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# General Tax Information

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

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

ii) **Average tax rate**: rate of tax that applies to the taxpayerʼs 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 taxpayer earns an additional dollar moving them to another bracket, even though it might cause them to move to the higher marginal tax bracket, it canʼt affect the amount of tax they pay on their income falling in the lower marginal tax bracket

**Tax schedule**

- **s.117**: determine federal tax payable by applying the rate schedule

**Taxation period** is called the "**taxation year**" for personal income tax

- ***s 249 (1)*Calendar year (Jan 1-Dec 31**) is used and is due on April 30 the following year

**- All taxes have 5 components:**

a) **Tax base** – base upon which the tax is levied (income v consumption)

b) **Tax-filing unit** – responsible for paying the tax

c) **Tax rate** – rate applied to the base in arriving at the amount of tax owing

d) **Tax period** – period over which the base is measured and the taxes collected

e) **Tax administration** – administrative arrangements for tax collection

# Who Needs to pay Canadian Income Tax?

There are 2 important questions to be resolved by this part:

**1) Who is a taxpayer?**

*-* ***s.248(1)****:* each individual is a **"person"** under the *ITA*, regardless of age, capacity, ect…

- TPs can be individuals, shareholders, company/corporations, Bʼs of a trust/estate, partners of a partnership (but not the partnership itself), ect…

- Three points on specific TPʼs:

i) **Subsidiary corporations** – each corporation in a corporate group is **a separate TP**, so losses of one subsidiary canʼt set off profits of another company in the same group- ***ITA s. 248(4)***

ii) **Trust/estate** – The entity itself isnʼt taxable, but income from it is

- A trustee is a taxpayer twice over, for themselves, and for the taxes filed on behalf of the trust/estate

- Trustee (***s.248(1)*** is the “legal representative”) is **personally liable** to prepare T3 tax returns for the trust/estate and issuecertificates/information returns to the beneficiaries

iii) **Sole proprietorship** – not a legal entity; **TP is proprietor who gets income from business**

## Residents: What is Residence?

### GENERAL

- There are 2 types of TPʼs in Canada:

a) **Residents in Canada – *s.2(1)***

- They get the benefit of Canada and Canadian laws anywhere in the world; therefore they are subject to tax on worldwide income

- Residents must report investments from outside Canada if total cost is greater than $100,000

b) **Non-residents – *s.2(3)***

- Subject to Canadian tax only for their sources of income that are in Canada

**What is Residence?**

**a) Resident**

- there is no definition, itʼs a question of fact ***Thomson*:**

 -It’s **determined annually**

-If you’re **resident in the year, you’re resident for whole year**

b) **EXCEPTION “Part-time resident”**

- If a TP comes or leaves the country **permanently**, the taxation year will be split and the TP will be categorized as a **“part-time resident”**- On their tax return, must state the date on which the TP comes or leaves

- **Double taxation**: sometimes are residents of multiplenations; the TP will be subject to double taxation unless:

a) **Foreign tax credit**: ***s.126*** – Canada gives credit for every dollar of tax paid in another country. No worse off if made income in Canada.

b) **Tax treaty** – tax treaties prevail over the *ITA.* Provide relief against double taxation.

### Types of Residents

#### Factual residence

**Factual resident:** living in Canada

**-A person is a resident of Canada if it is where he/she settles into or maintains an ordinary mode of living, including social relations, interests, and conveniences *Thomson v MNR(****guy with a house available for use in NB, didn’t rent out house, went to Bermuda for diff passport, tried to claim not resident but court said is resident)*

**-Residence is question of fact and depends on each case; the more ties a TP has within Canada, the more likely they will be considered a resident. You need 1 significant and 1 or more secondary to be considered a factual resident.**. ***Lee v MNR****(English guy had Canadian wife, had house and bank account in Canada but he had English address, couldn’t stay in Canada for long time because denied visas. Court said still a resident and subject to cdn tax)*

**Factors assisting in determining whether someone is a resident of Canada**

***IT-221R3 (Consolidated), Determination of an Individual’s Residence Status***

- Describes residential ties:

**a) Significant residential ties**

 -Must sever ALL significant residential ties to not be a resident of Canada:

i) **Permanence and purpose of stay abroad** (see ***Thomson***…temporary golf holidays)

ii) **Residential ties** within Canada…includes:

a) **Dwelling place** – keeping house in Canada suitable for year-round occupancy, leasing it at non-armʼs length will be considered not to have severed ties

b) **Spouse**, **CL partner**, or **dependents** in Canada (see ***Lee***)

iii) **Residential ties** elsewhere – everyone must be resident somewhere

iv) **Regularity and** **length** of **visits to Canada** – if more than occasional visits, ie: ***Lee***

**b)** **Secondary residential ties -** looked at collectively:

i) **Personal property** (furniture, clothing, vehicles)

ii) **Social ties** (membership in recreational and religious organizations)

iii) **Economic ties** (employment in Canada, involvement in Canadian business, bank accounts, RRSPs, credit cards, security accounts)

iv) **Landed immigrant status** or appropriate **work permits**

v) Hospitalization and medical **insurance coverage** from a Canadian province

 vi) **Driverʼs license**

 vii) **Seasonal dwelling place**

 viii) **Canadian passport**

 ix) **Membership** in Canadian unions or professional organization

- **If an individual wishes to become a non-resident of Canada**, they must:

a) **Sever** all residential **ties**b) Go to local Canada Revenue Agency and **pay** (**departure tax**)

#### Deemed Residence

**Deemed resident:** -***s.250(1)(a)****:* a person shall be deemed resident throughout a taxation year if the person sojourned in Canada **for a total of 183 days or more. Once they are deemed a resident, they are taxable on income for the whole year.**

**DOESN’T HAVE TO BE CONSECUTIVE DAYS.**

**Determine year by year. Stop counting when year is over: IE:** International student in cananda from non-treaty country. Comes sept 2011 stays til april 2012In 2011 it’s 122 days out of 365 and 2012 122/366 so neither year did he exceed 183, so not a sojourner UNLESS he comes back in fall 2012

**NOT Commuters: People commuting from another country to work in Canada are not residents. *R & L Food (****two US shareholders in company commuted across border and wanted to be deemed residents for sojourning in Canada but denied)*

#### PART TIME RESIDENTS

**Part-time resident:** If a TP comes or leaves the country **permanently**, the taxation year will be split and the TP will be categorized as a **“part-time resident**

- ***s.114***, there are **special rules for calculating the taxable** **income** **part time resident**

**-** Income will **be split** **ONLY** in the year an individual **establishes or ceases residency in Canada**

- One consequence of leaving Canada is a **“departure tax”** where there is a large capital gains tax on assets, even if they are not sold

#### ORDINARILY RESIDENT

- **“Ordinarily resident”**: ***s.250(3)****:* where an individual **has not severed all of his residential ties** with Canada but is **physically absent for a considerable period of time** they **may be “ordinarily resident”**

 - **Intention is key**: an individual can be “ordinarily resident” while physically **absent as long as they show an intention to return and no intention to permanently sever ties**

**-If a TP goes and lives abroad but does not sever all secondary residential ties to Canada, they will be “ordinarily resident” in Canada and will be taxed on all of their worldwide income for the entire taxation year *Queen v Reeder (****cdn guy moved to france for training. Sold house but kept bank account and health plan, found to be ordinarily resident)*

## Residency of Corporations

- Under the Act, a corp is separate TP, may be a resident or non-resident of Canada for income tax purposes

- If company is a Canadian resident TP, they will be taxed on all world-wide (foreign-sourced) income

**a) Incorporation IN CANADA after April 26, 1965 – subject to *ITA***

- ***s.250(4)(a)****:* a corporation incorporated **in Canada** after **April 26, 1965** **is a resident in Canada throughout a taxation year and forever a resident of Canada and subject to Canadian income tax**

- Therefore, wherever the Board of Directors meet, shareholders live, or company carries on business is irrelevant

**b) Incorporation before April 27, 1965 – not subject to *ITA* unless,**

- ***s.250(4)(c)****:* a corporation incorporated **in Canada before** April 27, 1965 will be

**deemed a resident only** if, at any time in the taxation year or at any time in a preceding taxation year ending after April 26, 1965, they were

i) **Resident in Canada**

Corp=Deemed Resident **If central management and control in Canada (where it carries out its real business) *DeBeers (****diamond mining co registered in SAfrica but directors in England. Deemed resident in england)*

 ii)**carrying on business in Canada**

**After** these **triggering events**, the company **will be permanent residents** **forever** after

- ie: company foolishly decides to have a Board of Directors meeting in Canada, bound to pay tax to Canada forever!

**c) Not Incorporated in Canada**

 **-**don’t need to pay Cdn income tax unless **directors exercise central management and control in canada. *DeBeers***

-**assessed yearly**

**d)Non-Resident Corporations**

i) only taxable on canadian sources of income (income from **carrying on business** in Canada)

ii)only taxable on the income of the particular years earned in canada.

## TRUSTS AND ESTATES

***s.104-108***

- The test for the residence of a trust is analogous to the corporation: **central management of control *Garron Family Trust 2010 FCA(****beneficiaries were exercising control so residence of trust was where beneficiaries were)*

- **Note**: location of Beneficiaries isn’t relevant in determining residency because they have no control over trust property **UNLESS the Bs are making the important decisions *Garron Family Trust 2010 FCA***

## PART 1:NON-RESIDENTS TAXATION

***Part I, s.2(3)*** :**non-residents are subject to income tax** if they **earn income, carry on business, or dispose of property in Canada**

- Non-residents file an income tax return in the same way as all residents of Canada and are taxed on this income at the **relevant marginal rates**

### Non- residents EMPLOYED IN CANADA

- ***s.2(3)(a)****:* non-residents **employed in Canada must pay tax on Canadian income** (not foreign income)

- The non-resident employee must,

- **Physically enter Canada**

- Perform **duties of employment** in Canada

- **Pro-rate time performing** duties in Canada ***(s.115(1)(a)(i))***

- **Note:**Employment contract can have been made anywhere

### CARRYING ON BUSINESS IN CANADA🡪have to pay tax

- ***s.2(3)(b)****:* non-residents carrying on business in Canada must pay tax on Canadian income

* **Where the substance of doing business in Canada is present (ie: contracts, payments, deliveries, bank accounts, intent to do business in Canada), it will take precedence over a lack of form (ie: no offices/official agents in Canada) and establish “carrying on business” in Canada. Will have to pay tax. *GLS Leasco(****American company bought and leased equipment in Canada. Wanted to be taxed under part 1. Not much physical presence but was found to carry on business in Canada)*
* OLD View: **Criterion for carrying on business includes where the contract is made; the determining factor is where the contract is accepted (formed) *Grainger & Sons(****G canvassed orders for French wine merchant. French guy decided whether to accept offers for wine)*
* NOW: ***s.253(b)* CRA extended the meaning of “carrying on business in Canada”** to **include “solicitation of orders through an agent or servant”**
* BUT court says **an agent must have authority to bind the principal, *Sudden Valley***
* **Court looks to where orders solicited to see if fall under 253 b. Say that soliciting orders should be binding and not include “a mere invitation to treat.” *Sudden Valley (****American developer of Washington property had office in Canada where it tried to invite cdn buyers to come down and see US Property. Gave mortgages and wanted to be taxed as carrying on business.)*

### DISPOSITION OF TAXABLE CANADIAN PROPERTY🡪have to pay tax

- ***s.2(3)(c)****:* non-residents are taxable for capital gains of “taxable Canadian property”

- Since itʼs tough to go after foreign vendors, Canadian resident purchasers of real estate must be mindful of the *ITA*:

**a) Real Estate Provisions**

- ***s.2(3)(c)****:* non-resident taxable for capital gains from disposition

- ***s.115(1)(b)****:* “Taxable Canadian property” includes real property in Canada

*-* ***s.116***: if a **non-resident is disposing of property and submits an estimate of capital gain and payment for 25% of that amount, the Minister shall issue a certificate as proof** of payment for the resident purchaser

**b) Onus on the resident purchaser**

- Purchaser is required to make a **“reasonable inquiry”** into the vendorʼs residency status

- If purchaser makes reasonable inquiry and **vendor non-resident; needs to be compliance with s 116 otherwise purchaser on hook to withhold 25% of purchase price to govt of Canada**

- ie: get a “clearance certificate” and pre-pay tax on the transaction; otherwise, **if the vendor is a non-resident, the purchaser must collect and remit tax to the CRA or else be personally liable**

## PART XIII: NON RESIDENT WITHHOLDING TAX

***Part XIII, s.212***

- Where certain payments are made **by a resident to a non-resident**, a non-resident **“withholding tax”** must be paid on the **gross amount** by the **resident payor.**

**-EXCEPTION: *s.216(1)****:* **NON RESIDENT LANDLORDS** can **elect** to have the rent taxed on **net income** **under Part I** and file a return as though a resident of Canada rather than be subject to withholding tax.

