(1), 239 – pli)
  - Civil penalties (less onerous) s.162(1) pliv, repeated failure s.162(1) pliv to 163.1
    - s.163(2) – civil penalties on parties other than taxpayer at hand (3rd party)
- Criminal offence – open attempts to take advantage of tax law, requires mens rea + actus reus (*R. v. Jarvis)*
  - Will turn to civil penalties where no MR
- Tax Havens – jurisdiction with no taxes, where no tax treaties with Canada, and authorities won't exchange info w/foreign tax authorities (i.e. banks etc won't disclose information)
- IC 00-1R: Voluntary Disclosures Program (as of 22 Oct 2007)
  - Taxpayers may avoid being penalized (civ) or prosecuted (crim) if they make a valid disclosure (tax amnesty)
    1. Voluntary
    2. Facing penalties (ITA ss238,239)
    3. More than 1yr overdue
    4. Full disclosure

    → Tax Amnesty
- CRA must give warning to TP that TP has constitutional rights against self-incrimination when predominant purpose of the audit shifts and becomes a criminal investigation (*R v. Jarvis*)
- s.230(1) – all taxpayers must maintain books and records of account

R. v. Jarvis	handout

F *A* failed to report tax return on his deceased wife's estate, also failed to report the profit he himself made as business operator of her artwork in 1990 and 1991 (6 figure sums for both years). CRA determines he committed gross negligence, triggering s.163(2). Also considered tax prosecution and sent *A*'s file for referral to investigations, but never informed *A* that this material could/would be used in criminal prosecution, didn't inform

him of *Charter* rights, deceived *A* about risk of prosecution.

I Is there a difference b/w CCRA audit and *ITA* investigative functions, if so, when does it exercise audit and when investigation?

H New trial ordered.

R Audit and investigation are separate. TPs statutorily bound to cooperate w/audit for tax assessment, but "adversarial relationship that crystallizes between the taxpayer and the tax officials when the **predominant purpose** of an official's inquiry is the determination of penal liability" (p3). Act needs penalties, s.238 is to enforce compliance, not penalize criminal conduct. s.239(1) creates offences to catch those who unfairly increase burden placed on honest taxpayers. Determining where switches from investigative to adversarial is contextual (**mixed fact and law**), looking to the factors:

a) Did the authorities have reasonable grounds to lay charges? Does it appear from the record that a decision to proceed with a criminal investigation *could have* been made?
b) Was the general conduct of the authorities such that it was consistent with the pursuit of a criminal investigation?
c) Had the auditor transferred his or her files and materials to the investigators?
d) Was the conduct of the auditor such that he or she was effectively acting as an agent for the investigators?
e) Does it appear that the investigators intended to use the auditor as their agent in the collection of evidence?
f) Is the evidence sought relevant to taxpayer liability generally? Or, as is the case with evidence as to the taxpayer's *mens rea*, is the evidence relevant only to the taxpayer's penal liability?
g) Are there any other circumstances or factors that can lead the trial judge to the conclusion that the compliance audit had in reality become a criminal investigation?

Nothing preventing the prosecution from using materials obtained through the proper exercise of audit function. Once purpose shifts to penal, then can't compel further testimony, no further written documents inspected or examined except via judicial warrant. Can only use information obtained prior to criminal prosecution commencing as the predominant purpose (can have parallel so long as primary purpose is audit). Cannot use s.231(1) 231.1(1) to compel information for purpose of criminal investigation.

In this case, investigation did not turn penal until after search warrant issued, so this evidence is admissible.

Fairness package (pxlvii, p746 in case materials)

- Allows Minister **discretion** to: (ref IC 07-1, june 4 2007)
  - provide refunds beyond normal limitation period
  - waive interest and penalties (but note: not principal sum)
  - allow taxpayer to make/amend/remake certain elections beyond normal filing deadline
- Taxpayer relief provisions – e.g. can apply for tax refunds back longer than 3 years, shorter than 10 (>3<10)
  - TP can also make "elections" after statutory time limits (up to 10 years)

Income Tax Disputes

- Begins with self-assessment (annual return) → assessment/reassessment/additional assessment → objection → appeal
  - Taxpayer can file notice of objection w/in **90 days** of assessment/reassessment (s.165(1))
    - Details on what notice looks like – p747
  - Taxpayer who has filed notice of objection can appeal to TCC
    - w/in 90 days of filing notice of obj if Minister hasn't reassessed or notified TP of confirmation/vacation of assessment
    - w/in 90 days of day Minister confirmed assessment, or reassessed
  - CRA Appeals Branch → Tax Court of Canada → Federal Court of Appeal → SCC
    - Tax Court Informal Procedure:
      - If federal tax and penalties ≤ $12G, amount of loss in dispute ≤$24G, or only issue is interest
      - May appear in person or rep'ed by non-lawyer agent
      - No special pleadings
      - Subject only to judicial review by FCA (and subsequently SCC)
    - Tax Court Formal Procedure:
      - Must appear in person or be represented by lawyer
      - Procedure similar to Federal Court
      - Appeal to FCA – 30 days after TCC's judgement

    - Trial: TP leads evidence (onus on TP)
        - Minister's assumptions presumed to be correct unless specifically disproved by TP, as assumptions relating to facts and not to law (if Minister makes assumptions as to law, onus rests on Crown to prove correct)
          Johnston v. MNR [1948], SCC
        - But if Minister assesses outside normal limitation period on basis TP was negligent etc (s.152(4)) then onus is on Minister
          Pilsbury Canada Ltd v. MNR [1964] Ex Ct
  - No "compromise settlement" – *CIBC World Markets*
- Remission Order – for taxpayer where no legal reason for claim, but hardship element present
  - Treasury Board BC *Financial Administration Act* s.19(1)
  - "If the Lieutenant Governor in Council 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 Lieutenant Governor in Council may… authorize the remission of
    - (a) any tax, royalty, fee or other sum"
  - **What about the rule of law?!

Settlements

- 93% of objections resolved w/in CRA, 7% unresolved, go to court
- No compromise settlements (CIBC), s.220(1) p 1900
  - This means can't mediate or arbitrate
- Private creditor – money judgement from court, then limitation period of 10 years for recovery
- CRA – issues certificate of debt, files it in federal court, s.222(5) (no limitation period)
  - Can also file lien on real property (then pecking order for creditors – crown priority)
- 3rd party garnishment (s.224), eg bank – CRA files on bank, bank freezes bank count and remits proceeds to CRA
  - judgment by certificate s.223, lien on property
  - write of seizure and sale s.225, *Silva*

CIBC World Markets Inc. v. Canada	2012 FCA 3	handout

F *P* issued offer to *D* for 90% of reassessment for input credits (instead of 100 one way 80 the other). *D* didn't accept the offer on the basis not allowed to in powers as Minister.

I Whether the Minister can make deals.

H *J* for *D*. No compromise settlements.

R TCC has rule to encourage out-of-court settlements – court can consider any offers made. "Only offers that, as a matter of law, could have been accepted can trigger costs consequences" – the Minister cannot make reassessments on the basis of compromise, that are regardless of the facts and law. "The Minister is obligated to assess "on the facts in accordance with the law and not to implement a compromise settlement." (*Galway* principle – must stick to facts and law). As matter of law, Minister could not have accepted *P*'s compromise offer.

- There are 3 stages of audits:
  a) "Desk audit": CRA checks what you file (documents, calculations, matching items, etc…)
  b) "Office audit": CRA calls the TP into the office, asks TP to bring cheques, receipts, etc…
  c) "Field audit": CRA pays the TP a friendly visit at their home or office and investigates

- Sections 231.1-231.2 deal with the civil auditing powers in the *ITA*, where the TP has no rights:
  a) Civil powers of investigation and enforcement
    - s.231.1(1): Grants various powers to the Minister:
    a) Allows a person authorized by the Minister to "inspect, audit or examine" a wide array of documents, reaching beyond those the *ITA* might otherwise require the TP to maintain
    c) In the course of the inspection, audit, or examination, the authorized person may enter into any premises or place that is not a dwelling-house
    d) There is a correlative duty upon persons at the premises or place to provide "all reasonable assistance and to answer all proper questions relating to the administration or enforcement of this Act"
  b) Judicial warrant
  - s.231.1(2): Absent the occupant's consent in s.231.1(d), a judicial warrant may be obtained for entry into a dwelling house
  c) Requirement power
    - s.231.2(1): The Minister may compel any person to produce any information or document

- To be effective, self-enforcing regulatory schemes require not only resort to adequate investigation, but also the existence of effective penalties, and these criminal investigative powers trigger the *Charter*:

a) Summary offence

- s.238(1): summary offence that is triggered by non-compliance with filing requirements or with other of the Act's provisions, such as ss.231.1(1)

Taxpayers' options when Dealing with Tax debt problems:

1) pay off debts – with available cash, selling assets, or even borrowing
2) work on a repayment plan with CRA – a plan that CRA will accept and that will fit with other monthly commitments
3) apply for CRA fairness – a government program that could reduce the interest and penalties but not the principal portion
4) file consumer proposal
5) file for personal bankruptcy

Chapter 2 – The Source Concept of Income

- s.2(1) – taxable income for each taxation year of each person resident in Canada
- *ITA* s.3(a) – legislative expression of the source concept of income
  - "taxpayer's income for the year" is net income from each source plus net taxable capital gains
  - income from each source calculated separately, then aggregated (s.4(1))
  - for income not usually considered a "source", can be included via "Other Sources of Income" s.56
- Classic example of source concept – renter can't deduct rent, but no tax on rental value, so tax system is effectually subsidizing homeownership
- Revenue from both legal and illegal sources is taxable, illegal=irrelevant
  - Expenses from illegal activity are in theory deductible (*Eldridge*, p 387)
- Taxable income – the enumerated sources, at p84-85, + Net taxable capital gains (As of 1971)
  - *ITA* ss.3(a), (b) NTCG = TCG - ACL
  - ½ capital gain = taxable capital gain (TCG)
  - ½ capital loss = allowable capital loss (ACL) (only deductible from TCGs p81)
- Income = yield, capital = source of the yield (fruit v. tree/land)
  - s.4(1) – income from each source calculated separately, then aggregated to compute TP's total income
- Other sources of income – *ITA s.56* broadening the tax base since 1971, new sources
  - Gambling is windfall – p85 (doesn't flow from productive source)
    - Windfalls must comply with criteria p86/87 (see *Bellingham* below)
  - Job – note the difference between contract of service (=employee), and contracts for services (=business)
  - Nontaxable sources include:
    - Gifts – unless there is consideration (*Savage*)
      - Gifts of property may make donor liable for tax
    - Windfall gains – unexpected, incl betting/finding etc *Graham*
    - Strike pay
    - Life Insurance
    - GST/HST refundable tax credits
    - Inheritance
- For damages/settlements- look to the nature and purpose of the award (*Bellingham*)
  - If there had not been a loss, would the profit have been taxable income from business?
  - Compensation for loss of profit is taxable. Eg comp for loss of rent is taxable as a substitute for the rent
  - Compensation for breach of contract – subject to the surrogatum principle – contract cancellation fee is taxable since it is in lieu of profit that would regularly be income
    - But cancellation of long term contract may involve capital receipts, so could be taxed as capital income
  - Damages for personal injury/wrongful death are tax-free, as is:
    - Permanent/long-term disability
    - Temporary disability
    - Pain & suffering
    - Medical costs

Role of the Courts in Defining Sources of Income

Bellingham v. The Queen	[1996] FCA	p82

F Town expropriated land, compensation later determine to be 6x the Town's offer. Litigation ensued, taxpayer's share of settlement split into 3 parts: compensation for land, ordinary interest, and "additional interest". Compensation for land included in taxpayer's income from business (BECAUSE she intended to flip the property, so was income from business). Ordinary interest taxable pursuant to *ITA*. Federal Court held additional interest to be taxable as income from a business. Taxpayer contests ruling on compensation, and additional interest.