-In this situation, it is usually favourable for the landlords to be taxed on **net income** as it allows for **deductions**

**a) 25% withholding tax on gross amount of passive property payments to non-residents**

- ***s.212(1)****:* non-resident must pay 25% tax on any payment from a resident for:

i) Management fees

ii) ~~Interest (~~*~~Sudden Valley~~*~~)~~

- **Update**: in ***s.212(1)(b)****,* **as of 2008, any form of interest payments to non-residents are no longer subject to withholding taxes**

**However: 212(3) says interest which is not-exempt is non-arms length lenders and borrowers (unless subject to Can US treaty).** IE if a relative from Italy loans me $, he would be taxed on interest but not if too arm’s length person. USA friend would be exempt

iii) Estate or trust income

iv) Rents, royalties, etc… (***GLS Leasco***)

- **Update**: alimony is no longer subject to withholding taxes either

 v)pensions

- **s.*212(2)****:* non-resident must pay 25% tax on dividends from corporate residents in Canada

**b) Other provisions**

*-* ***s.214(1)****:* taxes payable under ***s.212*** are payable **without deductions for expenses** from the amounts (see *Sudden Valley* and *GLS Leasco*)

- ***s.215(1)****:* **resident payor is responsible** for paying the withholding tax

- **s.215(6)**: if a **resident fails** to withhold tax from a non-resident, they are **personally liable**

**c) Exemptions – bonds and foreign currency deposits**

- ***s.212(1)(b)(ii)****:* bonds, including federal, provincial, and municipal bonds

- ***s.212(1)(b)(vii)****:* long-term corporate bonds

- ***s.212(1)(b)(iii)(D*)**: foreign currency deposits at financial institutions

## There must be a connection between Taxpayer and Income: NEXUS Test

* **The person who has to pay tax is the person who actually reaps the benefits of the income. *Field(****wife withdraws fraudulently from husband’s rrsp. He gets no benefit but CRA wants to tax him anyway)*
* **Stolen trust money will be taxed in hands of fraudulent trustee even if only a conduit. *Buckman***
* **Money obtained illegally during the course of a business is taxable if the conduct has the earmarks of a business (active, risk &reward, repeated transactions, systematic.) *Buckman (****lawyer embezzled money from clients said hes just conduit no nexus)*
* **BUT: Benefits from Ponzi not taxable: *Johnson*:** Lady who benefited from Ponzi scheme made income that was determined to be a windfall, not a capital gain.

## INCOME SPLITTING

**=when someone tries to make income that would be theirs belong to someone else in family (**bad because benefits the rich)

**Canada is a jurisdiction that discourages income splitting**, and **redefining the nexus** between a TP and a source of income

- **Govʼt fights back**: **“attribution rules”** that attribute the transferred income/property back to the transferor

- **Example**: the 2000 **“kiddie tax”: *120.4* kids under 18 have to pay highest marginal rate of tax but child earning employment income will not be subject to highest marginal rate.**

- **Example**: a sole practitioner is a TP that can deduct expenses from his business

- subject to ***s.68*** which entails that **wages paid must be** **"reasonable"** for them to be a tax-deductible expense

- ie: if wife employed as bookkeeper, kids working as receptionists, etc…may not be “reasonable”

### Indirect receipt and Income Assignments

- 2 of the most popular techniques that attempt to split income are:

**1- Indirect receipt:** TP Diverts income to person taxed at lower rate

**2- Income assignments:** Assignment of a right to earn income from one TP to another taxed at lower rate

#### Indirect receipt of income (received by someone other than TP) Use dividends to avoid attribution!

*-* ***s.56(2)****:* **Income will be attributed back to the TP if** the CRA can prove **4 elements**: ***Neuman***

**1) There is a Payment to a person other than the reassessed TP**

- ie: payment usually written to a lawyer would instead be written to the lawyer's child

**2) Allocation must be at the direction or with the concurrence of the reassessed TP**

- ie: laywer tells the client "please make the payment to my child"

**3) Payment must be for the benefit of the TP or for the benefit of another person whom reassessed TP wished to benefit**;

- ie: lawyer and child are in same family unit and live under the same roof, and giving the money to the child would keep the money in the same family unit and benefit the lawyer

**4) Payment would've been included in the reassessed TP's income if it had been received by him/her**

**If money is diverted as a dividend of a company it is successful in splitting income because it does not meet the 4th condition in 56 (2) which requires that the diverted money would have been part of the taxpayer`s income.**

***Neuman (****husband own shares in corporation funded by his law firm. Wife directs dividends to be paid to herself. They can’t be attributed to husband because they belong to corporation. Husband wouldn’t have received it)*

Good idea to make a business a corp and distribute dividends to wife and adult kids!

####  Income assignments: Transferring right of income (including loans to non-arms length)

***s.56(4)****:* where TP:

* + ***Transfers of a right to income [from any source]***
	+ ***To a non-arm’s length person [family, companies owned by tp]* and it**
	+ ***Would have been transferor’s income [beneficial entitlement]***

The part of the amount shall be included in computing the TP's income for the year **unless the income is from property and the TP has also transferred or assigned the property**

**The court will attribute income to the taxpayer when the TP transfers a right to income to a non-arm’s length person/corp if the income would have been the transferor’s income, unless property also transferred (s 56 (4)). *Boutelier(****tried to assign right to income to his corp but failed)*

**People hoping to successfully split income need to pay close attention to the form (ie treat corp as a separate entity, have it carry on active business, incur expenses etc). *Boutelier*** *(B incorporated company to receive trailer fees that he would normally receive MNR attributed the fees the corporation earned back to B)*

### PROPERTY TRANSFERS, LOANS AND INCOME ATTRIBUTION

2 other methods often used to split income are:

**1) Property transfer:** Transfer of property that generates the income or gain

**2) Income attribution:** Use of low-interest or non-interest bearing loans to invest

- In these subsections, income from **“property**” is attributed back to the **TP if the property is transferred to a spouse or minor/relative under 18 that doesn’t deal at arm’s length with the TP.**

**Also 56 (4.1) says any income earned on the investment made from a low-interest or interest free loan from a family member is attributed back to the lender.**

**Definitions of "related persons" and "others"**

- ***s.251(1)(a)****:* "related persons" defined as child or other dependent, brothers/ sisters, nieces/nephews

- ***s.251(1)(b)****:* "others" is a question of fact

#### TRANSFERS AND LOANS TO SPOUSES

- ***s.74.1(1)****:* where an **individual has transferred or lent property either directly or indirectly** (except a retirement pension), to the individual's **spouse or common-law partner**, any income or loss of that person…**shall be deemed to be income or loss of the individual who transferred NOTthe spouse**

-***74.2*-** when recipient spouse **disposes of the relevant property**, the capital gain or loss is **also attributed to the transferor**

-**attribution continues** **for the period that transferor/creditor while**: (a) resident of Canada; (2) not divorced transferee/debtor; (c) alive; (d) cohabiting w transferee.

-BUT Attribution **does not arise where recipient pays fair market consideration** for property.

#### TRANSFERS AND LOANS TO MINORS

***74.1(2)*** Transfer or loan to **a minor related person under 18 years**; **income earned** on that **attributed to the parent/uncle** (they have to pay tax on it even though child keeps the income)

-**Attribution ends when**: (1) transferor cease to be Canadian resident; (2) turns 18; (3) transferor dies.

***s.74.5*; no attribution** if transferor **received consideration equal to the value of the transferred property or charges a rate of interest on the loan equal to the prescribed generally for the purpose of the act.**

-***s.74(3):*** section applies if TP makes transfer or loan to a trust for the benefit of a non-arms length minor or a minor niece or nephew

# What is Taxable Income? = Revenue from a Source

Formula for determining Tax payable:

## General

- There is **no definition of income** in the *ITA*; instead, system is **based on the source concept of income**

- In general, income **must come from a recognized source** (either inside or outside Canada) to be taxable

- Three of the most critical sections of the *ITA* are below:

a) **Tax payable by all persons resident in Canada**

*-* ***s.2(1)****:* an income tax shall be paid, as required by this Act, on the **taxable income for each taxation year of every person** resident in Canada at anytime in the year

- "**Taxable income"** = net income from each income source **(revenue – expenses = profit/loss)**

- "**Taxation year"** = calendar year (ie: January --December)

b) **Income must come from a taxable source *Schwartz***

- ***s.3(a)****:* to determine the TP's income for the year, determine the total of …TP's income for the year from a **source inside or outside** **Canada**, including, **without restricting the generality of the foregoing**, the TP's **income for the year from each office, employment, business, and property**

- **s.3(a)**: "**without restricting the generality of the foregoing**”; however, while courts say that it’s **illustrative and they** can add additional sources of income as long as **from a source.**, they donʼt because people resent taxation without representation**. *Schwartz (****guy got comp for work K cancelled before started court said not inc from source)*

c) **Income from each source is calculated separately**

- ***s.4(1)****:* income from each source is calculated separately, and then the income (or loss) from each source is aggregated to computed a TPʼs total income

d) **Parliament can add other sources**

- ***s.56***: **examples of taxable things that Parliament has added** such as pension benefits, EI benefits, amounts received out of a RRSP, and **retiring allowances** which might otherwise not be considered attributable to a source- **Note**: scholarships and bursaries are now, contrary to the text, not taxable

##  Examples of Income from a Source

- **General rule**: if income does not fit into one of the **s.3** recognized sources or another **s.56** source, it is not taxable because of the source-based tax structure

- Concept of **"ordinary income"** is set out in ***s.3(a)*** of the *ITA* which includes several recognized sources:

**a) Office and employment**

- "Office" = judge, MP, etc…holds an office and receives income from a source

**b) Business**

- Self-employed individuals get income from business

**c) Property**

- Yield from investments of bonds, stocks, real estate, etc…

**d) Taxable capital gains**

- Since 1972, **½ of capital gain taxable and ½ of capital loss is can be netted out** (against capital gains)

**e) Other sources**

- ***s.56****:* Parliament can add "other sources of income", such as pension benefits, employment insurance benefits, RRSP payments, termination pay, ect…

 **f) Illegal Revenue** is Taxable ***Buckman***

Dishonest employee stealing money from employer considered business income ***Poynton***

Expenses for Illegal activities are deductible ***Eldridge***

**g) Retiring allowance**

 **h)Damages:** depending on what they are for: **economic damages meet surrogatum principle and are taxable**

 **i)reimbursement for legal expense *56(1)(l.1)***

- **"Ordinary income"** has 3 hallmarks to classical economists:

a) **Activity** – TP's activities or from TP's property "earnings"

b) **Recurrence** – Periodic or recurring "year" (like a crop from a tree)

c) **Convertible** – Cash or convertible into cash "received"

## Non-Taxable Income Examples

**a) Gifts**

- Gifts do not flow from a source of production.

**b) Windfall gains**

- These are *an* ***unexpected/unplanned payment not of a recurring nature***

- Not income because they are accretions to wealth by chance

- **includes gambling, betting, lottery money, accidental finding of valuable property**. B/c bet is “irrational agreement” ***Graham v Green*:**

- BUT gambling as a business/vocation could become a taxable source (ie: bookies, .insider info, and advantage over ordinary person) ***Walker*:**

-**punitive damages/additional interest*Bellingham***

-**damages for mental distress *Bellingham***

**-damages for defamation *Bellingham***

**TEST used to assess if income from a windfall: *Bellingham (****land expropriated court said didn’t have to pay additional interest because more like a windfall. Not income from a source)***:**

a) TP had no enforceable claim to the payment

b) There was no organized effort on the part of the TP to receive the payment

c) Payment was not sought after or solicited by the TP in any manner

d) Payment was not expected by the TP either specifically or customarily

e) Payment had no foreseeable element of recurrence

f) Payor was not a customary source of income for the TP

g) Payment was not in consideration for or in recognition of property, services, or anything else provided or to be provided by the TP; payment was not earned by the TP, either as a result of any activity or pursuit of gain carried on by the TP or otherwise

**-Compensation for loss of capital (including income earning potential) is likely tax free, but compensation for loss of income has to be included in income *Bellingham(****ordinary interest for income she would’ve lost was taxable but not additional interest because wasn’t replacing income)*

- **Surrogatum principle test**: amounts received by TP **in place of income** from a source **may be included in income** as if such **amounts were income from that source *Bellingham***

- **Q**: what is the money replacing? Is it replacing income or capital? Or unexpected?