I

H Need to determine (according to facts) what part is compensatory and what is punitive. Here, should restore TCC decision (primarily for embarrassment etc). Punitive damages are tax-free.

R Proceeds of disposition are certainly income, but additional interest is not – **the purpose of this interest punitive to expropriator, not compensatory, so is windfall.** Note the difference between the receipt of income from a source and the disposition of the source itself (distinction between income (former) and capital (latter)).

Paragraph 3(a) makes clear that named sources are not exhaustive (note difference from UK law). Tends to be interpreted narrowly, futile to construe contextually because Parliament has included random items (for social purposes etc). Outside of paragraph 3(a), windfalls: gambling gains (bc not from a productive source), gifts, inheritances. Income involves creating new wealth. Whether a receipt is income from a source:

a) taxpayer has no enforceable claim to the payment
b) no organized effort by taxpayer to receive payment
c) payment not sought after or solicited by taxpayer
d) payment not expected by taxpayer
e) payment has no foreseeable element of recurrence
f) payor is not a customary source of income to the taxpayer
g) payment was not in consideration/recognition of property services or anything else provided by taxpayer, not earned by taxpayer

Money exchanged for discharge of even a questionable legal right may constitute income (*Mohawk Oil v. Canada*). Strike pay does not constitute income from a source; benefit of doubt goes to taxpayer (*Canada v. Fries*). Key factor in this case is that **punitive damages doesn't flow from performance/breach of market transaction.** Look to nature and purpose of source, not the same just because arise from same transaction.

- Surrogatum principle – amounts received as civil damages in place of income from a source may be included in income as if such amounts were income from that source (applies to civil damages etc)
  - *London and Thames Haven Oil v. Attwooll* 1967 (p89)
  - Includes liquidated sum – look to source

Schwartz v. The Queen	1996 SCC	p90

F Employment contract signed, employer said no longer needed, employee/taxpayer accepted lump sum in settlement for breach of contract.

I Factual issue about what the payment was for – employment, or as compensation for embarrassment etc. Legal issue about whether if was the latter, could still be taxed as retiring allowance (s.56(1)(a)(ii))

H Essentially, there is no factual basis for FCA to apportion the damages into the amounts they did (fact issue). Since TP was never actually employed, can't be income under s.3 or retiring allowance. Is in fact punitive, therefore not taxable, no "source".

R *Curran v. Minister of National Revenue* – payment for resigning employment and starting work elsewhere is not income from employment, but **is** income from a source under general provision of s.3. *Canada v Fries* – income from unenumerated sources is taxable under general provision, though strike pay is not in the nature of income from a source. Must assess taxability according to amendments of *ITA* – terminations are taxable as constituting a retiring allowance. Parliament chose to deal with these payments in provisions on retiring allowances. "one must be in the service of another person to be an employee" – employment doesn't just begin at time of signing employment contract. Since taxpayer was never actually in service of another, never employed so can't fall under the retiring allowance found in s.248(1).

Note: damages from a **wrongful dismissal would fall under a retiring allowance

- Other tax-free heads of damages:
  - Punitive/exemplary damages (*Bellingham*)
  - Mental distress/aggravated damages
  - Defamation
  - Discrimination/Harassment

- Tort damages for assault, battery
- Personal injury/wrongful death (p99 #6)

- Source concept also applies to expenses in *Schwartz* – if there is no taxable source for the item, then there is no taxable source for the expenses incurred to receive that item, so expenses are non-deductible

- Two tests for applying surrogatum principle from *Tsiaprailis v. The Queen* [2005] SCC:
  - 1) what was the payment in tended to replace? If the answer to this question is sufficiently clear:
  - 2) would the replaced amount have been taxable in the recipient's hands?

Losses

- s.4 – separate determinations of income from each business/business location
- s.3 institutes a global income tax, where income from various sources is aggregated and the total is subject to single tax rate structure.
  - Losses within a business year reduce taxpayer's income, allowable capital losses are "quarantined" by para 3(b) – can only offset taxable capital gains in manner consistent with schedular income tax (so TP can't time their gains/losses, so market functions better)
  - Quarantining rule has exception for Allowable Business Investment Losses (ABILs), which are deductible against all sources of income
- Carter Commission: Govt shouldn't have to share in all losses, but subject to this limitation, should place TPs on equal footing
  - So question is, When and to what extent can business losses reasonably be taken into account in determining income?
  - Business loss should be applied to income in the same year.
  - If ^^ doesn't completely offset the loss, should it be carried back or forward against income of other years?
  - With comprehensive tax base, TP shouldn't be regarded as having taxable capacity until all losses from any source have been recovered
- Courts require that where deduction claimed for losses incurred in carrying on an activity that has an element of personal enjoyment or benefit, taxpayer must demonstrate that the predominant objective was to earn a profit, and that the activity was carried out in accordance with "objective standards of businesslike behaviour"

Loss Carryovers

- Tax payable calculated by applying relevant tax rates to taxable income and then reducing this amount by any available tax credits. (subsection 2(2))
  - To the extent that current year losses can't be used in year they arise (s.3 doesn't allow for negative balance), losses can be carried over to another year (forward OR backward)
  - Rules for carryover depend on source of loss
- Non-Capital Losses
  - Paragraph 111(1)(a): non-capital losses (defined subsection 111(8)) can be deducted 3 years back, 20 years forward
  - Generally no restriction on source of income from which loss is deductible
  - Where there is change of control, corporations taxation year deemed to end immediately before the acquisition, losses in that year/previous year cease to be deductible (so ^^ doesn't apply)
    - UNLESS the corporation continues to carry on the loss business with reasonable expectation of profit, then losses are deductible only against income from the business
    - Similar restrictions – see p103
- s.39(1)(b) Accrued v. realized losses (disposition)
  - no loss on depreciable property
  - capital cost allowance – "terminal loss", can have a CG on the sale of a building but can't have CptL on sale of depreciable property
    - will allocate purchase price based on price for land, and building
    - land = capital, building (sale price) = profit from business
    - if building part is profit from business, can't have capital loss on sale of building
- Canadian small business deduction
  - ABIL: losses on a loan, stock in small business
  - ABIL - half deductible from all sources of income, s.3(d), 29(1)(c), p242
  - Quarantining does not apply to ABIL
-
- Farm Losses & Restricted Farm Losses

- Farm Losses (defined subsection 111(8)) and restricted farm losses (section 31) carried back 3 years, forward 20 years (paragraphs 111(1)(d) and (c)).
  - Doesn't apply to Hobby farms
  - Farm losses can be deducted from any source (subject to change of control rules ^)
    - Max losses $8750, rest of loss must be carried over to other years
      - Remember, NPV of $$ is higher than future value,
  - Restricted farm losses only deductible from farming income
- Net Capital Losses
  - Defined subsection 111(8), can be carried back 3 years and forward indefinitely
  - Are deductible only from taxable capital gains according to subsection 111(1.1)
  - Where control of corporation is acquired, its net capital losses are not deductible (subsection 111(4)).
  - Corporation may elect to realize accrued gains against which the non-deductible capital losses may be offset

Nexus between Taxpayer and a Source of Income

ITA tries to solve:

1) What amount of revenue must be recognized as income?
2) What amount of expenses must be recognized as deductible?
3) When must the relevant amounts be recognized

- Employment income: taxable to the individual who receives it (usually person who earned it though services)
- Business/property income – "the profit therefrom", i.e. provider of services/owner of property
- Capital gains/losses: "gain or loss from disposition of property", ∴ owner of property who controls disposition
- Who are the potential taxpayers?
  - Personal income tax – natural persons, trusts, estates, are individuals
  - Persons – natural as well as legal persons, so businesses and societies
  -

Peter D. Field v. The Queen	2001 TCC	p106

F *TP*'s wife forged RRSP withdrawal forms to withdraw funds paid into their joint account, then withdrew funds. S.146(8) "all amounts receied by taxpayer in the year as benefits out of or under RRSPs". T*P* appealed, arguing had never received the funds.

I What is meant by s.146(8)?

H *J* for TP.

R Shouldn't require taxpayer to pay the tax and then go after the wrongdoer in civil court, makes more sense for Minister to include the amount in offending party's income (where sufficient evidence). Minister should assess on basis that money involuntarily removed has not lost tax-exempt status. TP did not receive benefit of funds, in the plain and ordinary sense. No nexus between Mr. Field and the money in question.

Buckman v. M.N.R.	1991 TCC	p108

F TP embezzled funds from clients, Minister included income from misappropriations in his income.

I

H Embezzled funds are taxable.

R TP argues had no right to the money so ∴not income from business. Argues should be considered a borrower, because will have to repay the funds, so is not really income. Minister argues is taxable despite being from illegal source. *Minister of Finance v. Smith* (PC) says can't defeat taxation by creating a wrong. *Gilbert v. Commissioner* 1977 2nd circuit – *TP* intended to repay the funds, here no such intention.

Queen v. Poynton ONCA held: fraudulently acquired money was taxable in his hands as a benefit to officer/employee under s.5(1). Court held strict legal ownership is not the exclusive test of taxability, a Court, <u>in determining what is income, must have regard to circumstances of actual receipt of money, manner in which is held</u>. So if trustee (under obligation to transfer $$ to cettui ce trust) transfers money, no taxability, but if fails to transfer, becomes taxable because the manner of holding has changed, though the entitlement has not. Benefits of the money fall within s.3 and s.5 *ITA*. …Court found the money was income from a business…"does not affect finding that money accruing in such a manner, whether as the result of an isolated transaction or from a series of transactions, is taxable income."

Here, TP never treated money as a loan, no intention to repay. Number/methods of misappropriations had quality of business. Treating funds as income flows from facts of the situation. Behaving as though you are entitled to the

money is enough to make the money taxable (says Shepp).

Income Splitting

- Transfer of income from one person to another, where the second person is taxed on the income at a lower marginal tax rate than the first. TP thereby retains use of income but not legal ownership.
- 4 techniques:

1. Direction of payment by 3rd party to person other than who earned income
2. Assignment of right to income from 1st TP → 2nd TP
   a. Family management
3. Transfer of property generating the income from 1st TP→2nd TP
4. Low-interest or non-interest bearing loans
   - Attribution rules – intended to prevent income splitting – can consolidate financial info of subsidiaries for financial statement, but need separate tax returns
   - Of course, ideal situation is where all family members are taxed at lowest marginal rate, so may try to split income to reduce overall tax
     - Attribution rules try to prevent this
     - E.g. Kiddie tax – kids are taxed at highest marginal rate, so defeats purpose of income splitting (s.43.7, p129 #5)
   -

<u>How to split income properly (so it works):</u>

Employer has contract of service with employee, who has contract of service with family member

- Have to have employer agree, required by employer in first contract of service
- S.8(1)(i)(ii), p36 p130 #1(c)
- *ITA* s.67 requires amounts be reasonable in circumstances
  - e.g. if bring baby in, not in fact providing value
  - will look to fair market value
- *Boutilier* tried to do this, but facts didn't support it

Dividends – come out after tax. Corporation pays corporate tax rate, what's left is available for distribution to shareholders

- Dividends are after-tax earnings, distribution of profits (not an expense)

Trustee/personal representative relationship – not a legal person

- If person is entitled to spend money as they see fit, then this is their money (for tax purposes), is taxable as such
- If the decision has to pass through 3rd person, this is not their money, not their "income"
- RRSP – tax deferred, money not payable until withdrawn from account

Generally Accepted Accounting Principles (GAAP) of income:

- Entrepreneurship
- Repeated Transactions
- Method
- Reward of profit/risk of loss

Neuman v. the Queen	1998 SCC	p114

F TP incorporated company with different classes of shares, wife held one type of shares and he held another type, were both officers with wife as director. Wife declared dividend of $5000 for husband's shares, and $14800 for her shares, then lent husband $14800 with promissory note as security. Wife died, loan never repaid.

I Should dividend income be attributed to husband?

H Dividends cannot fall into s.56(2), so cannot be properly construed as income for benefit of husband.

R *ITA* s.56(2) does not apply to dividend income, so dividend income received by wife cannot be attributed to husband for tax purposes. For s.56 to apply, must have:

1. Payment must be to a person other than reassessed TP
2. Allocation must be at the direction or with the concurrence of the reassessed TP
3. Payment must be for the benefit of the reassessed TP or for the benefit of another person whom the reassessed TP wished to benefit, and
4. Payment would have been included in the reassessed TP's income if it had been received by him or her

Dividend income cannot satisfy 4th requirement, so s.56 cannot apply.

McClurg – s.56(2) doesn't apply to dividend income since until dividend declared, profits belong to corporation as retained earnings – wouldn't have been otherwise included in TP's income. Dickson CJ in *McClurg*: purpose of

s.56(2) is to ensure payments aren't diverted to a 43rd party as anti-avoidance technique. Dividend payment cannot reasonably be considered a benefit diverted from a TP to a 3rd party.
Non-arms-length transactions are presumed to lend themselves to tax avoidance, but taxpayers are entitled to arrange their affairs for the sole purpose of avoiding tax, *Stubart*. Is inappropriate to consider the contributions of a shareholder when determining whether s.56(2) applies (as Dickson did in *McClurg*) Distribution of dividend is not determined by quantum of shareholder's contribution so would be illogical to use contribution as a criterion for s.56(2).

Ms. Neuman – Class F, Mr. Neuman – class G. Family Holding Company – Melru. Mgmt contract to mgmt company

- Director's discretion to "sprinkle" dividends among classes
- each family member pays for shares with personal funds

Difference with Boutilier – he didn't do the paperwork – argued set up this structure to income split, but defective paperwork meant that attribution rule caught him (so taxable)

Boutilier v. The Queen	2007, TCC	p121

F Reassessment of TP included "trailer fees", fee paid by mutual fund managers, attributable to services brokers provided on ongoing basis, where clients retain the mutual fund instead of redeeming it (??). Appellant is registered financial planner, with dealer Hicks. In 1997, TP incorporated a corporation and family trust, with himself as trustee (family members beneficiaries). TP was controller, director and officer of corporation. Transferred into the corp the trailer fees in exchange for 200 shares, filed taxes as corp. Hicks paid trailer fees to Corporation. Minister then reassessed, including the amounts in TP's income.

I Should trailer fees from Corp be included in TP's income?
1) What is the nature of trailer fees?
2) Were the trailer fees earned by the Corp, or did the TP earn the fees and assign them to Corp, so that s.56(4) applies?

H

R Transfer of fees to corp was a scheme to artificially reduce the TP's income. He remains beneficially entitled to those fees, with corp as receptacle for flow of revenue. Trailer fees are fees earned for services, not the same as a commission for sale. For s.56(4) to apply, must satisfy tests:

1) beneficial entitlement test – whether the amounts would have been included in the TP's income, had the right to the amount not been transferred or assigned to the Corporation, i.e. who beneficially earned the trailer fees? (*MFC Bancorp Ltd v. R* 1999, TCC).
   - Here: Corporation did not carry on active business, no assets, no services mentioned, no expenses for rents/wages/employee benefits (factual conclusion). Manner of providing services didn't change upon incorporation, TP personally incurred the services for trailer fees
2) arm's length test (fails 1st so 2nd isn't discussed in this case [?])

s.56(4) requires a person transfer a "right to income" (requires a right to income to exist, unlike s.56(2). So, TP's argument that the Corp already paid tax on the income has no bearing to the case, is an issue the Corp must deal with.

Basic Moral of Boutilier – if you split income, pay attention to legal form, make sure rights are actually executed

- basically, Boutilier failed to get through s.56(4) – failed #1 because he had control of company was transferring to
  - company didn't do anything – B did all relevant actions, had no written contract of employment w/company, so clearly company wasn't the one earning the income so also fails #3
  - company was not beneficially entitled to income because of ^, so was attributed back to B

Property Transfers and Income Attribution

- Transfer of Loan to a Minor: s.74.1(2), 74.3 – 74.5
  - Income or loss derived from transferred property is attributed to the TP (where TP transfers property to minor who does not deal at arms length from money, or is niece/nephew) –s.74.1(2)
    - Unless TP receives consideration equal to value of property, or charges interest.
    - For all property – real estate, stocks, bonds, cash
    - Even where that child sells the property and buys another – 2nd is consider substitute, income still attributed back
  - Attribution ends when TP ceases to be resident in Canada, minor becomes 18, or transferor dies.
  - Capital gain/loss realized on the property is NOT attributed to TP
  - s.74.3 attribution – income derived from property attributed to TP to extent income paid/payable by the trust to the minor.
  - On a loan at undervalue, s.74.4 deems TP to receive interest from transferee corporation (prescribed rate)

    - Does not apply if transferee corp is a "small business corp" as per s.248(1)
  - Once child reaches 18, can split income
- **See problem questions, 10/16/12**
- Transfer/Loan to Spouse/Common Law Partner
  - Attribution of income or loss from property under s.74.1(1) – amount must be recognized by transferor
  - When spouse (recipient) disposes of property, capital gain/loss attributed to the transferor - s.74.2)
    - this is called spousal rollover
    - s.74.1(1) – spousal rollover (deferral of taxable capital)
  - Attribution continues while transferor:
  1. Is resident in Canada
  2. Has not been divorced from transferee
  3. Is alive
  4. Is cohabiting with transferee
  - Attribution of income from property ends if live separate and apart due to marital breakdown
  - Attribution of capital gains/losses ends where two parties so elect (??)
  - Attribution of capital gains/losses, income, and losses from property does not arise where recipient pays fair market consideration **see p132 for specific rules**

Concept of a "Transfer", and "Income from Property"

- For attribution to apply, must have transferred/loaned "property" – only property income, capital gains and losses, NOT to income from employment or business (p132)
- Transfer to a trust s.74.3 – any accrued gain/increase in property's value while under trust would be taxable for beneficiary
  - If gift of property, CG says (ch7) "deemed to be disposed of at fair market value" so would have to pay CG tax on that property

Chapter 3 – Who is Subject to Canadian Income Tax?

- 3 jurisdictional bases for taxation: Citizenship/nationality, residence, and source of income
- Citizenship/Nationality:
  - Virtue of being easy to apply, downside is (arguably) undue importance on citizenship
- Residence
  - The Primary basis for taxation in Canada
  - "Closer relationship with the country than citizen, but short of domicile" p140
  - Domicile of choice – 1) fact of presence within jurisdiction, 2) present intention to maintain permanent home w/in jurisdiction
  - Residence – present ties to a jurisdiction (not intention)
  - Advantageous because of ability to pay principle, and easier to enforce
- Source of income
  - Where derive income from a source in the country, though are not a resident

Residents

Individuals:

- s.2(1) – worldwide income of taxpayers resident in Canada at any tie in taxation year is subject to tax
- residence is a question of fact – no special or technical meaning
  - can enter Canada to reside permanently, or leave to leave permanently – must cut ties w/intention to cease residency (go through the tax motions)

Thomson v. MNR	1946 SCC	p141

F

I Whether TP falls within s.9, is resident in Canada.

H *J* for *D*.

R Ordinary residence is "residence in the course of the customary mode of life of the person concerned, as contrasted with special/casual/occasional residence" (p143). Tax assumes every person has at all times a residence. In this case, the TP's residence is just as rooted in Canada as in the U.S., so will fulfil the ordinary residence component.

Note: Taschereau: TP never ceased to be considered a resident just because occasional and even protracted – not looking at the length of visits home to see if they establish residency, rather, seeing that the visits are viewed as returns home.

- *Thomson* sets CL residence – social, economic ties
  - Significant ties – IT-221R3 para 4-7: physical presence, dwelling place, etc
  - Secondary ties: paras 8-9 p155-156, also *Lee v. MNR*, below

Factual Residence:

- IT221R3 , *Thomson* – residential ties
- *Lee* – spouse
  - See para 4-7 for "significant" ties
  - See para 8-9 for "secondary" ties
  - Note: if one significant factor, then well on their way.
    - If two, then pretty much established
    - Or, if one significant plus a couple secondary
    - This is an area of uncertainty (can apply to CRA to get ruling though)

Lee v. MNR	1990 TCC	p146

F June 1981 bought house in Ontario, Sept 1982 TP's wife borrowed money via mortgage, guaranteed by TP (where he swore was not a non-resident). During 3 yr period, regularly returned to Canada. TP never paid tax anywhere, was not allowed to work in Canada, was out of Canada more than 183 days/year, had bank accounts in both Canada and Caribbean.

I Whether TP was resident in Canada for income tax purposes in 1981, 1982, 1983.

H *J* for *D* except for part of 1981.

R Residency is factual issue, see list of factors p148. Clearly was resident Sept 1982 because swore but also because that home became the matrimonial home. Question is when became resident (was clearly not resident in Jan 1981). TP did not become resident until date of marriage, mid 1981.

Deemed Residence (p151)

IT -221R3 – Determination of an Individual's Residence Status

- *ITA* creates "irrebuttable presumption" where sojourn 183 days or more (aggregate days of actual phys presence)
  - Presence in Canada for a "temporary purpose"
    - If come to work, this is not a temporary purpose (e.g. crossborder commuter), but if same person comes to Canada on vacation, then is sojourning
    - Based on calendar year – e.g. 244 days from sept 2011 to april 2012, 122 days each 2011 2012, then not sojourning (even though >183 days /365).
    - Partial days count, but not just flight layovers
  - Deemed resident for whole year
  - Protected from this if are coming from treaty country
- where are resident in more than one province on Dec 31, will be the one with the "most significant residential ties"
  - Residential Ties in Canada – most important factor (SEE *Lee* above for significant/secondary factors!)
    - Dwelling place
      - If leave house available for habitation, then considered significant
      - If leases the dwelling to 3rd party at arms length, may not be significant
    - Spouse
      - Where was living separate by reason of breakdown of marriage, not significant
    - Dependents
  - Secondary ties looked at collectively to evaluate signifcance of any one tie (one of factors alone wouldn't → determination of factual residency while abroad)
    - See list at p. 158
- Ordinarily resident – where have not been resident for several months or years but have not severed ties, may regard absence as insufficient to avoid tax based on "ordinarily resident" term
  - Evidence of intention to permanently sever ties
    - E.g. if have employment contract waiting for you, will consider return to be foreseen
    - Or if complied with Act dealing with taxation of persons ceasing to be resident – e.g. tax payable on capital gains from deemed disposition of property
  - Regularity and length of visits to Canada
  - Residential ties outside Canada
  - Sojourners – someone who has not established factual residency but sojourns in Canada for 183 days or more

- Individual "deemed" to be resident will be liable for tax on worldwide income THROUGHOUT the year, whereas person who is factually resident in Canada for only part of the year will only be taxed on worldwide income during that part of the year

R&L Food Distributors Ltd v MNR	1977 TRB	p151

F TPs had their small business deduction (125(1) *ITA*) disallowed bc TP was not Canadian-controlled corporation. Labe (one of 2 co-operators) commuted to Canada for the business – had home synagogue and residence in Michigan, but no business interests there. No residence in Canada. Spent 300 days for work in Canada. Rosenthal owned home in Michigan, commuted daily to work, no residence in Canada but all investments in C. Member of social clubs in both US and Canada, filed personal income return in both countries.