- **A**: if an amount received is a substitute for a capital right/earning potential, it is taxfree

**c) Strike pay *Fries***:

**d) Life insurance proceeds (**premiums aren’t deductible because death is a loss of a capital asset (life) so payments on death are compensation for loss of capital)

**e) Lump sum/periodic damages *Bellingham Schwartz***

- Includes personal injury wrongful death payments, as what is being replaced is the capital asset

**f) GST/HST refundable tax credits**

**g) Inheritances of property**- However, if you give real estate, the donor may be liable for taxes

**h) Work Contract Terminated before employee begins: the amount of the settlement is not taxable *Schwartz (****S quit job to take job with Dynacare, before position started was told they wouldn’t need him and he got settlement for breach of K. court said not taxable because not a retiring allowance since he hadn’t started working))*

# Ch4: What is INCOME FROM OFFICE AND EMPLOYMENT?

**Note: Withholding of tax by employer**

- ***s.153(1)(a)****:* every person paying at any time in a taxation year salary, wages, or other remuneration…**shall deduct or withhold from the payment the amount determined in accordance with prescribed rules and shall remit that amount to the Receiver General on account of the payeeʼs tax for the year**

**-Tax payable on received and paid basis.**

## WHO IS AN EMPLOYEE VS INDEPENDENT CONTRACTOR?

i) **Contract *of* service** – man is employed **as part of a business and his work is done as an integral** **part** of the business-EE

ii) **Contract *for* services** – manʼs work, although **done for the business, is not integrated into it but is only accessory to it-IC**

### 3 TESTS for whether employee or Independent Contractor: Is it a contract *for service* or *of service?*

**a) Control Test – Baron Bramwell in *R. v. Walker [1858] CCR***

- Based on the nature and degree of control over the work done

- IC told “what” must be done; EE is told not only “what” must be done but **also “how” to do it**

- 4 factors to determining **nature** and **degree** of **control**:

i) Power of selection of the servant

ii) Payment of wages: EE paid for time, IC paid for achieving a certain result

iii) Control over method of work: ER controls EE methods, IC control their own method

iv) Masterʼs right of suspension or dismissal

- - **Note**: this is **no longer the accepted test**, as **most EEʼs work more independently nowadays** due to highly specialized field of labour

**b) Total Relationship Test – Lord Wrightʼs “Fourfold Test” in** - **Adopted by Fed. CA in *Wiebe Door (****WD hired men to go and fix doors. Had own equipment, determined how to do work. Court said self employed)***;**

i) **Control** – same as control test above (power selection of servant, payment of wages for time, EE lacks control over method of work, master has right to suspend or dismiss employee)

ii) **Ownership of tools** – IC provides their own tools, maintenance costs, insurance, ect.

iii) **Chance of profit** – EE has less opportunity to share in profits than IC; EE gets remuneration based on time while IC gets paid at completion of project

iv) **Risk of loss** – EE entitled to payment regardless of whether business profits; IC has risk of not getting paid if he/she screws up and must redo the work

**c) Integration Test – Lord Denningʼs “Integration Test” in relied on in *Weibe Door*** *WD hired men to go and fix doors. Had own equipment, determined how to do work. Court said self employed*

- This test examines the question from the **point of view of the individual worker**

- **Q**: does the individual consider **themselves to be part of the business? Whose business is it?**

**T4s: Just because an employer issues a T4** **does not mean** that the **income is from employment**. It’s for the courts, to decide**. *Cavanaugh (****teaching assistant says not employee; wants to deduct travel and business expenses; court applies fourfould test and integration test and finds he is self-employed despite employer giving him t-4)*

Teacher’s assistants are NOT employees; they’re Independent Contractors**. *Cavanaugh***

## 3) ATTEMPTS BY EMPLOYEES TO AVOID CHARACTERIZATION OF AN OFFICE OR EMPLOYMENT

- The obvious advantage of being an IC is being able to **deduct business expenses** instead of being limited to specific deductions in ***s.8*** as an EE **so people try to redefine their relationships to avoid being employees**

- The **3 most common methods of redefining the employment relationship include**:

**a) Interposing a contract *for* services**

**b) Interposing a corporation or a trust**

**c) Capitalization of the employment benefit**

### A) INTERPOSING A CONTRACT FOR SERVICES

- redefine the relationship is through the **introduction of a different form of contract making EE an IC**

- The change must be in **substance** as well as **form**

- **Key**: EE **must have a break in employment** (ie: resignation for a period of time) and then get paid fee based on invoice

### B) INTERPOSING A CORPORATION OR TRUST

- Some TPs have attempted to alter their employment relationship by interposing either:

a) **Trust** – TP and family members become beneficiaries

b) **Corporation** – owned by former EE

- **Employment relationship terminates and the EE creates a corp and the ER employs the corp** which provides the same service of that EE. ).

-A company cannot be an employee for income tax purposes, **so the remuneration paid by the former employer to the company for the services is income from business to the company**.  The former employee can draw a salary or take dividends.

- However, government has tried to diminish the effects through **classification of a “personal services business”:**

**a) No saving in small business tax rate; gets general corporate tax rate**

- ***s.125(7)****:* a “**personal services business”** carried on by a corporation means an **individual who performs services through the corporation** to a would-be ER, **where but for the service company, the individual would’ve reasonably had EE status**

**b) Personal Service business Can’t deduct business expenses**

- ***s.18(1)(p*)**: says the **personal services company** **can deduct the salary it pays to its employee** (the former employee as in the previous answer), but **prohibits deduction by the company of other expenses except for the main ones available to employees.** The object is to deprive the company of the more generous deductibility of expenses permissible to business income.

- **Note**: to get around the preceding two subsections, such **categorization can be escaped by employing more than 5 EEʼs in the business**

## WHAT IS INCLUDED IN COMPUTING INCOME FROM AN OFFICE OR EMPLOYMENT

### 1) SALARY, WAGES, AND “OTHER REMUNERATION”

- **s.5**: includes in TPʼs income any amounts received as salary/wages, gratuities, and “other remuneration”

a) **“Salary and wages”**: includes compensation **for services** rendered by **EE in course of their duties**

b) **“Gratuities”**: **voluntary payments** made in **consideration of services** rendered in the course of Office/Employment

c) **“Other remuneration”**: includes honoraria, commissions, bonuses, gifts, rewards, and prizes **provided as compensation for services**

#### PAYMENT AS REMUNERATION FOR SERVICES

 **a) Payments by ER to EE**

- ***s.6(3)****:* an amount **received by an EE from ER while employed**, or on **account of agreement made immediately prior to, during, or immediately after the period of the employment**, shall be **deemed remuneration** for the payeeʼs services rendered **as employment**

- Therefore, gifts, back pay, and reimbursement of expenses can be considered as income from employment **under this rebuttable presumption**

 **Under this presumption, the following are income from employment:**

i) ***s.6(3)(c*)**: “inducement payment”…**signing/hiring bonuses** in the context of employment

**-Where a signing bonus-style** payment is made to induce a person into a subsequent employment agreement, **the payment is categorized as income from employment and it taxable because it is payment for services TO BE RENDERED. *Curran(****guy was given inducement payment to leave job and take new job. C said it was capital receipt cause it compensated for loss of source of income but SCC said it was income from employment because payment for services* ***to be rendered)***

ii) ***s.6(3)(e)****:* **non-competition agreements** (OK for ERs but not EEs) and **confidentiality agreements**

####  “Retiring allowances” are taxable

**Retiring allowance i**s taxable income from employment ***s.56***

- ***s.248(1)****:* a “**retirement allowance”** is an amount received in **recognition of services or damages for wrongful dismissal**.

- ***s.153(1)(c)****:* ER required to **deduct at source from retiring allowance**, **except the amount that the EE is permitted to rollover into a RRSP (~$2000/year after 1989 3,500/yr before)**

- ***s.60(j.1)****:* the former ER can, **instead of paying money directly to EE**, agree with EE to **put money into EEʼs pension plan or RRSP and “roll-over” the money (put the money in tax-free) then employee gets taxed on less and money can build and take out after.**

- Can **only** make **tax-free contributions** if **working in the same job since 1996**; if you started work **after 1996, youʼre out of luck**

* + EX:100,000 lump sum damages/settlement for wrongful dismissal (ie ritrement allowance)
		- -**56,000 rollover** to RRSP/RPP (tax deferral) (12 yrs at 3500, 7 yrs at 2000)
			* 3500 PER yr up to 1989 and 2000/yr up to 1996
		- No withholding on 56 000
		- =44,000 (-30% withholding)
		- =30, 800 cash = ‘retiring allowance’ (taxable)

- ***Schwartz***: TP received damages on the **termination of his employment K before he had actually started working**…amount found to be neither a “retiring allowance” nor income from a source under **s.3**

### 2) *BENEFIT*S are Taxable Employment Income

- ***s.6(1)(a)****:* TP must include the value of “**board**”, “**lodging**” and “**other benefits of any kind whatever**” (cash and non-cash) **received by the TP in respect of their office and employment in computation of their income**

- **OLD approach** is that **only money or something capable of being turned into money** can constitute **income** for tax purposes ***Tennant v Smith (****court said lodging not money so not taxable benefit)*

**TEST: AsK: is this a benefit to EE or ER? If it benefits the employer (or is required by him) it is NOT a taxable benefit. But if it is a benefit to the employee, it is taxable. *Tennant v Smith (****bank required employee to live at bank for after hour deposit collections. Benefit to bank so not taxable benefit)*

**-In order for a benefit to constitute “lodging” under *6(1)(a)*, it needs to be shown that the TP in question actually lives in the accommodation provided by choice *Sorin (****guy took cat naps in room at hotel. Didn’t get food, had a second home that he would’ve rather slept in but didn’t have the time to go back and forth. Court said this was for benefit of employer and not taxable.)*

**Examples taxable benefit**

Employer paying life insurance, parking (not taxable benefit if required by employer for work), daily commuting, car allowances (depends if required), spouses on trips, employer assisted childcare, employee gifts over 500, employee discounts

####  What is “IN RESPECT OF, IN THE COURSE OF, OR BY VIRTUE OF AN OFFICE OR EMPLOYMENT”?

- The fact that a TP “received or enjoyed” a “benefit” does not automatically make the benefit taxable- Rather, **s.6(1)(a) requires that the benefit is “received in respect of, in the course of, or by virtue of an office or employment”**

-**Recipients need to be confined to employees and the benefit has to somehow relate to employees; doesn’t necessarily need to be remuneration for services. *Queen v Savage (****employee took upgrading courses and received award of 300 from her employer after graduating from the classes. Court said it IS taxable benefit because was received in respect of employment (which is broader than just remuneration)*

##### Gifts are taxable benefits unless not cash and worth less than 500

- ***s.258***: CRA now permits employers to give **non cash** gifts worth up to $500,

**- Exception for scholarships *s.56(1)(n) (3)***

**-Where regular gifts (expected by employee) are made to Employees by Employers in order to obtain future beneficial results for business, the gifts are taxable as income from employment if they’re cash or worth over 500. *Laidler v Perry (****employers were giving turkeys to employees then began giving them 10$ vouchers to increase morale and make them work harder. Court said it was taxable because was to promote loyalty and expected)*

**If employer doesn’t deduct it, and gives it to employee in special circumstances it is tax free because it’s a true gift *Laidler***

##### Incentive Plans are taxable benefits

**If a benefit is tied to performance at work (ie incentive plan), it is taxable. *Waffle v MNR(****W worked for franchise of ford. Ford had incentive plan that gave president cruise for achieiving sales levels. Prez didn’t go so W and spouse did. Court said because an incentive plan, it was taxable benefit)*

#####  Reimbursement for things required by employer are not taxable benefits

- If an **ER requires an EE to do something and offers remuneration** (ie: travel, buy clothes, move), it is **not a “benefit” *Lowe (****re-imbursed for trip)****Huffman (****EE reimbursed for amount spend on work uniform)*

**Examples of things which are for the benefit of the employer and non-taxable benefits when re-imbursed:** continuing education costs, law society dues, recreational facilities, club membership dues, meals while working overtime ($17 max), taxi home if you work late, out of pocket expenses, business travel

##### Business Trips are not taxable benefits if required

- **if it’s primarily a business trip (required by employer) its not a taxable benefit.*Lowe(****Lowe’s boss paid for a business trip for Low and his wife. Spent so much time with clients got no time to enjoy for themselves. Court said trip not personal benefit because primarily for business and only incidental pleasure)*

##### Reimbursement for Clothing Expenses not taxable benefit

Work Clothing benefits an employer, thus reimbursement for it is tax free**. *Huffman(****Plain clothes policeman got reimbursed for $ spent on work clothes. Court said tax free because they were reimbursing him for money spent. Didn’t confer an economic benefit)*

##### Reimbursement for loss on sale of house (relocation) was benefit but now subject to rules and can be benefit

**Relocation payments** which reimburse the EE for actual losses incurred on a sale of the EEʼs house **were not** taxable ***Ransom(****E was transferred by employer and lost money on sale of his home. ER paid him for moving expenses to compensate. Court said not taxable benefit or remuneration for services rendered because it wasn’t for employment services and because he gained no economic advantage for the transaction)*

- **But now reimbursement for housing loss IS A TAXABLE BENEFIT**- **s.6(19)**:**. However, if its an ELIGILBLE relocation, TP doesn’t have to pay benefit on 15 000 compensation for loss, and then after deducting the 15 000, has to declare ½ of the reimbursement as benefit.**

-ie: reimbursed for 60 000 loss – 15000 exempt= 45 000 (1/2) = 22 500 **taxable benefit** (Employer could deduct the full 60 000 for the amount it paid)

- **Note: Eligible housing losses** sustained when **eligible relocation**

*-* ***s.248(1)****:* the **relocation must be 40 km closer to your new job than old residence.**

##### Remuneration for commuting expenses = Taxable benefit

##### Reimbursement for moving costs= NOT taxable benefit

##### Compensation for moving where higher cost of living is a taxable benefit

***-s 62 (3)* says reimbursements for higher cost of living incurred when relocating are taxable benefits because the more expensive house purchased increases networth of the taxpayer. *Phillips (****P had to move for work and employer gave him $ for increased housing costs in new city. Court said taxable benefit because was not mere reimbursement and new house would increase Ps net worth)*