I

H *J* for *D*.

R *ITA* says residence will be deemed where person sojourns for 183 days in aggregate. What does sojourn mean? To make a temporary stay – commuting to work is not tantamount to making a temporary stay. Home and social ties were clearly in US, not Canada.

Part Time Residency (s.114)

- Where person leaves Canada with intent to permanently sever ties, or enters with intent to permanently reside
- Date of arrival or date of departure
- *ITA* s.114 split year rule
- Emigrating from C to elsewhere – IT-221R3 para 11, 12
- Can't just leave – won't be entitled to get the split year provision
  - Have to go through the process and talk to CRA

Schujahn v. MNR	1962 Exch Ct	p159

F TP moved to Toronto for business, stayed a couple years, then moved back to US. Kept bank accounts and etc for wife and child to facilitate move to US for a couple months after he moved. Visited Canada a couple times afterwards.

I When TP ceased to be resident.

H

R When determining residence, is factual issue. Look to various connections to place, not necessarily permanent, or sole residence. See *Thomson* case. Here, only reason wife and child stayed in Canada was to ensure sale of house. Visit for Christmas and on business were transitory, not like *Thomson* where perceived as visits home. If TP had kept the Toronto residence for another purpose, not just for selling it, might have diff outcome.

Ordinarily Resident (s.250(3)) (p163 casebook)

- "ordinarily resident" has wider scope than "resident", look to TP's activities over a number of years, not just taxation year
- Is a statutory extension of common law concept of residence
- Physical absence for months, even years, won't extinguish residency in eyes of CRA

The Queen v. Reeder	1975 FCTD	p164

F TP got job offer for Michelin in Nova Scotia, but required to do training in France for some months. Originally lived in Ontario – packed up things and put into storage and gave up apartment. Moved to France and kept Ontario license, had NS bank account. Then moved to Germany to work for a month, then worked in France again, living in furnished apartments.

H *J* for *P*.

R In previous cases, when referring to the "peripatetic jetsetters of yesteryear", looked at travelling as an occasional residence but no change of "home". (*Leven v. Commissioners of Inland Revenue*, *Thomson v. MNR*).
Material factors for residence:
- past and present habits of life
- regularity and length of visits in jurisdiction asserting residence
- ties w/in that residence
- ties elsewhere
- permanence or otherwise of purposes of stay abroad

Thomson: Ordinarily resident = place where in the settled routine of life the person regularly, normally, or customarily lives. Here, absence was indeterminate but was temporary. Ties in France were temporary and abandoned on returning to Canada.

Corporations:

- *ITA* considers corporation to be person and taxpayer (so if resident in Canada – worldwide income, if resident elsewhere, income in Canada)
- para 250(1)(a) - Corporation is **deemed** resident in Canada if incorporated in Canada
  - irrespective of where central management and control is (will have residence for **indefinite future**)
  - except if incorporated before April 27, 1965
  - These corps, before ^, only deemed if were resident in Canada or carried on business in Canada before that
- Courts have held that corporation is resident where its "central management and control actually abides"
  - Applies to corporations not incorporated in Canada
  - Control test for the taxation year – can change **year to year**
- Company that is not incorporated in Canada, does not have central mgmt & control in Canada, but carries on business in Canada will be taxed on profits from that source only
- *De Beers* adopted in *Birmount Holdings Ltd The Queen* [1978] Fed CA – "it is the actual place of management, not that place in which it ought to be managed, which fixes the residence of a company"
  - Corporate residence (contemporary purposes) depends on exercise of board powers at the level of each corporation (even if ceremonial)
    - *Wood v. Holden* (2006) Eng CA – shareholder's influence is not the same as usurping decision making
  - If two or more jurisdictions, can have more than one residence (*Swedish Central Ry v. Thompson* 1925)
- CL residence can change, that was purpose of 1965 statutory *ITA*
  - P173 – important decisions made (not about operations, daily decision-making, etc, about important decisions)
  - Question of fact
-

De Beers v. Howe	1906, House of Lords	p171

F Regular meetings at head office in South Africa, where some directors resided. Majority of directors resided in England, meetings in London were where much of business was conducted.

I

H

R Determining residence for corporation should be analogous to individual, rule should be where its real business is carried on. Here, majority of directors and governors live in England, and director's meetings in London are where real control is always exercised in practically all important business. London controls contracts etc, has always controlled where need majority of shareholders.

Trusts and Estates:

- Used to be that trust was resident where main trustee resides, where was more than one, would be where majority of trustees reside – *Thibodeau Family Trust v. The Queen* [1978] FCTD, IT-447
- Then changed in *Garron Family Trust v. The Queen* [2010] TCC – apply the central management and control test
  - Persons who exercise actual control over trustee's decisions
  - Can be more than one jurisdiction (says CRA). CRA will look to:
    - Location where legal rights are enforceable
    - Location of trust assets
- *Fundy* extends central mgmt and control test to trusts for purpose of residence
  - If central mgmt and control of trust is in Canada, then resident in Canada

Fundy Settlement v. Canada	2012 SCC 14	handout

F *see handout for notes*

I

H

R

Non-residents:

Canadian Source Income

- Part I: income from employment, business, or disposition of taxable Cdn property (s.2(3))
  - Tax filed in same way as Cdn residents
  - Employment – s.115(1)(a)(i) – net income
  - Business – s.115(1)(a)(ii), s.248(1) – net income

- s.2(3)(b)
- *Buckman, Bellingham*
- Active pursuit of profit, NOT passive investment
    - Canadian Property – s.115(1)(b), s.116 – taxable CG
    - Enforcement:
        - Nonresidents file T1 income tax return, same as residents
        - But are only taxable on cdn sourced income (net basis)
        - Measures under pt 1 (i.e. temporary withholding) are interim
- Part XIII – income from property situated in Canada – resident who makes payments (rents royalties interest) to non-resident must apply a withholding tax to the gross amount
    - No tax return with respect to this income, but may do so sometimes (s.217)

Part I:

- Note that residence is irrelevant – issue is whether was employed in Canada, or carrying on business, or taxable Cdn property
- Agent/Principal: non-resident agent has authority to bind principal
- Servant/employer: non-resident employer→contract of service→employee (servant)

Grainger v. Gough	1896, House of Lords	p177

F Wine merchants, act as middleman in UK between purchasers and suppliers elsewhere. Didn't make any contracts themselves.

I Does selling product in country mean you are now resident?

H *J* for *P*.

R Since the merchants didn't do anything to further the business except seek customers, and then the customers themselves assumed all risk and cost of shipping, tax does not apply. The mode of soliciting orders should not make the difference as to whether the business is occurring in UK.

GLS Leasco v. McKinlay Transport Ltd	1986, TCC	p182

F GLS incorporated under laws of Michigan, is subsidiary of corporation Centra under Delaware. McKinlay is corporation under ON, subsidiary of corporation under laws of Michigan, which is in turn a subsidiary of Centra. GLS leases transportation equipment in US. It also leased equipment in Canada to McKinlay between 1977-1980. GLS computed taxation amount should be nil because it deducted non-capital losses against income. McKinlay leased equipment from GLS and used it in Canadian business, so made rental payments to GLS.

I

H *J* for . Is resident in Canada.

R Question whether company is "carrying on business" is issue of fact (*The Queen v. Gurd's Products Ltd* [1985], *Erichsen v. Last*, [1881]). "business" is as defined in act (profession, calling, trade, manufacture). "Carrying on business", look to s.253 – "solicited orders or offered anything for sale in Canada".

Where agent is representative in the foreign jurisdiction, and that is all, then not carrying on business. *Standard Ideal*, *Loeck*. Place where contract made is held to be paramount – *Erichsen, Grainger, Smidth, Firestone , Geigy,* and *Capitol Life*. *United Geophysical* is particularly relevant, and looked to 5 points:

1. Governing contract made in US
2. Amount of rental determined in US
3. Rental started when equipment delivered in US
4. Payment received in US
5. Rental was result of use by appellant in Canada, not because US was obliged to service or repair it in Canada

^ led to conclusion parent company was not carrying on business in Canada, so Cdn subsidiary was liable for withholding tax.

Queen v Gurds Products held business was being carried on in Canada bc:

1. Company intended to carry on business in Canada
2. Established bank account in Canada
3. Purchased product in Canada and earned profit therefrom
4. Had official agent in Canada
5. Its associates were not dealing at arms length

Here, substance of GLS doing business in Canada was evident. GLS intended to do business in Canada, had

bank account, had all the equipment, had always 2 employees.

- *GLS Leasco* – passive, McKinlay is resident so should be deducting and withholding tax (as per pt 13) on rental payments
    - GLS trying to argue its activity is enough to constitute business
    - If can characterize rents as business then will work – e.g. hotel will work, because are providing services like a business

Sudden Valley Inc. v. Canada	1976, Fed CA	p187

F US developer selling recreational land in WA, downturn depressed land market so company turned to Vancouver market, leased office space, hired telephone operators in Vancouver. Company had no license to sell real estate in C, not one sale was made in C. Offers/deposits all made in US. Advertising resulted in 70% of lots purchased by Canadians, but advertising didn't say land for sale, just invited customers to view Sudden Valley.

I

H Not resident. *J* for *D*.

R Cannot view "soliciting offers" under the *ITA* s.253(b) as mere invitation to treat – must look at this under normal contract law, i.e. an offer that if accepted would become a contract. On this basis, nothing was offered for sale in Canada.

- *Sudden Valley* – wanted to be taxed under part 1 so could deduct expenses

Disposition of Taxable Canadian Property

- Para 2(3)(c) – taxable CG from "taxable Canadian property"
    - Defined in s.248(1), including real property situated in Canada
        - Location of real estate, whether vendor/purchaser is resident

Non-Resident Withholding Tax (s.212)

- Part XIII: flat rate (25%) on gross amounts (note: part 1 = net basis, can deduct expenses) – brutal (brutalness is deliberate as incentive for countries to make treaty w/Canada)
    - 1) non-resident must be paid/credited (or deemed paid/credited) by person resident of Canada
    - 2) amount is in lieu of payment, or in satisfaction of specified types
        - rents
        - royalties
        - pension benefits
        - management fees
        - dividends
        - annuity payments
        - estate/trust income
    - 3) specified percentages of amounts are payable by resident person as a withholding tax
- non res can go to CRA direct and get ceritficate
- 2 levels of tax on non-resident's business in Canada – on income as earned by corporation, and again on dividends paid by corporation to non-resident
    - no tax if after-tax profits are reinvested in Canada (s.219)
- Withholding tax will be reduced by tax treaty.
- So, *Sudden Valley* wanted to be taxed under part 1 instead of pt 13 bc could deduct expenses
- 5th protocol to US/Can tax treaty (p194), eff
- s.216(1) – can elect to file return as though resident of Canada, and be taxed on net basis (pt 1)
    - basically, file it as though are a resident but the Canadian source income is your only income
    - but note limits on deductions – operating expenses, capital cost allowance, etc
    - Election will be beneficial to non-resident investors
    - Fully exempt interest if non-resident lender, at arm's length (as of Jan 2008) – s.212(3)
- Tax Treaties
    - Foreign tax credit dollar for dollar reduction in Canadian tax (CRA is the "competent authority")
    - Countries will assist against tax evasion

Chapter 4 – Income from Office and Employment

Who is an Employee?