##### Remuneration for legal fees=taxable benefit **IT99R5**

#### What is the Value of Benefit ? = Fair Market Value

**a) Value of benefits**- ***s.6(1)(a)****:* requires that the “value” of a taxable benefit be included in income

- “Value” under Canadian law is **fair market value** (i.e. the amount that a **person not obligated to buy would pay to a person not obligated to sell)**

**Fair market value [CANADA]= cost to employer**

-Ex if employer gets bulk discount or special deal on hockey tickets, the figure you use for valuing is cost to employer

**Frequent flyer points are no longer taxable after 2009.**

### ALLOWANCES are taxable

- **allowance is** an **arbitrary amount** usually paid in lieu of **reimbursement** the employee is not required to account for amount provided ***Ransom***

- “**allowances” are taxable under the Act *s.6(1)(b)***

**Exceptions** (there are a bunch under s.6(1)(b)

*-* ***s.6(1)(b)(i)****:* government travel or person expenses

- ***s.6(1)(b)(v)*** *or* ***(vii)****:* **reasonable** allowances for business travel expenses

- ***s.6(1)(b)(vii.1)****:* reasonable automobile allowances are tax-free (but must keep logbook and record in accordance with act)

-**Receipt of an allowance to compensate for cost of voluntary services is TAXABLE and not subject to deductions for cost of service. *Campbell(****nurse voluntarily drove patients and got $50 allowance. Court said she didn’t ercord properly and was voluntary so =taxable allwance)*

**-In order for an automobile allowance to be tax-free, it has to accord with government rules. *Campbell(****didn’t record km of car on kilometric basis so because didn’t comply, had to pay tax on allowance)*

***-*A reimbursement for an actual expense is not an allowance. When there’s just a tiny little extra left over from reimbursement it is NOT an allowance. *Huffman (****clothing allowance left 80$ extra after compensating for expenses. Still it was reimbursement and such a small amount it can’t be a taxable allowance)*

## DEDUCTIONS IN COMPUTING INCOME FROM OFFICE AND EMPLOYMENT

### 1) GENERAL

- **s.8** authorizes deductions in respect of employment income, but **s.8(2)** limits deductions that may be claimed by an officer or EE to those expenses set out in **s.8**

- **Bottom line**: if an **expenditure is not listed in s.8, EE is not entitled to deduct it from gross income**

**- General principles** on deductions in computing income from office and employment:

a) **Employment K** - expenses must be required by the contract of service

b) **Income-earning purpose** – expenses must be related to earning employment income

c) **Apportionment of expenses** – expenses are **partly deductible** if for business and personal use,

d) **Current v. capital expenditures** – **only current expenditures are deductible** (ie: recurring annual expenses); once in a lifetime or infrequent expenditures are not (ie: initiation fees)

e) **Reasonableness requirement** – **s.67** mandates all expenses be reasonable in the circumstances (applies to all sources)

f) **Section 8 –** if an expenditure is not listed in **s.8**, it is simply not deductible due to **s. 8(2)**

**Tax-free reimbursement from employers is much more preferable** for employees because **you get 100% back**

### SPECIFIC DEDUCTIONS

* **Commission sales employees *8 1 f:*** Self-employed sales people get some very generous tax deductions and so do employee sales people

####  TRAVELING EXPENSES

- The requirements for claiming travel expenses for all employees are in **s.8**:

**a) Requirements for claiming travel expenses**

- **s.8(1)(h)**: EEʼs required to **pay their own travel costs can deduct them if they**:

i) **Retain receipts** for proof

ii) **Are obliged** by their employment K to travel

iii) Have **not received a tax-free reimbursement**

**b) Motor vehicle expenses**

- **s.8(1)(h.1)**: EEs can claim their own motor vehicle expenses (gas, oil, repairs, insurance, fines) **if required to perform duties away from ERʼs place of business or in different places as long as not already reimbursed by the ER**

**c) Interest costs**

- **s.8(1)(j)**: interest costs to **finance the purchase of a vehicle are deductible as well as depreciation relating to its use to earn employment income**

- This **capital cost allowance** allows for reimbursement for wasting asset (ie: car)

**d) meals: *s 8(4)* meals:** employee must be away for at least 12 hours

**e) ~~Commuting~~**

- **commuting is a personal** **expense** and NOT deductible because where one chooses to live is a personal choice ***Cavanaugh***

- BUT **self-employed individuals** getting income from business that **have a home office** can **get tax** **deductible expenses**; he was traveling while at work, not traveling to work ***Cavanaugh*:**

**EEs working on commission get more generous deductions for travel under s.8(1)(f)**: they must be “**Ordinarily required”** to **carry on duties of employment away from his/her ERʼs place of business** to qualify for deductions

####  LEGAL EXPENSES

**Can deduct Legal expenses only on amounts “owed” by current or former ER s.8(1)(b)**(ex: employer’s business insolvent and employee terminated. Cost of hiring lawyer to recover unpaid salary = back pay, vacation, bonuses)

-if TP is **not successful in court/fails to est** that an amount is owed, NO DEDUCTIONS ALLOWED **IT99R5**

**-Can deduct legal bills to collect “Retiring allowance”**- **s.60(o.1)**

**-can only deduct in the years u receive the retiring allowance or reimbursement for legal expense and against those amounts. If exceeds can be carried forward 7 years. IT99R5**

**-**must include reimbursement for costs in income **IT99R5**

-can be to labour relations person or some1 else to est income owed. Need not be lawyer **IT99R5**

-all TPS under **60(o)** can deduct fees or expenses incurred and paid for advice or assistance in preparing or prosecuting an objection or appeal in respect of: tax assessment; decision of cdn employment and imm commission; assessment of income tax by foreign govt; assment or decision under CC

-people entitled to deduct under ***8 1 f* (commissioned sales ppl) might deduct legal costs arising from event that is risky and incidental to income earning activity (ie real estate agent deducting fees in defence of charges of misrepresentation)**

**-s.60(o.1)** does not permit deduction of legal fees for division of property after **breakdown of marriage**

#### PROFESSIONAL AND UNION DUES

- Section 8 also provides for a deduction for **annual** professional and union dues: **initial fees NOT deductible**

**a) Professional and union dues**

- **s.8(1)(i)(i)**: **union members** can deduct union dues; similar deduction for **members of law society** who pay dues

- **Payment of additional fee on entry is not a deductible employment expense** because the deductible dues **must be annual**

- **s.8(1)(i)(iv)**: deduction available for annual dues to maintain **membership in a trade union**

- **s.8(1)(i)(v)**: deduction **available to those required to pay union dues as condition of employment even though they are not members of the union**

**b) Dues providing benefits**

- **s.8(5)**: dues that provide benefits to members are deductible as long as they are **required in order to maintain professional status**

- **Note**: the profession must be:**a) Recognized by statute as a professional statusb) Required to be paid by statute in order to be part of a profession…**Therefore, while you can deduct LSBC dues, canʼt deduct CBA

####  HOME OFFICE

- If employee has home office, can only deduct if they are renting (cant deduct if own the office space) **s.8(1)(i)(ii).** Can deduct office supplies **s.8(1)(i)(iii)**:

**Note**: no deduction of utility bills, property taxes, ect

**Note:s.8(1)(f)**: commission salespeople get much more liberal deductions for home office expenses (similar to that of self-employed)

***S 18(12): self-employed***: can claim mortgage interest, insurance premiums, property taxes, capital cost allowance (but not good idea cause of effect on principal residence exemption)

- **s.8(13**)**Deductions of Home office expenses from office and employment income are limited so that ir:**

- **Must be required by ER (explicitly or implicitly) to keep a home office**

-, must show that:

i) Home office is the **principal place of work** (more than 50% of the time), OR

ii) Have a **space set aside exclusively for employment purposes**, must meet with clients on a regular and continuousbasis in that space

**EEs also: Need to apportion expenses:** apportion what’s used for business from personal. Figure out square footage of home office and deduct rent, electricity, repairs, cleaning, and office supplies

#### MOVING EXPENSES

- **s.62(1)**: **deductions** of moving costs are **permitted if they are not reimbursed by the ER (always better served to get re-imbursed)**

- Must move to a new place of work/study that must be at least **40 km closer to work/school: eligible relocation**

**These expenses include:** travel costs for tp and household**;** moving costs for household goods**;** meals and lodging for 15 days**;** costs of lease cancellation**;** selling costs of old residence**;** cost of cancelling the lease if tp lessee of old residence**;** can deduct legal fees for buying new house**;** property purchase tax

**Non deductible:**pre-move expenses**;** fixing up expenses to improve former residence for sale**;** loss on sale of old residence (but your employer might still reimburse you)

# CHAPTER FIVE- What is INCOME FROM BUSINESS OR PROPERTY?

## What Is INCOME FROM A BUSINESS

**Note the distinction between:**

a) **Business v. windfall gains**: businesses are **expected**, **planned**, **organized**, and **involve recurring efforts with a profit motive; windfalls are exactly the opposite**

b) **Business v. hobby**: if **motive is to make a profit, itʼs business**; if itʼs **for fun and enjoyment, itʼs a** **hobby**. which means the income is tax-free but expense deductions are unavailable

### 1) WHAT IS A “BUSINESS”

- See the *ITA* for definition of a “business”:

**a) “Business”**

- **s.248(1)**: “business” includes a **profession, calling, trade, manufacture, or undertaking of any kind whatever and…an adventure or concern in the nature of trade** (isolated transaction) but does not include an office or employment

- i.e.: buying/selling inventory, speculation, performing services to increase value.

**TEST FOR BUSINESS INCOME *Graham v Green (****G bet on horses on large scale and made income from it. Court said winnings were windfall and tax-free because its not meet standards for business)*

**1-Business income is distinct from property income because property income is passive and business involves activity on the part of the taxpayer (Activity= making cotnracts etc)**

**2-Business income also is organized (system)**

* **Gambling** is not a source of income; it is windfalls and irrational agreements with one side winning and losing. ***Graham v Green***
* **BUT, gamblers with INSIDE INFORMATION are generating income which is business-like and therefore taxable (organized system). *Walker(****owned race horses, used inside info to bet and make $. Court said business income because organized things in such a way so that he would make a profit)*
* **Source of income from a business can change from year to year. *Morden(*** *was running horses and betting. Then stopped running and just bet. Court said when he was running, income from business, but when topped running and just betting for fun not business)*
* **Courts focus on the organization of the TPʼs activity in determining if there is a business (ie if gambler has inside information and system for betting) *LeBlanc(****guys made 5.5 milly on sports betting but not income from business cause no inside connections or systems.)* ***Morden***

**3-Business also has a profit motive: risk and reward (this distinguishes professionals from non-professionals)**

* **NOW: Reasonable expectation of profit not required. should only be used as a factor to demonstrate that an activity is a business when a personal element is involved. *Stewart(****real estate investor bought property for rental revenue. Had to pay huge interest and wanted to deduct the losses. Court said didn’t need to have REOP because it was a commercial activity taken in pursuit of profit)*
* **TEST: *Stewart***
	+ **1-is the activity of the taxpayer undertaken in pursuit of profit (commercial activity) or is it a personal endeavour? Consider:** business plan, profit/loss experience, tp training, anticipated capital gains,
	+ **-**If TP is in pursuit of profit or it’s a commercial activity then that is the end of the story and no reasonable expectation of profit is required.
	+ **-If the activity has a personal element,** then
	+ **2-ask is there a reasonable expectation of profit?** (TP must demonstrate that his predominant intention is to make a profit and its been carried with indicia of business…look to activity, risk etc.)

**Adventure or concern in nature of trade**

* If TP enters into an **isolated transaction**, the transaction is **speculative** and **intended to yield the profit**, the income may be taxable as **business income (Ex: Flipping properties. Ask what was intention of TP?)**
* **Look at intention of person buying property. If they buy to keep for a while (rent/live)=cap gain. But if buy purely for purpose to resell soon=adv in nature of trade=business. *Bellingham***

#### B) Where might you want to decide if income from business a CAPITAL GAIN? When you speculate and sell property

- A profit from the sale of property may be characterized as either a **capital gain** or income from **business**:

a) **Income from a business**

- When a TP is in the business of buying and selling property

- If a speculative transaction **produces a loss**, TP will want to characterize the transaction as an **adventure or concern in the nature of trade** so that the loss is **fully deductible** in computing income…whereas only ½ of a **capital loss** would be deductible and only against **capital gains**

b) **Capital gain**

- When a TP buys property for investment purposes and eventually sells the property for a gain

- Treated more favourably than **business** income, as only ½ of **capital gains** is included in income

- If a speculative transaction is **profitable**, TP wants to characterize the transaction as a **capital gain**

## What is INCOME FROM PROPERTY??

**-Note:** depending on activity of TP, owning a property and getting income from it can be income from property or business.