- Individual who is retained to provide services to another person – either employee or contractor

- *ITA* s. 248(1) definition of office:
  - "office" means the position of an individual entitling the individual to a fixed or ascertainable stipend or remuneration and includes a judicial office, the office of a minister of the Crown, the office of a member of the Senate or House of Commons of Canada, a member of a legislative assembly or a member of a legislative or executive council and any other office, the incumbent of which is elected by popular vote or is elected or appointed in a representative capacity and also includes the position of a corporation director, and "officer" means a person holding such an office
- 4 main distinguishing features between employee and independent contractor (reasons why it matters):
  1. Payment/Withholding of Tax:
     a. An employer must withhold/remit prescribed amount from each payment to employee – s.153.
     b. This is not required for independent contractor (IC may be req to make instalments of tax, s.156)
     c. Employer who fails to withhold is liable civilly and criminally
     d. s.67 – must be reasonable
  2. Basis of Measurement:
     a. income from O/E = cash basis, income recognized when received (s.5, s.6(1)(a)), expenses deductible when paid
        i. all cash or non-cash benefits caught bc concept includes any benefit **actually** received
     b. income from business = accrual basis, recognized earned, expenses when incurred (when liable to pay).
        i. Self employed (i.e. Independent Contractor) falls into accrual basis
        ii. Works in favour of SE person b/c can claim more deductions, can claim them even when won't pay until following year
        iii. Business income is $$ **earned** and expenses **incurred**, not received/paid
  3. Reporting Period:
     a. Income from o/e is on calendar-year basis
     b. Business income – fiscal period (defined s.249.1: For the purposes of this Act, a "fiscal period" of a business or a property of a person or partnership means the period for which the person's or partnership's accounts in respect of the business or property are made up for purposes of assessment under this Act, but no fiscal period may end…[see ITA])
  4. Scope of Deductions:
     a. employee may deduct limited set of expenses in s.8,
     b. business person has wider scope, s.9 & 20
- Because not much of a definition in *Act* to differentiate contractor and employee, common law looks to nature and degree of control over the work to be done – if worker has no control, considered employee
  - *R v Walker* (1858) – difference b/w principal/agent (IC) and master/servant (employee): "A principal has the right to direct what the agent has to do, but a master has not only that right, but also the right to say how it is done."
  - Courts have generally looked to 4 aspects:
    1. Power of selection of the servant
    2. Payment of wages
    3. Control over method of work
    4. Master's right of suspension or dismissal
  - *Di Francesco v. MNR* (1964, Tax ABC): "servant acts under direct control and supervision of master, independent contract is entirely independent of interference, merely undertakes to produce a result
- However, ^^ less relevant today since relationships don't conform to this master/servant model
  - So, courts have moved from single criterion test, like above, to examining whole scheme of operations (*Wiebe*)

Wiebe Door Services v. MNR	1986 FCA	p221

F Company is in business of installing doors etc, 75% of business in repairs. Works with door repairers, who each have understanding would be running own business, responsible for own taxes etc.

I How to determine whether someone is IC or employee.

H *J* for *P* – back to Tax Court.

R Having an understanding in place isn't conclusive of itself whether workers are IC or employee. Traditionally, have looked to *R v. Walker*, but problems with this test in practice – IC may have very specific contract that controls how sthg is done, employee may have more leeway bc are more experienced that manager. Instead. Should look to <u>the whole of various elements constituting relationship between parties</u> – esp. is the person carrying on business for himself or on behalf of another? *Montreal v. Montreal Locomotive Works* [1947] DLR 161 set out <u>4part test</u>: 1) control, 2) ownership of tools, 3) chance of profit, 4) risk of loss. *Cooperators Insurance Association*

v. Kearney [1965] SCC set out "organization test": control test should be replaced by organization test, i.e. was servant part of employer's organization? Was work subject to co-ordinational control re: where, when, rather than how?

FCA here says must apply organization test from the perspective of the employee, not the employer (too easy from employer perspective to see everything as arranged for purpose of company). While applying test keep in mind question of whose business is it? Is the person performing the services a person in business on his own account? If yes, contract FOR services (IC). If no, contract OF service (employee).

No exhaustive list, control is important but not sole determining factor, but the following matter: whether person provides own equipment (#2), hires own helpers, degree of financial risk taken (#4), degree of responsibility for investment and mgmt, degree of opportunity of profit (#3). Must weigh all factors. In this case, there was erroneous application of organization test, so should go back to Tax Court.

- *Weibe Door* didn't give weight to common intention – said Tax court applied it wrong, should have looked to perspective of the worker, the IC who fixes the doors, not from perspective of company
  - Integration test (organization test) should be from worker point of view
- 4 in 1 test:
  - control test
  - ownership of tools and equipment
  - chance of profit
    - opportunity to profit by working more efficiently
    - more opportunity of this for SE person than employee
    - s.6(1)(A) employee – salary, wages, gratuities, benefits
    - s.9(1) SE – profit from business
  - risk of loss
    - employer legally obligated to pay employee same rate, regardless of profit
    - SE person gets to share in profit but also loss
- Total Relationship test (*Weibe Door*):
  - Must look at "whole of various elements"
  - so integrate the "4 in 1" test with integration test (from employee perspective)
  - These 4 are not exhaustive list
  - Control is important, not sole determining

Cavanagh v. Canada	1997, TCC	p231

F TP is TA for university course, no ongoing contract. Provided own supplies, was responsible for offcampus expenses, not supervised. University issued T4 slip. TP was denied automobile expenses because considered employee.

I Whether TP is employee or IC, whether is "business income" and should be allowed to claim deduction for auto.

H *J* for *TP*.

R Should use 4-in-1 test as per *Wiebe Door*. Control by York/professors minimal, not equivalent to employer/ee – could set time, place of mtgs, etc. TP provided tools, paid parking fees, etc. Had no tenure. Had the right to hire someone else to do the work if wanted. Opportunity for profit – could make more if properly calculated how many students would be in the class/drop out (clever argument!), would lose if made mistake. Wasn't paid regularly. Sure, there was T4 from York, but York not entitled to determine whether was employee or IC, court is. Here TP was IC.

Attempts to Avoid Characterization as Office or Employment

- Employees have sometimes inserted different contract in order to characterize it as office
  - Courts are not bound by terminology in contract, will characterize based on "substance" of relationship (*Boardman v. The Queen* [1979])
  - Interposing contract for personal service – change from contract OF service to contract FOR services (but same employer etc)
    - To make it work should really have a month's lapse, slightly diff service, have different benefits that an employee has
- May also try to interpose a corporation or trust, where TP and family are beneficiaries (see *Field, Buckman* – nexus btw TP & income)
  - E.g. instead of usual employer→contract of service→employee, will be principal→contract of service→corp→contract of service →employee/shareholder

- Corp cannot enter employment, so would be income from business
- BUT govt changed this (??), so corp taxed at general rate, no small business deduction

- Capitalization of employment benefit – attempt to make income from employment into income from capital

Curran v. MNR	1959 SCC	p235

F TP was geologist for Imperial Oil, was induced to join as general manager of Federated Petroleums. Agreement between TP (grantee) and Brown (grantor): grantor agreed to pay $250,000 in consideration for TP's resigning, and lost pension rights from Imperial Oil etc.

I

H *J* for *MNR*.

R In reality, the sum was not paid as consideration for TP's loss, but as payment for services to the company. Company paid so that TP's services would be available, so falls under para 3(a) of *ITA*. Paras 6(3)(c)(d)(e) establish burden of proof, says that will deem certain payments to be payments under s.5 unless proven otherwise.

- Brown was 3rd person, lump sum as something of hiring bonus
- Employer → employee hiring bonus s.6(3)(c)
  - Rebuttable presumption that payment is remuneration (s.5, 7)
  - Which means it will be income from employment
  - Irrebutable presumption of remuneration if s.6(3)(c) inducement, or noncompetition agreement s.6(3)(e)

Amounts Included in Computing Income from Office or Employment

Benefits

- Gratuities – voluntary payments in consideration of services rendered in course of TP's office/employment.
- Important policy considerations – sufficient tax base, equity for TP, cost of administration can't exceed income from taxing benefits
  - Also political considerations to do with labour unions of transportation systems (common "benefit")

Backgrounder for Carter Commission:

  - Fundamental principle of taxation – only money or something capable of being turned into money can be taxable. Mere benefit/advantage cannot – *Tennant v Smith*, House of Lords (man had property for benefit of employer, was not entitled to use it, so not considered income)

- Just because TP enjoyed a benefit doesn't mean the benefit is taxable.
  - But, s.6(3) – rebuttable presumption of remuneration from employer → employee
  - Originally, saw para 6(1)(a) as requiring causal connection between services rendered and receipt of benefit – remuneration for services.
  - Then (via *Queen v. Savage*) became much broader definition

Sorin v. MNR	1964, TAB	p243

F TP often stayed in hotel where he worked, to avoid disturbing brother (who he resided with) at 4am.

I

H *J* for *TP*.

R Room TP stayed in was not really his residence – also used as storeroom etc, TP demonstrated that his home was with brother (on the facts). Hotel ∴ did not count as "lodging" under s.5(1)(a), so not a benefit.

"In respect of, in the course of, or by virtue of…"

The Queen v. Savage	1983, SCC	p244

F TP received $300 from employer, Excelsior, for completion of examinations (Life Office Mgmt Assoc'n). Courses voluntarily taken, will improve her knowledge of the field. Company policy that those who completed course would be compensated $100/course. Excelsior claimed the expense as a prize, under price of doing business, and issued T4A.

I

H *J* for *P*. Benefit is taxable.

R Receipt of prize falls under para 56(1)(n) *ITA*. Paragraph 6(1)(a) includes in income the value of benefits "of any kind whatever…received or enjoyed…in respect of, in the course of, or by virtue of an office or employment." This phrasing goes further than English statutes, meaning of "benefit of whatever kind" is quite broad. *Nowegijick v. The Queen* 1983 SCC defined "in respect of" as wide scope, "some connection" between two related subjects. *Paterson v. Chadwick* 1974 (England) – explicitly said is not just benefits that represent remuneration for services.

Will fall within the "in respect of" clause if confes economic benefit, and is not an exemption (loan, gift). Here, no element of gift, personal bounty, etc – purposes were in line with TP's employment.
"a material acquisition which confers an economic benefit on taxpayer" (from *Poynton*, reaffirmed here).

Laidler v. Perry	1965, House of Lords	p250

F Company had practice of giving gifts in kind, which gradually morphed into 10-pound gift certificates.
I
H *J* for *R*.
R Clearly, definition in Tax Act can cover the vouchers, but the section only applies to emoluments *therefrom*, i.e. from office or employment. Could it be considered to arise from something else? This practice, on the facts, was followed to promote happiness in the staff, which was thought to be good in itself and also likely to benefit company. Question is whether these are personal gifts, or reward for service. Here, were not mere personal gift. Is a question of degree – if is considered a regular thing which offset their regular wages, cannot be a personal gift. Here, facts suggest vouchers were in return for services rather than as gifts not constituting reward for services. Good work was remunerated by bonuses independent of vouchers – this has been element in favour of TP in past cases, but here this factor is outweighed by those against the TP – regularity of bonuses, etc.