Ex: Rental income: one could rent out property to someone who takes care of it all and that’s income from property but someone could be running a hotel and getting income from business

### 1) CONCEPT OF PROPERTY AND LIABILITY TO TAX

- “Property” gets a wide definition in the *ITA*:

**a) Statutory definition of property**

- **s.248(1)**: ““property” means **property of any kind whatever**, whether **real or personal** or **corporeal or incorporeal, and without restricting the generality of the foregoing, includes:**

i) A right of any kind, a share, or a chose in actionii) Unless a contrary intention is evident, money

iii) A timber resource property, and iv) The work in progress of a business that is a profession

- Therefore, under **s.248(1)**, income from property can include income from:

**a) Interest income**

**b) Rents and royalties**

**c) Capital gains and losses**

- See **s.9(3)**, which specifies that the TP can disregard capital gains when computing income from business or property, but also disregards the losses)

d) **Dividends**

- Although the preference is for dividends to be among different sources

### 3) INTEREST INCOME

#### A) LEGAL MEANING OF INTEREST

- **s.12(1)(c)**: any **amount received “as, on account of or in lieu of payment of, or in satisfaction of, interest” is included in a TPʼs income**

b) **Common law** – defined interest as **compensation for the use of money** belonging to another person, **referable to a principal amount that accrues daily at a particular rate**

- Therefore, **interest = principal x rate** (i.e. principal amount of debt obligation x interest rate)

- ex. loan principal = $1000 for one year, rate = 10%, interest = $100, if the interest accrued daily = $100/365 days, which works out to $0.27/day

#### TIMING OF INTEREST INCLUSION

-**12(3)(4)**  **people cannot defer interest income for more than a year. They have to report it if it was earned in the year—ACCRUAL METHOD**

**s.12(1)(c)**: interest must include in income when it is received or receivable,

3 ways of accounting for interest-- **Example**: if 10% x $10,000 GIC, $5000 interest paid on maturity in year five, how is interest reported?

**a) Received method – report cash when money is received**

- All that is accounted for in an accounting period is revenue actually received by the TP and expenses actually paid by the TP

-would have to pay tax on the 5000 when received in yr 5.

**b) Receivable method – report cash when money is legally “receivable”: entitled to receive it**

Ex:- - TP can leave $ with financial institution (not cash in) and continue to earn interest, but he has to report the $5000 at the end of the fifth year because he’s entitled to it.

**c) Accrual method – report income as it is earned in the year—**would pay tax on 1000 each year

#### B) BONUS is way to avoid paying tax on interest

- **Bonus**: is consideration that is not interest, it’s a set payment, not a percentage

- **Tip**: instead of using the word “interest”, one can use the word “bonus” and the **excess amount** can be characterized as a **capital gain**, only **½ of which would be included in TPʼs income for the year**

- ex. loan = $1000, repayable = $1050 (with $50 being a “bonus”, as **no rate was used to calculate repayment and interest** always is “interest = principal x rate”

#### C) BLENDED PAYMENT OR HIDDEN INTEREST (court will apportion when ppl try to avoid paying interest)

**- Blended payment**: where a TP receives a **single payment** under a K or other arrangement which **includes both the repayment of capital and interest but doesn’t say that it is interest..**

- i.e. mortgage payments, deferred payments for sale of capital property, bonuses, ect.

- **s.16(1)**: where, under a contract or other arrangement, **an amount can be reasonably be regarded as being in part interest or and in part an amount of a capital nature, the interest/income part will be included in the TPʼs income**

**Where a payment is structured in a way that subverts interest, under s.16(1), a portion of that payment can be assessed as interest and taxed as such *Groulx (****G sold farm to company at above FMV rate but claimed wasn’t charging intereset on payments. Court said that there was hidden interest because he overcharged and it was taxable income from property)*

**3 factors MUST BE PRESENT to find hidden interest and make it taxable: *Groulx***

1-there is an invariable practice to charge interest on this type of transaction

2-price greater than fair market value

3-taxpayer bargained for higher price w/o interest rather than charge interest

#### D) POST JUDGMENT AND PRE-JUDGMENT INTEREST

- This court-awarded interest is a **separate head of damages (not interest) and is tax-free IF the underlying sum of money payable is also tax free**

- **Q**: Does this apply to both pre-J and post-J interest under the *Court Order Interest Act*?

**a) Pre-judgment interest not taxable**

- **IT-365R2**: “Where an amount in respect of damages for personal injury or death has been awarded by a Court or resolved in an out-of-court settlement, no part of such amount will be income to the recipient, even though referred to as interest”

**b) Post-judgment interest taxable**

- **IT-365R2**: “However, where an amount that has been awarded for damages is **held on deposit, the amount of interest earned will be included in the income of the injured TP**” (ie if D doesn’t pay damages right away, they are charged interests and this interest is TAXABLE interest

### 4) RENTS AND ROYALTIES MUST BE INCLUDED IN TP INCOME

- Under the *ITA*:

**a) Payments based on production or use**

- **s.12(1)(g)**: “any amount received by the TP in the year that was **dependent on the use of or production from property** …” **must be included in the TPʼs income**

- DEFINITIONS

**a) Rent**

- Fixed payments for the use of property for a given period of time

**b) Royalty**

- Mineral royalties and royalties for use of intangible/intellectual property

- Original owner gets to share in the profits or a percentage of the profits based on use or on the number of units, copies, or articles sold, rented, or used

####  PAYMENTS BASED ON PRODUCTION OR USE = business income

**Problem:** Sale of property where sale price dependant on production or use of property.**) this addition to the purchase price is income from property**

**OLD Approach: Law used to allow TPs to convert what would otherwise be fully taxable rent or royalty incomes into more favourable capital gains *Spooner (****lady sold land that had oil. She had royalty right to oil but eventually accepted $ instead of oil. Court said that the sale of the land and money she got was a capital gain even though it was reliant on production of oil..which would usually be royalty).*

- BUT  **NOW** Parliament passed **s.12(1)(g)** soon after *Spooner* **to catch extra amount on sales of property where the sale price is dependent on the production or use of the property. The extra will now be income from property. Orig amt=cap gains**

**Techniques for avoiding s.12(1)(g)**:

* Sale for fixed price—with future instalments determined by formula
	+ Ex: selling for 100 000 but you have time to pay, ex: over 10 years but if it doesn’t make $, then you don’t have to pay 10 000 a year, you can pay 5 000 over 20 years. Or if its very profitable, you can pay It all off in 5 years at 20 000
* Sale for maximum fixed price—reducible according to formula “reverse earn out”
	+ Ex: sell land to 100 000; if output below certain level in first year, refund a sum of $ (vendor’s refund= capital loss)
* Sale for minimum fixed price + formula
	+ Sold asset instead of 100 000 for 50 000, + a % formula which should yield me at least another 50 000

### 5) DIVIDENDS

- **Dividend**: a payment on the shares of the corporation that represents the return on equity investment

- Dividends may be paid in cash, in kind, or with new stock of the corporation

**B) SPECIAL TREATMENT OF DIVIDENDS**

 Dividends are **taxed at a lower rate than other forms of property income; even lower than capital gains**

- *ITA* provides special rules to provide relief from double taxation by allowing:

a) **Individual shareholders**: pays tax, but can **reduce tax through “enhanced dividend tax credit”**

- Beyond the scope of this course, but reduced since company already paid tax on profits

b) **Corporate shareholders**: receive dividends tax-free

- **Note**: **they arenʼt a deductible expense** because the expenses have already been deducted in the calculation of profit

## DEDUCTIONS IN RESPECT OF INCOME FROM BUSINESS OR PROPERTY

### Key sections to think about for deductions in business and property

- The key sections of the Act that either disallow or allow various deductions from business or property income include:

 a) **Section 18 – specifically limits deductions for certain expenses**

- **s.18(1)(a)**: **no deductions** for expense that are **not incurred for the purpose of earning** **business or property income**

- **s.18(1)(b)**: **no deductions** for **capital expenditures**

- **s.18(1)(h)**: **no deductions** for **personal or living expenses**

**-** s**18 1 (l) (ii) businesses can no longer deduct club membership fees. (l)(i) businesses can’t deduct expenses for use or maintenance**

 b) **Section 20 – overrides section 18 and allows various deductions**

 - **s.20(1)(a)**: **allows** deductions for **capital cost allowances**

 - **s.20(1)(c)**: **allows** deductions **for interest**

- However, to the extent that **s.20** limits on the availability and amount of a deductions, **s.18** applies to prohibit the deduction of a particular expense

 c) **Section 67 – requirement of reasonableness**

d) **section 67.1 Business Entertaining:** only 50% of business entertaining expense is deductible

 e) **Section 67.5 – bribes are not deductible**

f)**Section 67.6: penalties and statutory fines not deductible**

- **General rule**: business expenses get much more favourable tax treatment than personal expenses

### 2) GENERAL APPROACH TO DEDUCTIONS

- **General rule**: an expenditure properly deducted **under GAAP** will be deductible for tax purposes **unless** it is prohibited by some provision of the *ITA*

- Conversely, an amount not deductible pursuant to GAAP will not be deductible for tax purposes **unless** the *ITA* specifically provides for a deduction

**2 part TEST for deductibility of expense**:

a) **Is the expense deductible according to GAAP for financial statement purposes?**

 - This is a question of fact for accountants to answer

 - Relies on **s.9(1)** and GAAP

b) **If the expense is not deductible for a financial statement, does the *ITA* overrule GAAP to permit the deduction?**

 - This is a question of law Relies on **s.18(1)(a)** is it **incurred for the purpose of earning business** **or property income?**

### 3) BUSINESS PURPOSE TEST

- **s.18(1)(a)**: “an **expense is deductible to the extent that it is made or incurred for the purpose of earning income from a business or property**”

- “**Made**” = paid; **“Incurred**” = when legal commitment to pay arises (accrual)

**-Accrual is better for deductions** cause you can deduct them when you find out you have to pay them.

**-Option: s35 for the “bills delivered method”:** they don’t have to report income from professional fees until client receives the bill. Lawyers do this to lower their tax burden

**-Accrual is not as good for reporting income** because you have to report when it is earned (u give bill) rather than when you actually receive the amount

- Expenses can be **apportioned** “to the extent”

- Consider **Purpose** NOT result ***Imperial Oil***

 **-Property:** usually does it on **made/paid** basis whereas **businesses** do **incurred** (accrual basis)

**-An expense can be deductible even if it is not productive of any income and results in a loss; as long as its is incidental to the business, it is a deductible expense *Imperial Oil (****company’s ship collided and company had to pay a settlement of. Wanted to deduct settlement paid. CRA said not deductible expense because it* ***didn’t produce any income*** *court said* ***deductible*** *because* ***incidental to doing business)***

**-A causal connection between a deduction and income is not required. It must be shown that the expense is for the purposes of the business and incidental to the operation of the business to be deductible. *Royal Trust Co (****co paid employees membership fees to social clubs to attract business. CRA said not deductible cause can’t match and ‘once and forall. Court said doesn’t need to match and basically recurring expense deductible under 18 1 a)*

BUT the expenses in that case would be PROHIBITED BY s**18 1 (l) (ii) businesses can no longer deduct club membership fees. (l)(i) businesses can’t deduct expenses for use or maintenance of yacths, camps, lodges and golf courses**

### 4) PERSONAL OR LIVING EXPENSES

#### Generally personal or living expenses are not Deductible

- Generally **not deductible** in computing income from a business or property because prohibited by **s.9(1)** (“income” defined as “profit”) and **s.18(1)(a)** (not for the “purpose” of earning income)

- Further limitation in **s.18**:

 a) **General limitations on deductions**

- **s.18(1)(h)**: **no deduction** shall be made **in respect of personal or living expenses** of the TP, **other than travel expenses incurred away from home in the course of carrying on TP’s business**

 b) **Definition of “personal or living expenses”**

- **s.248(1)**: expenses for personal enjoyment not for purposes of earning income

- **Note**: **exceptions**:

 a) **s.63**: child care expenses

 b) **s.62**: allows certain moving expenses

 c) **S 64: tax credit for attendant care for disabled people**

#### Must Apportion Expenses so that only deducting business and not Personal

**-**TPs **must apportion expenses** between actual business use and personal use. **Can only deduct business**.***Benton(****man operating farm had domestic helper who was farm laborer and took care of him. Court said can’t deduct help in home, just help for business. Must apportion)*

**Note**: **S 64: tax credit for attendant care for disabled people**

**Factors to consider if an expense is for a business purpose: *Leduc***

a) Is the deduction **ordinarily allowed as a business expense by accountants** and therefore widely accepted as a business expense?

b) Is the expense **normally incurred by others in the TP’s business**?

c) Would the expense **have been incurred if the TP was not engaged in pursuit of business income**?

d) Would the **need for the expense exist apart from the business?**

#### Legal Defence Fees deductible? Depends if charge incurred in normal course of business

**If criminal charges stem from an activity carried on in the normal course of business, then the legal expenses incurred to defend those acts are deductible *Eldridge*; however, if the activity that led to charges is not a normal part of the production of income, they are not deductible. *Leduc(****lawyer incurred legal fees for criminal charges not related to work. Court said were personal expense because incurred so he wouldn’t go to prison, not so he could continue to practice law)*

-legal fees for **Criminal** prosecution under ***239*** not usually deductible because not for purpose to earn income. But may be deductible if can be shown to relate to defence of practices which arise in normal course of TPs income-earning activities **IT99R5**

##### Legal fees for income tax assessment = deductible

-reasonable fees and expenses incurred for advice for prepping and filing tax returns normally deductible under **s9** not limited under **18 1 a**

-all TPS under **60(o)** can deduct fees or expenses incurred and paid for advice or assistance in preparing or prosecuting an objection or appeal in respect of: tax assessment; decision of cdn employment and imm commission; assessment of income tax by foreign govt; assment or decision under CC

#### Childcare Expenses deductible? Not as business expense but under 63

**Childcare expenses: not a deductible** business expense under **18(1)(a)** because Taxpayers **can deduct subject to s 63**.***Symes (****female wanted to deduct childcare as business expense that enabled her to earn business income. Court said can only deduct subject to s 63)*

Note: s 63 limits amount that can be deducted per kid (doesn’t allow for actual cost of care to be deducted)

#### Food and Beverage deductible?

Traditionally, food and bev fell under **18(1)(h)** as non-deductible personal or living expenses. Because ALL humans need it.

**BUT: If a typically personal need can be characterized as a business need, it will be deductible from business income *Scott* Specifically, Couriers who consume extra food and drink as fuel can deduct it as a business expense. This only applies to fuel consumption in this transportation type of occupation. *Scott (****courier wanted to deduct food and water expenses incurred to fuel himself through the day. Court said it was an expense the way fuel for a car would be. Doesn’t apply to construction workers etc.)*

Extra food for e couriers and rickshaw drivers: **flat rate of 17.50 per day.** **Overtime EE meal allowance at $17**

#### Commuting Expenses deductible?

- Expenses incurred by TPs to **travel between home and work are generally personal or living expenses**

-But people who use **public transit entitled to tax deduction s.118.02**

**-Automobile expense for travel between home office and other place required for employment is a deductible business expense. *Cumming (****anesthesiologist maintained home office and travelled from office to hospital, wanted to deduct expense. CRA said commuting but court looked to whether he had an office at hospital and other factors indicating that home office was his base and said travelling for business)****Cavaganauh (****TA commuting between home office and university)*

**Note:** one could claim capital cost allowance on the car (depreciation on the car), operating expense, interest expense (if paying off loan to buy a car), leasing costs (deductible if you’re leasing car for work)

 **BUT these are subject to limitations:**

* **s.13(7)(g)**: **CC Allowance rate 30% @ max: cost 30 000**
* **67.2 max interest $300/month**
* **67.3 max leasing cost 800/month**

#### Home office expense deductible?

**s.18(12)**: deductions by an individual of **home office expenses are prohibited unless HO is:**

i) TP’s “**principal place of business,”** OR

ii) **Used exclusively for business AND on a regular and continuing basis for meeting clients, customers, or patients**

A: expenses are usually **apportioned based on square footage of the house** (ie: determine amount of space occupied by the office compared to total usable area of the home), and then a proportionate amount of the expenses of the home are then taken as a business deduction

- ie: renting = % of rent/utilities/insurance; homeowner = % of mortgage interest, insurance, property taxes, maintenance fees, utilities, and possible capital cost allowance

#### Entertaining expense and business meals deductible?

If the **principal purpose of entertainment is business**, then **expenses are deductible**

**BUT: s.67.1**: **only allows you to deduct 50%**

### PUBLIC POLICY CONSIDERATIONS

* Crime is a business
* Profit from criminal activity is taxable
* Expenses and losses?

#### A) EXPENSES OF CARRYING ON AN ILLEGAL BUSINESS

-**Income from illegal activities is income from business and taxable. *Buckman* Following this,expenses of illegal businesses are tax deductible if receipts can be provided. *Eldridge* (***madam of bawdy house wanted to deduct expenses including legal expenses for defending her prostitutes when charged criminally)*

**-Also, an employer can deduct legal expenses to defend an employee if charged in the normal course of business *Eldridge***

GOVT Response: **s.67.5**: **no deduction allowed** for expenses incurred for **bribing public officials**

**CRA can determine taxability despite illegal business person not filing tax return**

**Net worth assessment s152(7)**

* **Net worth jan 1--------------------------net worth Dec.31**
	+ Increase in net worth + non-deductible expenditures – non-taxable receipts = presumed income for the year

#### b) FINES AND PENALTIES

**Fines/ Penalties were tax deductible *65302 British Columbia Ltd (****egg company fined for going over quota)***BUT s 67.6: fines and penalties imposed under law are NOT TAX DEDUCTIBLE. And S 18 1 T: interest on tax arrears and penalties are not tax deductible.**

### INTEREST EXPENSE

**Key:** Interest is **Deductible if borrowed for purpose of earning income. S 20 (c) (i) (ii)**

**-In order for interest to be a deductible expense, the borrowed money has to be used for the purpose of earning income from business or property. Courts will look to current use NOT what they were originally taking it for. *Bronfman (****trust beneficiary wanted $ from trust. Trustees didn’t want to sell investments so borrowed money from bank to give to her. Court said interest on borrowed money not deductible because giving $ to trustee was not for purpose of earning income from business or property)*

**-If a direct link is shown between borrowed money and eligible use, it meets the test and is tax deductible. (Looks to form not substance EVEN IF decision is TAX MOTIVATED) *Singleton (****partner in law firm took money from the firm and used this money to buy a house. Then went to bank and borrowed money (got mortgage on house) to repay the partnership. Court said tax deductible because borrowed funds were to make profit from business.)*

**-S 20 1 (d): compound interest:** treated the same way as other interest (deductible as if u actually paid it?)

**-S 20 (3); replacing borrowed funds: taxed same way as above**

**-S 20.1; loss of Fair market value: still the purpose is pure so tax deductible**

**-S 18(2), :interest and property taxes on vacant land (ppl who buy raw land) the interest on this borrowed $ is NOT TAX DEDUCTIBLE.**

**Note:** if you borrow $ to earn income that’s not taxable, the interest expense is not deductible (ie borrowing to buy life insurance, finance a lawsuit with tax free damages, or put in tax free saving account). Doesn’t matter if borrowed money **actually makes money** **just if it is being used TO EARN**

### Requirement of reasonableness

**ITA, s 67: GOVT HAS POWER TO DISALLOW UNREASONABLE AMOUNTS OF EXPENSES**

## What is a CAPITAL GAINS

-**NOTE:** primary residence is exempt from capital gains tax

- **only ½ of the capital gain is included in income and taxable and ½ capital loss is deductible only against capital gains**

- TPs seeking to characterize a property transaction as a sale of capital run into problems when:

a) Capital property is sold and the sale price is paid in instalments

b) The amount paid for capital property is dependent on use/production of the property

# What are losses? And From what Source of income can we net them out?

## Ordinary income losses

- ***s.3(d)****:* **current year losses** from office/employment, business or property can be **deducted from all sources** of income, **including taxable capital gains**

**“Netting out”**: Under ***s.4****,* **losses from one source can be deducted from other sources when calculating net income**

- **Note**: while you can use losses from “**ordinary sources**” to reduce income from other sources you **can only use** **capital losses to deduct from capital gains** (compromise of the ½ tax treatment)

## Capital Losses

**How to Calculate Capital gain/loss:** selling price **minus (** Purchase price + capital expenses (ie for improving it)) **minus**  selling expenses (brokerage fees, fixing it up etc.)=**capital gain or capital loss…1/2 of this if its profit is taxable capital gain or ½ if not profitable is capital loss.**

**Ex: Price= 200 000 MINUS expenses10000 MINUS adjusted cost base 50 000=capital gain 140 000…TCG=70 000**

* No capital loss on **depreciable property** : Focus on LAND, depreciable property is a “terminal loss” which is a business loss, not a capital loss. e.g. commercial buildings
* BUT if building **goes up in value** you get **capital gain**
	+ allocation problem – decided b/n buyer and seller of how much to be land and how much building
	+ building vendor wants price to be mostly land b/c capital gain, buyer wants it to be building so can write off depreciation

**“Quarantine rule” for capital losses**

- ***s.39(1)*allowable capital losses** are “quarantined” and can **only offset taxable capital gains**

- Under this subsection, only **½ of capital losses** are deductible

- it is only when **sold** thatthere is a **“capital loss”**

**Exception**: in year of death (and preceding year), can deduct capital losses from all sources

**Exception: Allowable Business Investment Loss**

-**If you lose money investing in a small business (incorporated and income under 750 000) you get a capital loss and 1/2 is allowable and can be subtracted against all sources of income…**

### Losses from Farms

**-*s. 31*** limits the deduction of certain **“restricted” farming losses to $8750 in any one year**

- Targeted tax payers are those persons whose **chief source of income is not farming:**- Part-time, **for profit** farms

**Hobby Farms:** get NO tax relief

## Loss Carryovers

Loss can be subtracted from past or in future years

**-** “**Carry-back**” provides that a loss in one **taxation year** can be applied to a previous year

**-** Results in a refund of the previous year’s tax (no interest though)

**-** “**Carry-forward**” provides that a loss can be carried forward to future years

**-** Results in a tax reduction in a future **taxation year** (without interest)

**Time periods for carryovers for different types of losses**

**- Non-capital losses - *s. 111(1)(a),* defined in *s. 111(8)***

- Carry-back **up to three years**

- Carry-**forward up to twenty years**

- Loss expires after this limit

- **Net Capital Losses** - ***s. 111(1.1)***

- Carry back **up to three years**

 carried **forward indefinitely**, but are deductible **only from** **taxable capital gains**

- **ABIL**

- Carry Back up to **three years,**

**-**Carry **forward ten years**

- After ten years, they become regular **capital losses**, and thus become deductible only against **taxable capital gains**

# Chapter 6 – When do you report income or deductions? Computation of Profit and Timing Principles

**I. Significance of Timing Principles**

* A person’s earnings are broken down into annual segments
* Present Value/future value (considers that $ increases over time by 8% because person can invest it to earn income)

**Tax payers ideally want to**

* **Receive** revenu**e now** but **defer** revenue **recognition**
* Accelerate business **expense** deduction
	+ **Deduct expense now** but **pay** amount **later**
* Accrual basis—good for expenses but bad for revenue

**II. Relevance of Financial Accounting Practice**

* **“profit”/ “loss” GAAP = factual, requires matching of income and expense in same year**
* **ITA Regs, cases, Income tax returns “questions of law”**
* **S 18(9):** specific prepaid expenses (insurance premiums and rent) are required to be matched.
* **S 9: “profit” is a question of law**

**There is no matching principle for tax purposes unless a specific provision in the act says so [18 (9)]. *Canderel***

**You can deduct the full amount in the year the expense was incurred, but you don’t have to. You can defer it as you please as long as you follow GAAP principles. Has to be consistent year to year. *Canderel (****landlord offered deals to prospective tenants to give them Cash to sign leases “tips”. Wanted to deduct full tip amount in year incurred rather than over the 10 year period, contrary to GAAP matching. Court said ok cause question of law)*

**What is the situation for the tenant receiving the “TIP”? Section 12 1 x**:tenants must report TIP and other inducements must be recorded as income in the current year

**You can’t just ignore the GAAP but where GAAP gives choice, you’re free to choose. *Denyson***

# Chapter 10-Dispute Resolution, Statutory Interpretation and Tax Avoidance: How do you file/dispute etc?

## Steps for dispute resolution

- **Note**: all disputes in this course are between the individual taxpayer (“TP”) and the federal Canada Revenue Agency (“CRA”)

**- Onus**: burden of proof is **always on the individual taxpayer to disprove** any assessment made by CRA

### 1) Return

- ***s.150*** provides that every individual taxpayer shall file with the minister a **return of income** that is in the prescribed form and that contains the prescribedinformation for each **taxation year by April 30**

**-Self employed persons and spouses** have until June 15 to file income from business Still have to pay interest on late payments if they make late payments ***S 150 (1)(d)(ii)***

**-TP must estimate amount of tax payable *s 151***

**-minister can demand return** at any time ***s 150(2)***

### 2) 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 ***s 152(7)***

-minister to examine TPs return and assess amt payable ***s 152(1)***

**-overpayment**

 **-**CRA must send NOA w cheque for refund if TP overpaid ***152(2)***

### 3) 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 ***s.152(3.1)(b)****:*

- This can be either a reassessment or an additional assessment adding new sources of income

**-There is no limitation for reassessment** if taxpayer has made a **misrepresentation caused by:** Neglect, carelessness, wilful default, fraud or waiver ***s152(4)(a)***

#### -Arbitrary or "net worth" assessment: (think for ppl who don’t file ie illegal businesses)

If the CRA notices a taxpayer didnʼt file a tax return, or donʼt trust the figures, they can make an arbitrary “net worth” assessment ***s.152(7)****:*

* **Net worth jan 1--------------------------net worth Dec.31**
	+ Increase in net worth + non-deductible expenditures – non-taxable receipts = presumed income for the year

- ***Eldridge*:** any increase in net worth creates a rebuttable presumption that it is taxable income

### 4) Objection

- Taxpayer 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

 **i) onus on TP to appeal final decisions**

*--* ***s.152(8)****:* tax assessments are **deemed to be valid**, **subject to objection or appeal by the TP or CRA within the 3 year limitation period**

**ii) File Notice of Objection**

*-* ***s.165(1)****:* TP must file a NOO within:

i) **90 days** from date of mailing the Notice of Assessment, OR

ii) **1 year from the due date of return** (April 30), **whichever is later**

- ie: since gov't has 3 years to re-assess, NOA may come 2-3 years after the filing due date

- There is no prescribed form; however, the NOO must set out the reasons for the objection and state all relevant facts

### 5) Appeal

- **Tax Court of Canada first  Federal Court of Appeal  Supreme Court of Canada (with leave)**