"Benefit of any kind whatever":

Lowe v. The Queen	1996 FCA	p255

F TP's job was to ensure smooth relations between insurance provider, and independent insurance brokers (who sold insurance from various providers). Question is about a trip to New Orleans that was paid for by employer. TP didn't consider trip a holiday, employer didn't consider it a perk. Was present to ensure brokers had a good time, was not optional. Spouses meant to be present, babysitting paid for.
I
H
R Was in New Orleans to serve employer. Whether something like this is a benefit for purposes of taxation "turns heavily on the facts". *Arsens v. MNR* - trip to Disneyland for publicity where employee's interest were incidental is not to be taxed as personal benefits. *Philp v. MNR* [1970] Can Exch. – when grocery workers received trip as result of sales competition, this was conferring something of benefit to them other than business purpose of trip. The "something of value" test was affirmed in *Hart v The Queen*. This *Philp* test is similar to *Poynton*, affirmed in *Savage*, that is, should only tax as personal benefit (subpara 6(1)(a))that which represents a material acquisition, and only if benefit is not a mere incident of what is primarily a business trip.

The Queen v. Huffman	1990, FCA	p261

F *TP* is police officer, worked in field on crime scene investigation. As result, clothes required frequent cleaning. Was compensated by police force for up to $500 for clothes. CRA argues this should be considered benefit. Trial judge applied *Lowe* test and found compensation does not fall within definition.
I
H *J* for *TP*.
R Looking to *Savage*, *Nowegijick*, and *Poynton*, benefit is construed widely. The test is "material acquisition which confers economic benefit on TP and does not constitute exemption". Here, TP was required to incur expense regarding clothing, reimbursement of this expense should not be considered benefit under para 6(1)(a).

Ransom v. MNR	1967 Exch	p264

F TP was reimbursed for loss on his house by his employer, so CRA said should have paid $700 more tax.
I
H
R Employer required TP to move to Montreal. Is not a benefit for services as an employee. TP has successfully rebutted presumption that payment was for remuneration of services. Indemnity supplied to TP for the capital loss cannot fall into 3 categories of: 1) consideration for office, 2) remuneration for services, or 3) in consideration of covenant for doing something before or after employment. Should be no difference between compensation for loss or for expense (like *Huffman*). ← reimbursement

Allowance is different from reimbusement, it is arbitrary amount in lieu of reimbursement, to employee to use as wishes w/o accounting for its expenditure. This is why are taxed as remuneration.

Here, is clearly not an allowance, because is just preventing employee from being out of pocket, not adding to his pocket. Do not confer a benefit on TP and should not be taxable as such.

Moving Expenses:

- Deductible:
  - s.62(3) – Travel costs for TP & household, costs for household goods
  - Meals, lodging for 15 days
  - Costs of lease cancelling
  - Commission on sale of old residence (but not for fixing up house to sell it)
  - Legal fees/taxes to register new home (property purchase tax, legal fees s.62(3)(d), (e), (f)
- Nondeductible:
  - Pre-move expenses
  - Loss of sale on old residence (*Ransom*)
  - Reimbursed expenses
  - Reimbursed higher cost of housing, of living

The Queen v. Phillips	1994, FCA	p267

F Company moved TP from NB to MA, TP sold house, purchased replacement house. Received $10,000 to compensate for increased housing costs.

I

H *J* for *A*.

R *Savage* establishes that 6(1)(a) requires payment be conferred to TP in capacity as employee, but not necessarily in exchange for services. Presumption that the benefit falls under 6(1)(a) unless TP proves otherwise. Whether the payment is gift/loan/extraneous considerations depends on employers intention. Collateral contracts can be evidence of subjective intent (but not conclusive in self). Here, clearly TP received $10,000 in capacity as employee. Apply the *Ransom* rule that: "reimbursement for loss in selling a house following job transfer is not taxable to the extent that the payment reflects actual loss".

Two kinds of losses on sale of house: capital loss, loss for discharge of mortgage that has interest rate lower than current market. A reason for keeping *Ransom* rule is it maintains equity between TPs working ofr same employer where one has to relocate and thus bear a capital burden – unfair for one of two employees to bear capital loss. *Ransom* rule stands, but has no application to expenditure, only capital loss. Here, company gave $10,000 with no restrictions, no reason why should get this benefit – employee in such a case will have to prove that the $$$ did not confer an economic advantage upon him relative to other employees. *Ransom* allows employers to compensate employees' loss for relocation, but not to confer a benefit.

- Court said *Ransom* is good law, but this would be extending it too far
- Tax differential is taxable as a benefit
- Fits *Savage* definition – benefit is a material acquisition which confers economic benefit
- Home Relocation Loan – p273, up to $25,000 interest free for 5 years
  - Cost of living adjustments p 273
  - Northern residents deduction p273
- Employer-paid parking – is a taxable benefit unless car is primarily for work
- Social club – a tax free benefit as long as employee isn't there for personal enjoyment (for bettering business)

Valuation

- How determine "value" under s.6(1)(a) (TPs must include "value of a taxable benefit" in income)?
- UK – *Wilkins v. Rogerson* 1961: employer paid tailor to make suit of clothes for each employee
  - Value was determined as the price for which employee could sell suit in marketplace, not the price paid for it
  - Should be its value to TP, not to their employer
- "Fair Market Value" rule applies in Canada – amount person not obligatied to buy it would pay to person not obligated to sell *Steen v. The Queen* [1988]

Allowances

- *Queen v. MacDonald* [1994] FCA is leading case on what constitutes an allowance under para 6(1)(b).
  - TP=RCMP transferred from Regina to Toronto, housing subsidy of $700/mo, TP didn't include this in income

- FCA held that $$$ was allowance, defined allowance as: 1) arbitary amount , predetermined sum w/o reference to actual expense. 2) includes allowances for any purpose (but must have specific purpose), 3) is in the discretion of recipient (i.e. recipient need not account for its expenditure)

- *Campbell* – held was taxable allowance, was taxed on it even though testified she had incurred expenses
  - Employer can pay reasonable allowance but must be **required**, and this was voluntary
- Tax exempt allowance for:
  - s.6(1)(b)(v) or (vii) – reasonable allowance for business travel expenses
  - overtime of >2hrs, then $17 meal and reasonable commuting costs (not more than 3x/week)
  - travel at work = favourable, travel to work = no special treatment

Campbell v. MNR	1955, TAB	p287

F TP received $600 from employer for allowance of $50/month for use of car. TP argues are not allowances but are $$ for services outside of employment, for rental of car. TP was superintendent at hospital for chronic patients, sometimes had to transport patients to other hospital. Hospital had no transportation service, so she transported at own expense (not part of duties as superintendent)

I treatment of allowances, Distinction between reimbursement and allowance

H *J* for MNR.

R Income paid to TP should properly be considered an allowance, without allowing deductions for expenses of running car.

The Queen v. Huffman	1990, FCA	p289

F see above. Trial judge found that TP spent more than $500, was reimbursed maximum amount allowed by contract, $500.

I

H *J* for TP.

R *The Queen v. Pascoe* [1975]: allowance is predetermined sum paid to allow for certain kinds of expense, amount determined in advance, and is at complete discretion of recipient who is not required to account for it. Payment in satisfaction of obligation to indemnify or defray costs is not allowance. Nature of payment here is clearly a reimbursement.

Deductions in Computing Income from Office & Employment

- Section 8 – deductions for employment income
  - If not listed in s.8, employee can't deduct it
- Section 8(2) – limits deductions in s.8
  - See also s.8(4), 8(5), 8(13),
- Section 67 – limits deductions from any source (incl O/E) – only reasonable portion of expense is deductible
- Note difference b/w deductions and exclusions – sometimes exclusion more advantageous than deduction or v.v.
  - Subpara 6(1)(b) for exclusions
- Travelling expenses: s.8(1)(e), (f), (g), (h), (h.1), (j); s.8(4)
  - Employer may reimburse employee, or provide allowance
- Legal Expenses:
  - Can deduct for legal fees incurred to establish right to salary (s248(1)), or to collect money owed
  - Taxation before 1990 – only amounts for collecting salary/wages (*Lyonde v MNR,* 1988)
  - Must employee be successful? CRA says: If money is not "owed", no deduction, but failure to collect doesn't preclude deduction if is established as owing.
  - Legal expenses to preserve employment: *Blagdon v The Queen* [2003] court said expenses to defend competence are non-deductible b/c to protect means of livelihood, not collect wages owed – justification may be warranted but should be by Parliament.
  - Para 6(1)(j) –awards/reimbursements should be included in income unless otherwise taken into account – this means that 8(1)(b) only allows deductions to the extent they represent cost of earning income/net of awards/reiumbursements in respect of expenses
- Union Dues: s.8(1)(i)(i), (iv), (v); s.8(5)
  - Para 8(1)(i) – deduction for dues (must be annual)
  - Must be statutory dues
  - Dues that confer benefits (insurance) are deductible provided insurance is prereq of prof. status
- Home Office:

Chapter 5 – Income from Business or Property

Profit: to be determined according to "well-accepted principles of business (or accounting) practice" except where these principles are inconsistent with the specific provisions of the Act or principles of law (p309)

- Not defined in *ITA*, is a question of law (*Canderel*)
- Act specifically requires certain items be included in computing income from business or property. **SEE LIST p309**
- Generally income from business and income from property are subject to same treatment, but sometimes it is necessary to characterize as one or the other. See examples, p 310
- Note: GAAP is now IFRS – International Financial Reporting Standards

Income from a Business

- S248(1) business: "a profession, calling, trade, manufacture, or undertaking of any kind whatever…an adventure or concern in the nature of trade but DOES NOT INCLUDE an office or employment" (vast case law on this issue)
  - Excludes windfall gains or hobbies
- In CRA's eyes, is "activity that you intend to carry on for profit, and there is evidence to support that intention"
  - *Stewart* – "activity you do for profit"
- *Smith v Anderson* (1880) "anything that occupies the time, attention, and labour of a man for the purpose of profit"
- Gambling has been a hot topic under this issue

Organized Activity:

- Scheme – *Buckman*
- Risk/reward, profit motive, hobby
- Windfall gains cannot be business in part b/c there's no organization

Graham v. Green (Inspector of Taxes)	[1925] King's Bench	p311

F Graham bet on horses at starting prices in a large scale, made this his living.
I Whether gambling winnings are profits, or gains.
H *J* for *P*.
R Merely finding an object of value is not a profit/gain. Betting is the same, it is based on an irrational agreement. Bookmaker, by calculating the odds, makes a profit – this is organizing an effort in the same way that a person organizes an effort to buy things and later sell them to obtain a capital profit. But better's activity cannot be said to "merge with trade" in the same way. Just because his betting is habitual, doesn't mean that it is organized like a "trade, adventure, employment or vocation".

Pursuit of Profit:

- *Walker v MNR* – intention to profit (was race horses), had inside information, systematic attendance, high scale of operations ∴ business
- *MNR v. Morden*: said for the years of 1942-48, horsebetting was a business, but not 1949-55, just hobby
- *Leblanc v. The Queen* (2006) – sport lotteries case
  - no "organization" – bet on long odds, lost money but also made tons
  - but no REOP, had recurring losses
- *Moldowan v. MNR* (1977), Dickson: "in order to have a 'source of income' the taxpayer must have a profit or a reasonable expectation of profit"
  - This evolved into understanding that TP's expectation of profit must be reasonable
  - Reasonableness determined by:
  - "objective determination to be made on the facts. Following criteria: profit and loss experience in past years, TP's training, TP's intended course of action, capability of venture to show a profit after charging capital cost allowance
  - e.g. *Landry* case where was practicing law so inefficiently could not have REOP, ∴ not considered business

Stewart v. The Queen	[2002] SCC	p316

F TP was experienced real estate investor, rented condo units. TP received projection of rental income and expenses, which showed negative cash flow/income tax deductions for 10 years. TP claimed losses, as result of interest expenses on money borrowed to buy units. Losses were disallowed by MNR bc TP had no REOP.
I
H
R TP's rental activities did constitute a source of income, so allowed to claim the losses. Can't equate reasonable expectation of profit (REOP) with a source of income – not in line with prev common law articulations of "business". Current use of *Moldowan* REOP test is too broad. REOP cannot be a test for determining whether

TP's activity is source of income (should look to s.3, and for business/property, s.9). Test for s.9:

1) is the activity of the TP undertaken in pursuit of profit, or is it a personal endeavour?
2) If it is not a personal endeavour, is the source of the income a business or property?

It is reasonable to equate "source of income" with activity undertaken "in pursuit of profit". A business requires an additional level of TP activity than does property income (Krishna, p240).
Activity undertaken in pursuit of profit, regardless of level of TP activity will be either a business or property source of income. Where TP's venture has elements hobby, but is undertaken in "sufficiently commercial manner" venture will = source of income. Only do this test where there is a personal or hobby element, not where clearly commercial undertaking (i.e. *Landry* is bad law). For activity to be SOI, TP must have subj intent to profit, but also obj evidence to support that intent. Test is whether TP is carrying on in commercial manner (REOP is one indication of commerciality but not the only one).

In this case, didn't need to look to test because was clearly renting to arms-lengths parties, there was no personal or hobby element in his renting. Note that a tax motivation does not affect the validity of transactions for tax purposes (i.e. just because you're doing it in order to get a deduction, doesn't mean your activity isn't sufficiently commercial to be considered a source of income).

- Must have Reasonable Expectation of profit (REOP) – *Stewart*
- Court said CRA wrong to apply REOP assessment to Stewart b/c he had a source and a profit motive – overall profit, even if not profit within the rental property
- P320: 1) is activity undertaken in pursuit of profit, or personal endeavour?
    - Subj: is profit predominant intention?
    - Obj: was activity carried out w/objective standards of business-like behaviour?
  - 2) if not personal, is the source business or property?

Income from a Business compared to other sources

- Capital Gains: TPs will try to characterize activity as CG because only ½ taxed, but loss as income, so all counted
- Distinction between property and business:
  - Depends on extent of activity of the owner in earning the income.
- *Lois Hollinger v. MNR,* 1972*:*
  - 1) whether income was result of efforts/time/labour by TP
  - 2) whether there was trading character to the income
  - 3) can income fairly be described as business income w/in meaning of the *Act*
  - 4) nature and extent of services rendered/activities performed
- ∴ if income derived principally from ownership of property, is income from property.
- If earning the income involves significant amount of activity, income is from a business
- *Walsh and Micay v. MNR* 1965:
  - Income accrued to the TPs due to their ownership of property, tenants were primarily paying for occupation, not for the services provided (the services were ancillary to the property itself, did not constitute enough activity to make this a business income)

Income From Property

- Section 12 – items that are typically derived from property source become income (note diff between "property" and "income from property")
- Compared to business income
  - Income from property = investment income
  - Ownership of property, capital assets
  - Passive – little activity or time/effort/organization
  - More of a profit motive
- Common types:
  - Interest, rents, royalties
- Property defined as:
  - A right of any kind, a share or a chose in action
  - Unless a contrary intention is evident, money
  - A timber resource property, and
  - The work in progress of a business that is a profession.
- But also generally includes anything of value. Income from property is generally income derived from ownership of property – eg rental income
  - Property income is subject to the 25% tax for non-residents

Income from Property compared to other sources of income:

- Capital gains
  - Are two separate sources of incomefor purpose of s.3, property income is fully included (not CG)
  - S.9(3) – income from property does not include any CG from the disposition of that property (fruit v tree)
  - S.16(1) and para 12(1)(g) are anti-avoidance measures to prevent people mischaracterizing prop income as CG or vice versa
- Imputed Income
  - Economic value derived by owner from use of own property is considered imputed income, not taxable.
  - Imputed income is: 1) non-cash, 2) arises outside the market place
    - Imputed income includes "any gain, benefit, or satisfaction from a non-market transaction or event" Eg rent foregone by living in your own house
    - Does NOT include rent in kind from tenant to landlord (just because is not case does not change nature of rent)
    - This is problematic in that it may impose higher burden on renter, so violates horizontal equity, and the principle of neutrality ALSO doesn't work as a homeowner (see p332 for argument).

Interest Income (s.12(1)(c), p50)

- Interest: "compensation for use of TP's money, referable to a principal amount, accrues daily." P332
  - *Buckman* says if receive income obliged to repay, this isn't income, so same principle applies – debtor can't deduct
    - Interest payable to lender is interest income
  - *Sudden Valley* p187
  - Can be recorded on cash basis, when interest actually paid, or on accrual basis, when interest is due
- Court Order Interest (*Court Order Interest Act,* BC)
  - Creates new type of damage
  - Prejudgement interest is a head of damages
    - Takes character from basis of claim, and underlying damages
  - E.g. *Imperial Oil* – wasn't settled for 3 years, so during that time interest accruing and in that case would be tax-free $$
- TP has choice of accrual method, or (SEE p339 g.1)
- Paragraph 12(1)(c) of *Act* says any amount receivable as interest is included in income
  - When can amount be considered interest, and when must it be included?
  - No definition
  - Interest Is compensation for the use of money belonging to another person, must be referable to a principal amount and must either accrue daily or be allocable on a day to day basis
  - See: *Re Referece as to Validity of s.6 of Farm Security Act, AG ON v Barfried Enterprises, Miller v The Queen, Sherway Centre Ltd v Canada*
  - Interpretation Bulletin IT 396R, 1984
- Discount – excess of the principal over its issue price (??)
  - Characterizing discount as interest = factual issue
  - OID = interest (for *ITA* purposes) where debt is non-interest bearing, or carries interest rate lower than market rate at time of issue.
  - E.g. where I owe $100 to A, and the bank buys this debt obligation from A for $90, so that I eventually give the bank $10 more than it paid – this is a profit
  - 3 cases (p333) characterized discounts as interest income of debt-holders.
  - When approp commercial rate charged & also there is discount, discount characterized as capital receipt
  - If debt obligation is issued at "deep" discount by government, discount is treated as income (s.16(2) and (3))
    - If yield (including discount) is more than 4/3 of stated interest rate
  - Discount from another TP will be either income or CG
    - If receiving TP is in business of purchasing debt obligations, will be income once realized
    - If purchasing debt obligation as investment, will be CG *Wood v MNR*
- Individual = up to a marginal rate of 43.7%
- Private Corporation – up to MR of 44.67%
- Capital gains, losses – top MR 21.85%
- Dividends – MR 25.78
-
- Bonus

- Amount in excess of the stated interest and principal payable on maturity/repayment/default of debt obligation
- Bonus payments are not interest, generally *Campbellton Enterprises Limitee v MNR, Neonex International Ltd v. The Queen, Riviera Hotel Co Ltd v. MNR*
- If bonus varies with the term of a loan and there is no interest stipulated, may be considered interest *Puder v. MNR*
  - If bonus is economically similar to OID then characterized as such
  - Characterization of bonus may be overridden by statutory provisions, e.g. bonus for early redemption etc – case law would say prob not, but stat characterizes as interest (s.12(1)(c))
  - S.12.1 – cash bonus on Canada Savings bond = interest, ½ included in income

- Blended Payment – where TP receives single payment which includes both repayment of capital and interest. S.16(1) says interest must be segregated and included in income

Groulx v. M.N.R.	1967 SCC	p336

F TP owned farm, resided in house on farm. Refused many offers to sell farm. Eventually, was negotiating sale and decided to forgo interest to bring price down. No interest except where payment is late, then will be 6%.

I Whether sums TP received are considered interest as per s.16(1) (then 7(1)).

H

R Farm was sold at higher than market price, and here was clear that TP was experienced in business and increased the capital while forgoing interest in order to lower his income for tax purposes. Therefore should be considered a blended payment with some portion considered as interest/income.

- Issue of whether on the facts, fair market price was paid
- s.16(1) requires all 3 factors: 1) invariable practice, obvious difference b/w amount and fair market value, and must be subject of discussion
  - no such thing as set fair market value, has a <u>range</u> – one person might say high, other might say low
  - principal residence exemption
  -

Rent and Royalties

- On real estate – e.g. office building, apartment building
- Rent/royalty not used per se but are considered through s.16(1)(g): amount received that is dependent on use/production from property
  - Rent is passive, if were motel/hotel then would be active income, so business
  - Degree of activity – if just cleaning the street once in a while, not business
  - s.9(3) CGs excluded
- Rent = a fixed payment for use of property for given period of time (usually periodic)
- *The Queen v. St John Shipbuilding and Dry Dock* 1980
- Rent = tangible property, royalty = minerals and intangible property (copyright, etc)
  - *Vauban Productions v. The Queen* – royalties are share in profit, akin to rental payments are based on degree or duration of use of right
- Declining Balance method for buildings – house will depreciate (separate from land)
- s.12(1)(g) – amount of instalments based on profitability will work
-

Dividends

- Dividend paid on shares represents return on equity investment
  - Dividends are distribution of a company's after-tax profits – company pays tax on income before distributes dividends, so shouldn't tax the dividend in the receiver's hands because this would be double taxation
- Any *pro rata* distribution from corporation to its shareholders is a dividend unless is made on liquidation of the corporation, or authorized reduction of corporation capital (*Hill v Permanent Trustee of NSW* 1930)
- S.84 says a divided is deemed where a corp
  - A)increases the paid-up capital in respect of the shares of any class of its capital stock
  - B) distributes funds or property on the winding-up, discontinuance or reorganization of its business
  - C)redeems, or purchases for cancellation its shares
  - D) reduces paid-up capital in respect of any class of shares otherwise
- Dividends are included in income

Deductions in Respect of Income from Business or Property

- General approach – look at GAAP/IFRA, then to *Imperial Oil, Royal Trust, Canderel* – profit/loss is question of law
  - Make adjustments as per s.18, s.20, s.67 (and s.67.5, 67.6)
- Income from business or property: "profit therefrom for the year" – s.9(1)
  - Income from Business should be on accrual method, as incurred/earned
- Section 18 limits deductions for certain expenses – e.g. expenses not incurred for purpose of earning business or property income, e.g. capital expenditures, e.g. personal/living expenses
- *Daley* (1950)– expenditure properly deducted under GAAP will be deductible unless prohibited by tax act
  - Confirmed 1998, *Canderel v. Canada* SCC - look to s.9(1)
  - Need to look to all three – 18(1)(a), 18(1)(h) and 9(1) [9(1) →GAAP]

Business Purpose Test

- Para 18(1)(a) – expense deductible to extent incurred for purpose of earning bus/prop, but doesn't limit anything more than GAAP under 9(1), but this wasn't the case under precursor to *ITA*, Income War Tax Act
- Starting point: look to financial statements, IFRA/GAAP, then see if *ITA* changes outcome
  - *Imperial Oil* and *Royal Trust Co* show that financial statements, profit/loss figures must be altered to fit legal rules
  - s.18(a) – disallows expenses that are not for the purpose of earning income
  - s.18(1)(b) – disallows capital outlays (except as permitted), s.18(1)(h) – disallows personal/living expenses
  - s.67 – all deductions must be reasonable amount, s.67.5 disallows bribes, statutory fines and penalties

Imperial Oil Ltd v. MNR	[1947] Exch Ct	p348

F Deduction for paying damage claims due to sea collision.

I

H *J* for *TP*.

R Appellant argued that collision was part of normal hazards of operating the petroleum transportation business, and the negligence that caused the damages was to be expected. *Strong & Co Limited v. Woodifield* [1905] – issue is whether the loss is truly "incidental to the business". If is, then deduction is allowed. If a trader has to pay damages for negligence of servants such that loss is incidental to trade, then amount paid is incidental. Issue of fact – yes, is incidental to the operation of vessels. But *Strong* was argued based on *Income War Tax Act*, not *ITA* – so is it the same?