- If the taxpayer disagrees with CRA's reassessment, they can file a **Notice of Appeal** with a certain time limit in the Tax Court of Canada ("TCC")

- A TP who has filed a NOO may appeal the assessment or reassessment to the Tax Court of Canada:

**i) Appeal**

- ***s.169(1)****:* If a TP has served a NOO, the TP may appeal to the TCC to have the assessment varied or vacated if **90 days have elapsed** after service of the NOO OR after the MNR has confirmed the assessment

**ii) Frivolity penalty**

- While the dispute process is going on, taxes don't have to be paid

- ***s.179.1***: however, if **TP loses, 10% interest is payable** if the objection or appeal is dismissed

***-* Where the Minister has relied on certain assumptions in making the assessment or reassessment, these assumptions will be presumed to be correct unless specifically disproved by the taxpayer *Johnston v. MNR***

- @ Tax Court of Canadathere are two procedures:

**Informal procedure** (likesmall claimscourt)

- Amount of taxes/penalties in dispute must be $12,000 or less

- Counsel not required

- No costs awarded upon a loss

- Since 2003, decisions fully appealable to FCA

- Limited judicial review opportunities

**General procedure**

- Amount of taxes/penalties in dispute must be more than $12,000

- Legal representation desirable and formal rules of evidence apply

- Costs awarded against the losing party

- Apply to FCA, or SCC with leave

- **Appeals of a TCC decision go to the Federal Court of Canada, which must be made within 30 days**

- Then, **with leave**, a dispute **may go on to the Supreme Court of Canada**

### 6) Alternative relief (option) Remission Order

- Available to taxpayers when the law is **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 govʼt 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**

- Taxpayer 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**

### Settlements

**Settlements for less than the full amount owing** aren't authorized by the *ITA* and are thus **unenforceable s220(1) *ITA***

- Therefore, while a taxpayer can settle a tax case, any settlement isn't binding on the CRA

**A settlement whereby the Minister does not assess in accordance with the law is an illegal agreement and not binding *Cohen*** *(compromised and settled with govt but govt changed reneged on agreement. He thought they should be bound. Court said no)*

## REFUNDS, INTEREST AND PENALTIES

a) **Refund**: repayment of any tax payments that exceed the tax owing

b) **Interest**: if tax is overpaid, **interest is given and prescribed by regulation**, but taxpayers must report this interest and **it is taxable**

***s.161***: if **tax is outstanding**, the **interest is charged to the taxpayer**

- However, interest doesn't start to run until 30 days after the April 30 deadline for a return

- While **interest charged on late payments is not tax deductible**, interest received is

c) **Penalties**: non-deductible civil and criminal penalties for late or false returns

### Voluntary Disclosures Program

* For taxpayers to come forward
* If taxes owing or interest outstanding, the government will allow taxpayers to come in and voluntarily disclose their income and only be assessed to tax on that income and to the basic interest charges for arrears **not be charged for excessive penal interest**
* Must be
	+ Voluntary
	+ Facing penalties
	+ Taxes due more than one year overdue
	+ Full disclosure--Tax Amnesty

### Audits and Investigation (Rules binding CRA investigation)

- There are 3 stages of audits:

a) **“Desk audit”**: CRA **checks what you file** (documents, calculations, matching items, ect…)

b) **“Office audit”**: CRA **calls the TP into the office**, asks TP to bring cheques, receipts, ect…

c) **“Field audit”**: CRA **pays the TP a 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

b) the authorized person **may enter into any premises** **or place that is not a dwelling house**

c) There is a **duty upon persons to provide "all reasonable assistance and to answer all proper questions relating to the administration or enforcement of this Act"**

**b) Judicial warrant:** can be obtained for **entry into a dwelling house without consent.*s.231.1***

**c) Requirement power**

*-* ***s.231.2(1)****:* The Minister **may compel any person to produce any information or document**

####  "Jarvis application":

=An application to exclude evidence at a criminal trial where a statutory inquiry begins as routine but turns adversarial and ends in criminal prosecution

**When the predominant purpose of the investigation becomes to charge a person criminally with tax evasion, the taxpayer is entitled to *Charter* rights. However, information gathered during the audit process before the purpose becomes criminal can be used to prosecute a person. *Jarvis (****man selling not disclosing, CRA started investigation pretending nothing wrong, never told him he was being criminally investigated. Court said entitled to charter rights when investigation became criminal)*

**Test**: to determine the line between **audit** and **investigation** is contextual and depends on the following factors:

a) Did the authorities have **reasonable grounds to lay charges**?

b) Was the general **conduct of the authorities consistent with the pursuit of an investigation**?

c) Had the **auditor** **transferred his/her files and materials to the investigators**?

d) Did the **auditor effectively act as agent for the investigators**?

e) Does it appear that the **investigators intended to use the auditor as their agent?**

f) Is the **evidence sought relevant to the taxpayers general liability, or does it go to *mens rea*?**

### Penalties: General

**Tax Planning:** plan to pay tax efficient manner

**Tax avoidance** (open attempts to take advantage of tax laws to reduce the amount of tax payable)

* + SCC says tax payers **are entitled** to select courses of action that will **minimize tax liability**

**Tax Evasion:** secret attempt to avoid paying taxes and intentionally deceive CRA

* + **Court considers whether tax payer is OPEN**
	+ If crown thinks there is **mens rea** they **will proceed with criminal prosecution**,
	+ Crown cannot pursue both civil and criminal

#### Civil Penalties

If a taxpayer does not pay tax, there are **non-deductable civil penalties** imposed by the *ITA*

a) **Failure to file income return the first time**

- ***s.162(1)****:* taxpayer is liable for a penalty equal to **5% of total tax payable** plus 1 cent/mo (not exceeting 12 mo) until filed.

**b) Repeated failures to file return**

- ***s.163(1)****:* taxpayer is liable for a penalty equal to **10% of total tax payable** if it's repeated failure in any of 3 preceding years

**c) Civil penalty for false statements or omissions**

- ***s.163(2)****:* taxpayer knowingly/negligently reported misleading tax figures

- CRA **most commonly uses this provision** because, unlike***ss.238-239***, which imposes criminal penalties, the Crown doesnʼt have to prove *mens rea*

**d) Third party civil penalties*s.163.2***: those who make, participate in, or **acquiesce in a false statement** made with regard to another's tax situation can be liable

#### Criminal Charges:

 ***mens rea*  is required**

**a)Summary Offence*****s.238(1)****:*

Persons who fail to file a return as required under the Act or fail to comply with certain sections of the Act are guilty of an offence and are liable on summary conviction for a fine between $1,000 and $25,000

- Can also be both a fine and imprisonment not exceeding 12 months

**b) Indictable Offence**

*-* ***s.239 (1)****:* persons who make false/deceptive statements, evade payment by altering or destroying records/books, or cooked the books are guilty of an offence and are liable on summary offence of a fine and/or imprisonment

### Collections

- **Remember**: TP must pay ALL income tax by April 30, not just file (or else face wrath of CRA collections)

- If individual **can't pay taxes by the "balance due date", at least file, as failure to file is an offence**

- After NOA is delivered, TP has 30 days after NOA is delivered to pay taxes

- Important sections of *ITA* regarding collections:

**a) Seizure of third party gifts**

- **s.160**: CRA can seize property from third parties to pay your taxes (ie: gifts)

**b) Creditor remedies for CRA**

*-* ***s.223***: CRA can issue a **"judgment by certificate"** for any debts, and then put a **lien/charge on the debtor's property** to satisfy the amount owing

*-* ***s.224***: CRA can make a "**third party demand**" for **garnishment to any bank**, as they are a super-creditor and can serve notice on any bank without knowing where account is

*-* ***s.225***: CRA can also **execute a writ of seizure** and sale to satisfy tax arrears

- ***Silva***: CRA seized a $300,000 yacht for a $30,000 debt, the yacht sunk first, but the taxpayer was still liable for the tax

### Fairness Packages

- **d IC 07- 1**The package is also known as "**taxpayer relief provisions**" that give the MNR the discretion "to administer the tax system more fairly" by:

a) **Extending the limitation period for tax refund applications further than 3 years**

b) **Cancel or waive interest/penalty charges** if extenuating circumstances exist for non-culpability

c) **Extending the election deadline up to 10 years** (ie: non-resident status)

- This is all a matter of administrative discretion and TP can file for judicial review if not satisfied

- **Note**: with the "fairness package", **can only waive interest or penalties**, not the principal sum owing

# APPENDIX OF USEFUL CASES :

## Chapter 3: Who is subject to Canadian Income Tax?

### Thomson

**Facts:**

* Left canada in 1930 to go to Bermuda and establish residence [pure farce]
* Travelled up and down eastern seaboard nb and florida
* Had home with servants in Canada vacant and **available for his occupation at any time** (**this was a critical factor in determining his residency**)
* He would still travel around the US and back to his home but spent approx. 160 days in canada
* He claimed he gave up his CDN residence and isn’t taxable on income

**Issue:** was he a resident of Canada in 1940?

**Reasoning**:**Having a house available** while out of the country was **a significant residential tie** to Canada.

If individual leases dwelling place on arms-length terms the CRA may not consider dwelling to be significant residential tie to canada

**Ratio: To determine residence, the court will look at whether an individual severed all residential ties with Canada. Look to intention to be resident or stop being resident**

**Look to regularity and length of visits to canada**

**Look to Residential ties outside canada**

### Lee v MNR

**Facts:** L held a **UK passport**, employed **full-time by a non-resident corp with all work done out of Canada**. However, L **married a Canadian** who **bought a house using a mortgage guaranteed by L**. L would **come into Canada to visit** his wife, but each time he would have to leave within the prescribed time period for a “temporary visitor” stay (about 20 days). L paid no income tax anywhere

**Issue:** Was L a deemed resident of Canada for tax purposes?

**Judgement:** Yes, L was a factual resident

**Appeal:**

- Lack of immigrant status does not preclude someone from being a resident for tax purposes

- Most important factor is **whether the individual establishes residential ties** in Canada

- Here, having a spouse and a residence with a mortgage he guaranteed made him a resident

**Ruling: Residence is, in part, a question of fact and depends on the specific facts of each case; the more ties a TP has within Canada, the more likely they will be considered a resident**

### R&L Foods

**Facts:** 2 shareholders in a Canadian company lived in Michigan but commuted to Canada every day**.** They wanted to be deemed residents under s.250(1)(a) (sojourn provision) to get a smallbusiness tax deduction

**Issues:** Were the controlling shareholders deemed residents of Canada?

**Judgement:** No.

**Appeal:** To “sojourn” is to make a temporary stay in a place, to remain or reside for a time

**Ruling: People coming from another country to work in Canada are not residents.**

### Reeder v Queen

**Facts:** Reeder accepted a job with Michelin Canada and was sent to France**.** He **sold his house and put his furniture and car into storage**; In France, he rented a furnished apartment, bought a car, and **drove with Ontario DL.** He **kept a bank account in Canada** R tried to claim part-time residency under **s.114** for March to November when he was inFrance

**Issue:** Was Reeder considered to be **“ordinarily resident”** of Canada under **s.250(3)**?

**Judgement:** Yes, R was found to be ordinarily resident in Canada and had to pay tax for the entire year

**Appeal:**

- residency is a question of fact in every case whether someone should be considered a non-resident for the purpose of going abroad

- should consider ties with canada and whether move abroad is intended to be permanent

- Here, Reeder always intended to return to Canada even though his length of stay in France was indeterminate in length

- Also, he didnʼt sever his secondary residential ties to Canada

**Ruling: If a TP goes and lives abroad but does not sever all secondary residential ties to Canada (ie intends to return), they will be “ordinarily resident” in Canada and will be taxed on all of their worldwide income for the entire taxation year**

- **Note**: R might have received relief from double taxation anyways as Canada had a tax treaty with France at the time

### Debeers

**Facts:**  A carried on a diamond-mining business in South Africa where it was registered**.** Majority of **directors however resided in England, and the meeting in London were those at which most of the companyʼs business was conducted**

**Issue:** where is Corp Resident?

**Judgement:**

**-**A company resides, for the purposes of income tax, where its real business is carried on; where the central management and control actually abides

**Ruling: A company is liable to pay income tax in whichever jurisdiction its real business is carried out, regardless of where the company is in fact registered**

### Grainger

**Facts:** Grainger was acting as an agent in England for Louis Roederer, a wine merchant in France**.** He canvassed orders and received commission for all orders fromEngland**.** However, Roederer in France actually had discretion over actually filling or rejecting the orders

**Issue:** Was Roederer carrying on business in England?

**reasoning**- Important to look at **where the contracts are made and where acceptance takes place**

- Here, Grainger never made a K to sell wine on behalf of Roederer in England

- K was only formed when Roederer agreed to fulfill it and was therefore formed in France

- Therefore, as an order given to a merchant for the supply of goods does not constitute **carrying on a business**, so therefore there were no tax consequences on Roederer in the UK

**Ruling: Criterion for carrying on business includes where the contract is made; the determining factor is where the contract is accepted.**

### GLS Leasco

**Facts:** GLS, an American subsidiary of Centra Inc., was a USA corporation that bought and leasedtransportation equipment in Canada, primarily to McKinlay who was also a subsidiary ofCentra Inc.**.**GLS wanted to be taxed under Part I “carrying on business in Canada” so they could deductlosses from profits on the basis of a non-capital loss carryover (ie: offset 79-80 profits with77-78 losses)