Can't determine "purpose of earning income from bus/prop" in isolation, must look at item of expenditure in light of connection with the operation/transaction to see if was "part of the process of doing so". Here, is appropriately deductible, falls under normal liability expenses etc.

- loss is incidental to the business in this case, part of the process of earning income
- operations included transportation of petroleum, this was one of necessary risks
- 1927 was when accident liability arose, but wasn't quantified & paid util 1930
  - wrinkle in the accrual method – must know what the amount owed is before can place it
  - GAAP – causal connection b/w expense and receipt
  - A ccountants would apply principle of matching, would defer expense to 1930
  - s.18(1)(a) looks to "purpose", says no matching required – as long as made and incurred in that year
  - is at the TP's option, can match if want but not required
-

The Royal Trust Co. v. M.N.R.	1957, Exch	p352

F Company required employees to join certain social clubs, company paid for membership and later claimed these fees as business costs.

I Whether club fees are included as expenditure for the purpose of income under business.

H *J* for TP.

R *Imperial Oil*: Should look to accounting principles to determine deductibility of expenses, unless deduction is prohibited by s.6(a) (now *ITA* 18(1)).
If expense was made in accordance with business or accounting principles, then move on to see if falls within s.12(1)(a)'s exception. If does not accord with business practices, then stop there. (clearly, if is listed under 18(1), then is excluded).
Here, clearly company's actions were in accordance with good business practice. This is first step, but doesnt make it automatically deductible. Next have to couch it in 12(1)(a) exception ("for the purpose of gaining income from the business"). If there is no actual income, but there is a purpose to gain income, still works. Factual consideration. Here, on the facts was clearly for the purpose of gaining income from the business

- argued initiation fees are **not** capital outlays bc didn't have lasting or enduring benefit
  - *British Insulated v. IRC* p477
- Parliament changed this in *ITA* s.18(1)(l) p137, p357#1, **reversed** *Royal Trust* decision
  - (i) discusses expenses for yachts, camps, lodges, golf course
  - ii – club dues are not deductible if playing fees
  - *ITA* s.6(1)(a) – club membership would not be a taxable benefit for employee if Royal Trust requires employees to play golf

Personal or Living Expenses

- Generally not deductible – s.9(1), para 18(1)(a), also 18(1)(h) denies deduction except expenditures away from home in course of business.
  - Expenditures not listed under s.248(1) could fall into 18(1)(h) – 248 is not exhaustive
  - S.63 – allows childcare expenses
  - S.62 – allows moving expenses
  - ^^ contain restrictions too

Benton v. MNR	1952, Tax ABC	p358

F TP is farmer, doesn't have any male help, is semi-invalid. Has Mrs Reed for medical purposes and for help around farm as housekeeper etc. TP seeks to deduct her wages from business of farm.

I

H

R MNR says are personal/living expenses, and evidence shows is primarily a housekeeper in usual domestic duties, contribution to income-earning work of farm was necessarily of secondary nature.

- Disability supports deduction for attendant care – s.64
- Medical expenses tax credit – s.118.2, .3
- Registered disability savings plan – s.146.4
- Disabled child – lifetime contribution of $200,000

Leduc v. The Queen	2005, TCC	p359

F TP is lawyer, claimed legal fees as business expenses – fees were for defending him on trial for sexual exploitation and offering sexual services for consideration.

I

H

R TP argued that needed to make expenditure in order to maintain business (because LSUC could disbar him if case against him was successful), so was properly deductible under business expenses. S.9 allows TP to deduct expenses incurred to earn profit except as limited by 18(1)(a) and 18(1)(h). In order to be deductible as business expenses, must be for purpose of gaining income from business as per 18(1)(a). Question of fact (*Symes*). Consider whether is normally allowed by accountant as business expense, whether is normal expense by other in same business, whether would have been incurred if TP as not in pursuit of business income. Also business need test (*Symes*): would the need exist apart from the business? If so, likely personal.
Ludco Enterprises v. Canada [2001]: SCC saystest to determine purpose for interest deductibility is whether TP had reasonable expectation of income at time investment made. TP here testified that investment in trials didn't actually increase income, no need to invest.

- It is not incidental to practice of law to defend from charges of pedophilia
-

Childcare:

- Limited deduction for childcare

Symes v. The Queen	1994, SCC	p366

F TP is partner in law firm, pays nany for children, deducted her expenses as business income. Argued denial of deduction was violation of s.15 (equality).

I

H Case dismissed along gender lines 7:2.

R Expenses were to make her available for business, not for business purpose itself. No evidence that child care expenses are considered business expenses by accountants. There is element of public policy, e.g. *Brooks v Canada Safeway* 1989 – "unfair to impose all costs of pregnancy upon half the population." Competing policy considerations – but Iacobucci says have to go by what s.63 says.

Food and Beverages:
- food and beverage traditionally fall under 18(1)(h)
-

Scott v. MNR	1998, FCA	p369

F Courier travels 150km/day carrying heavy backpack tries to deduct amount for food and water.
I
H *J* for TP.
R TP is allowed because has analogous compatriot – taxi driver is allowed deduction for gasoline. Construction worker with equal food/fuel requirements would not be allowed. Necessary to determine on the facts whetehеr TP requires extra food an water because of business as courier (factual determination not made bc trial judge held legally deduction not available).

Commuting Expenses
- limits on automobile expenses – s.13(7) – capital cost, s.67.2 – max interest, s.67.3 – max leasing cost
- Where to live is personal consumption decision, not deductible usually

Cumming v. MNR	1967, Exch	p375

F TP is physician, renders services at Hospital but not paid by hospital, come directly from patients. Administrative work is done at home. TP travels between home and hospital. MNR says travel to and from (two times total) is not don't fall under s.12(1)(a),as is limited by 18(1)(h).
I Issue of law: whether commuting is deductible, Issue of Fact: whether TP is actually commuting because of business reasons (or maybe just goes home when not busy).
H
R As to facts, clearly the base of business was at home. He would have had to get other office if not convenient to use home (location esp made home convenient). TP had claimed 8071 miles of car, but also said avg of 5 trips daily which would work out to 2000miles, so court held this 2000mi to be deductible. On same basis, that car was used 50% for business (because mileage but also time), also allowed 50% of capital cost under s.11(1)(a).

Public Policy Considerations
- Courts may prohibit deductions for public policy reasons
- Concept of income doesn't distinguish between income from legit and illegal business activities
  - Are expenses of carrying on illegal business deductible?
- Note: CRA not supposed to give info to other government agencies

MNR v. Eldridge	1964, Exch	p387

F Call girl operation in Vancouver. TP kept no books. Records found under seizure from criminal charge made their way to MNR. TP admits criminal guilt but argues that shouldn't be taxed at full rate of income, because of expenses.
I Are expenses under illegal business deductible?
H Yes, *J* for TP.
R Judge determines how much was expended, on the facts – records were vague so difficult to determine. Says "all such items if proved to be disbursed, would be proper deductions. There is no question were used in the conduct of the TP's business.

65302 British Columbia Ltd v. The Queen	2000, SCC	p394

F TP has egg poultry farm, produced over-quota to maintain major customer, until could purchase additional quota at affordable price. Egg Marketing Board fined producer.
I Is over-quota levy deductible?
H
R Parliament cannot have intended s.18(1)(a) to allow deduction of fines. Courts should not interpret legislation in a way that frustrates other legislation. Can't assume that in allowing deductions parliament is thwarting state policy, but also know parliament intends only to tax net income. Tax authorities are not concerned with legal nature of activity. Outlays and expenses will be deductible if for the purpose of gaining income unless otherwise directed by the *ITA* itself. Public policy determinations are better left to Parliament. In some cases Parliament has expressly disallowed expenses (e.g. bribes), also prohibited from deducting interest, penalties under the *ITA*, statutory royalties, etc.
NOTE: Dissent. Bastarache, p399.

- Judicial or statutory fines – deductible

Interest Expenses

- Para 18(1)(b) prohibits deducting payment on account of capital
- Para 20(1)(c) and (d) – statutory exceptions
  - Para 20(1)(c)(i) – allows deduction in year pursuant to legal obligation to pay interest on borrowed money used for purpose of earning income from a business/property
  - 20(1)(c)(ii) – allows deduction of interest payable on unpaid balance of purchase price of asset used by TO to earn business or property income
  - can't deduct where source of interest expense no longer exists (e.g. if sold shares at a loss, loss not deductible)
  - *Tennant v. The Queen* – spent $1mil on shares, 4yrs later only worth $1,000. TP continued to deduct loss but transferred shares. SCC held that deductibility not lost because sells property acquired with loaned funds, so long as TP reinvests proceeds in eligible use property

The Queen v. Bronfman Trust	1987, SCC	p405

F Trustees retained trust investments, financed allocations by borrowing from bank.

I Is interest paid to bank by trust on the borrowings deductible? Is deduction only available where loan used directly to produce income or also when loan is preserving assets? Does it matter if is trust/natural person/corporation?

H *J* for *A*.

R There are variety of ineligible uses for interest on borrowed money, deduction requires characterization of use of borrowed $$$ as either like eligible, or ineligible uses. If $$$ is commingled, may not be able to claim deduction at all (*Mills v MNR, No616 v MNR*). Also need to characterize "purpose" – earning income. Not relevant why borrow money, relevant purpose in using the borrowed money (*Auld v. MNR*). Current use that matters, not original use. Should apply to TPs, regardless of trusts/corps/natural persons. Limitation on the current use principle – must still be in TPs hands, as traced through proceeds of disposition of preceding ineligible use. Continuing obligation to pay interest doesn't necessarily mean that borrowed money has continuing use for TP.

Here, borrowed money was originally for capital allocations to beneficiary (no consideration). Clearly not income-earning. TP argues borrowed funds allowed trust to retain income earning properties, which otherwise would sell to make capital allocations. (this is looking at $$ in indirect way instead of first use of $$ which is not incomeearning). Caselaw and *ITA* suggest should look at direct use. Fact that TP continues to pay interest doesn't mean borrowed money is still being used by TP, or being used for income earning purpose. That the loan prevented capital loss doesn't assist TP in deducting the income paid on loan.

- Purpose of borrowing matters
- Should look to direct purpose of direct use of funds in account – paid out to beneficiary, so not deductible

Singleton v. The Queen	2002, SCC	p414

F TP had $300,000 capital in the law firm, wanted to use it to buy house, but then borrow from bank to reinvest it. Record unclear on what actually happened. TP paid interest, deducted interest on tax return.

I

H

R *Shell v Canada* [1999], SCC says amount must be paid in year or payable in year sought to be deducted, 2) amount paid pursuant to legal obligation, 3) borrowed money used for purpose of earning income, 4) amount reasonable. Here, issue is 3rd component. Not about purpose of borrowing but purpose of actual use. Not allowed where indirect. TPs are entitled to structure transaction in a way that reduces taxes. Irrelevant why the borrowing arrangement was structured the way it was.

Question is, to what use were borrowed funds put? This is not one simultaneous transaction, separate transactions. TP refinanced partnership capital with debt. This is an eligible use under s.20(1)(c)(i). Purchase of house etc has no consequence. Don't have to look for bona fide purpose, assume purpose is right unless evidence that is a sham.

Requirement of Reasonableness: s.67 – no deduction for expense otherwise deductible under Act, except to extent is reasonable in the circumstances

- Lawyers – supposed to report work in year done, but can elect to continue to deduct expenses on actual basis (cash basis), while reporting income on bills delivered method
    - Allows you to postpone income to a year when bill rendered to client, as opposed to when work occurred
    - s.35