**Issue:** Was GLS carrying on business in Canada during the years in question?

**Reasoning:** Yes, for GLS, **in substance their profits arose from operations taking place in Canada**

- However**, as a “matter of fact”, GLS was carrying on business in Canada, as:**

- All GLS contracts were executed in Canada

- All GLS equipment was purchased in Canada (always owned it, just leased to McKinlay)

- Had a branch office and bank account in Canada

- Therefore, GLS owed tax under Part I, could deduct losses, and McKinley not responsible for past withholding taxes

**Ruling: Where the substance of doing business in Canada is present (ie: contracts, payments, deliveries, bank accounts, intent to do business in Canada), it will take precedence over a lack of form (ie: no offices/official agents in Canada) and establish that business is being carried on in Canada .**

### Sudden valley

**Facts:**

* residential development in Washington
* incorporated in USA
* tried to find buyers in BC, established an office in Vancouver where interested people would call in then go down to Washington to see the property
* if people couldn’t afford, people would take mortgages from sudden valley (cdn res purchaser paying interest and principal to sudden valley)
* CRA said interest was part XIII income and cdn residents should have been deducting and remitting withholding tax and sudden valley would be taxed on gross amount because they weren’t really carrying on business in Canada
* Sudden valley relied on s253 b and said they’re soliciting orders from Canadians so carrying on business

**Issue:** Is SV carrying on business in Canada or should there be withholding tax on interest?

**Reasoning**: No. court looked to where contracts were made and this was USA. Also distinguished between invitations to treat and soliciting orders (which is an offer)

**RATIO: Court looked to where the orders were solicited to see if it fit under 253 b. Remember the difference between an invitation to treat and an offer. Soliciting orders is an offer that is binding when accepted merely advertising and inviting people to look is an ITT.**

**Comment:** Nowadays this interest would be non-taxable because interest is exempt from tax!

## Nexus

### Neuman

**Facts:**

* Corp (Melru), a holding company had different classes of shares for each family member
* Neuman had all class G shares
* Wife ruby had class F shares (paid for shares with her own funds)
* Ruby chose to pay dividends to her class of shares
* CRA said because mr. neuman set it all up to split his income from his law partnership, the income should be attributed to mr neuman and not to ruby

**Issue:** should Neuman be taxed on this income that he diverted to his wife?

**Reasoning:**

* Court looked to s 56(2) and found that the divid**ends would not have been the income to mr. Neuman because it would have belonged to the corporation.** Because it failed to satisfy 56(2)(4), the income splitting was permitted.
* Therefore Mr. Neuman wouldn’t have been entitled to the income

**RATIO: if money is diverted as a dividend of a company it is successful in splitting income because it does not meet the 4th condition in 56 (2) which requires that the diverted money would have been part of the taxpayer`s income.**

## Income attribution

### Boutelier

**Facts:**

* B is a mutual funds salesman who worked as an independent contractor
* Worked on commission and also charged **trailer fees** (remunerate salesperson for monitoring customer’s account and discouraging customer from selling the fund)
* B didn’t want the trailer fees to be considered his ‘income from business’ so he incorporated a numbered company and had the trailer fees go to the numbered company which would pass the trailer fees to beneficiaries as allocated by trustees
* B said he was transferring the opportunity to earn trailer fees to the company but CRA said he was transferring the fees itself\

**Issue:** should Mr. B be taxed on the income or just the company?

**Reasoning**

Court looked to ***sec 56 (4):***

* ***Transfer of a right to income [from any source]***
* ***To a non-arms length person [family, companies owned by tp]***
* ***Would have been transferor’s income [beneficial entitlement]***
* ***Unless property also transferred***
* And found that the right to income would have fallen to Mr B and he was beneficially entitled to the trailer fees, he transferred to non-arms length (corp he started).
* **Court considered:** the company was not providing any service to the clients (B was doing it );No employment contract between Mr. B and the company **;** He didn’t tell clientele services would be provided for by company

**RATIO**

**The court will attribute income to the taxpayer when the TP transfers a right to income to a non-arm’s length person if the income would have been the transferor’s income, unless property also transferred (s 56 (4)). People hoping to successfully split income need to pay close attention to the form in which they do so (ie treat corp as a separate entity, have it carry on active business, incur expenses etc).**

## Chapter 2: Source Concept of Income

### *Bellingham*

**FACTS:** Bellingham bought property in grand centre. The property B acquired in the area was expropriated (taken compulsory) from the town.. The town behaved badly toward B and ultimately B went to arbitration. There was a settlement following the boards rulings. $3770000 for compulsory taking of land; $ for ordinary interest; $ as additional interest under alberta expropriation act. B paid tax on income for land and ordinary interest but didn’t want to pay taxes on the additional interest.

**ISSUE:** is additional interest taxable?

**REASONING:**

 $377 000 fair market value for expropriation of land was taxable as income from business (property that she bought was a matter of speculation which makes it **income from business *ITA s248 “business=adventuer in the nature of trade”***

“**Ordinary interest**”/court ordered interest $181 319: is **income from business because the underlying sum on which it is based is income from business**

**Additional interest** is tax free. The amount is likeable to a windfall. It is actually a punitive damage award. It penalized the town for screwing over Bellingham.

Windfall: unexpected, taxpayer did nothing to earn it, not recurring, not fitting usual qualities of income

**RATIO:** .**Surrogatum principle: Ask what is the compensation for? Look at if its’s for a recognized source of income: employment, business, property, capital gains. If income doesn’t fall into those categories it’s not taxable.**

### *Schwartz*

**Facts:** Dynacare hired Schwartz for a senior position; they executed the employment K butbefore Schwartz started work, Dynacare changed its mind and said he was no longerneeded**.** S sues &Dynacare pays S him a lump sum in settlement.

**Issue:** Under the source concept of income, were the damages taxable/from a source?

**Judgement:** No, for S, he received the $360,000 tax-free. The amount paid to taxpayer was primarily to compensate for embarrassment, anxiety, and inconvenience*.* Wasn’t employment income because he wasn’t *in the service* of Dynacare. Wasn’t retiring allowance because he was never their EE.

 **Was it from another source?**- While **s.3(a)** gives the Court the power to add sources, Parliament has already chosen to deal with the taxability of these payments in the “retiring allowance” provisions

**Ruling**: **While income from unenumerated sources can theoretically be taxable under the** **general provision of s.3(a) of the *Act*, the Courts will not add sources of income** **if the *Act* has already dealt with payments in the area.**

**2-Settlements for employment Ks terminated before employment begins are not taxable because don’t come from a source.**

### Field v Queen-

**FACTS:**

* Wife was his financial advisor. She was in a fiduciary capacity but emptied his RRSP, put money into their joint account and then forged his signature and took the $ for herself
* CRA pounced on Field and said the withdrawn money was taxable.
* He claimed he didn’t do it himself but his spouse did it through forgery and breach of fiduciary duty

**Issue**: did the income belong to mr f? should mr. field be taxed on the withdrawals from his RRSP?

**Reasoning: No. If anyone should be taxed on this money it would be the spouse because she got the benefit of the money.**

**RATIO: The nexus between taxpayer and income requires the taxpayer to have the benefit of the income.**

### Buckman-

**Facts:** A solicitor had 2 businesses: the solo practice of law/mortgage broker, andembezzlement**.** He embezzled funds from clients, and the CRA taxed the shady lawyer on theembezzled funds**.** Buckman argued that embezzled funds weren't income because they didn't come fromrecognized source

**Issue:** Were the embezzled funds taxable? (Does embezzlement carry the "hallmarks of abusiness"?)

**Judgement:** **Yes.The funds received were income from a business and therefore taxable**. Buckman engaged in a business separate and apart from his law practice and mortgage brokerage.

- Here, Buckman argued that since the funds were **misappropriated in the course of his sole practitioner business**, he CRA must use generally accepted accounting principles (GAAP)

- Under GAAP however, funds wouldn't be included in the **profit** from his business because Buckman didn't have use of the funds absolutely without restriction, as they belonged to his clients at all times

- Of course, the court held thatthe number of appropriations and methods employed by Buckman had all the **earmarks of business**

- Therefore, embezzlement was found to be a 2nd business separate and apart from his law/brokerage business

- **No difference whether the thief acted as solicitor, agent, or employee; the fact that the funds are being treated as income flowed from the reality of the situation**

- **Note**: court rejected embezzlement as a new, unrecognized source of income under s. 3(a) "without restricting the generality of the foregoing", as was simply income from a business (of embezzlement)

**Ruling: Money obtained illegally during the course of a business is taxable if the conduct has the earmarks of a business**

## Chapter 4 INCOME FROM EMPLOYMENT

### Wiebe Door Services Ltd v MNR

**Facts:** W would send people out to repair doors for customers. People repairing had own trucks, tools, equipment, etc. door repairers determined how they were going to do the work. Claimed to be self employed CRA said employees.

**Issue:** were they employees or self-employed?

**Reasoning:** self-employed

**Ratio:**

 **Total Relationship test “4 in 1” PREDOMINATE TEST**

1. **Control**
2. **Ownership of tools/equipment (**employer provides for employees; self employed supply their own)
3. **Chance of profit (**employee less opportunity to share in profits than self-employed…just get paid for their time)
4. **Risk of loss (**employer must pay employee regardless of losses; self-employed financial risks of broken contracts, bad debts, cost-overuns, etc.)

**Integration/Organization Test (can also be used)**

* **From WORKER’S point of view ask Integral or accessory?**
* Employees work is integral part of employer’s business V self-employed person’s work is only accessory to the business

### Cavanagh v. The Queen [1997 TCC] :A teaching assistant is an IC and gets to deduct business expenses

**Facts:** Cavanagh was an accounting tutor (ie: TA) for a course at York University; the universityissued a T-4 setting out his income from employment, thinking he was an EE**.** He then filed an employment tax return, but then changed his mind and re-filed as a self-employedworker in order to deduct his traveling (ie: car/gas) and business (ie: stationary)expenses

**Issue:** Was Cavanagh an EE or an IC?

**Reasoning:** For Cavanagh, heʼs an IC so he gets to deduct all of his expenses.

- The Court applied both tests, both leading to the same conclusion:

**a) Lord Wrightʼs Total Relationship Test = IC**

i) **Control** – York university and professors exercised minimal control over Cavanaugh with regard to supervision, location, and scheduling; he wasnʼt a lecturer, only a tutorial leader

ii) **Ownership of tools** – all his own, not provided by the university

**iii)Chance of profit** – some

iv) **Risk of loss** – some, but depended on how many students he had and dropout rate

**b) Lord Denningʼs Integration Test = IC**

- Work was integrated into Yorkʼs work in that York was there to teach and C tutored/marked

- However, from the EEʼs point of view (*Wiebe*), Cʼs work was not an integral part of the business, as York couldʼve hired somebody else and C was free to hire somebody else

**c) “Specific Results” test = IC**

- Relationship finished after a specific task…ie: finished marking and tutorials were over

- After this, C ended any relationship with York, C would have to go back and resolicit another K or renegotiate a new relationship as he didnʼt have tenure

**Ruling: The issuance of T-4 is not determinative of whether a worker is an EE or an IC; instead, it is for Courts rather than the ER to determine whether income is income from employment**

### Curran v. M.N.R. [1959 SCC]

**Facts:** Curran, received $250,000 fromBrown, a substantial share of another company, as an “inducement payment” to leave IO for another company. C claimed the money represented a capital receipt and not income, as the agreement was to provide compensation for loss or relinquishment of a source of income.

**Issue:** Was the inducement payment income or capital? If income, was it taxable under **s.6(3)** of the *ITA*?

**Issue:** are signing bonuses taxable?

**Reasoning:** Yes. , payment classified as income from employment and therefore taxable under **s.6(3)** R**emuneration for (future) services.**

- Even though the payment didnʼt specifically fall under the **s.6(3)** definition, the payment from the ER was still considered remuneration, and thus was income from a source (employment)

- Result of the decisions is that Brown couldnʼt deduct the “inducement payment” as an expense; rather, C was taxed on the compensation.

**Ruling: Where a signing bonus-style payment is made to induce a person into a subsequent employment agreement, and not to acquire the rights of the EE against the current ER or strictly as compensation for loss of a future pension, the payment is categorized as income**

### Tenant v Smith HL 1892

**Facts:** Bank required employee to live on bank premise for when customers came to deposit after hours. Lived there rent free

**Issue:** taxable benefit?

**Reasoning:** No

* It was for the benefit of the bank not the employee

**Ratio: Only money or what is convertible into money can constitute income (rule in England). Ask who gets the benefit? If employer🡪Tax free. If employee🡪taxable income from employment**

### Sorin v. M.N.R. [1964] Tax. AB

**Facts:** Sorin, who lived with his brother, was a partner running a hotel with a bar; his duty was tomanage the bar and rent out the rooms. He stayed at the hotel until 4 am to close up the bar and also worked very long and awkward hours. He often took afternoon naps in a hotel room mainly used for storage. MNR taxed S on the benefit (“lodging”) for use of the room at half the normal rate for the year

**Issue:** Was the room used by S “lodging” under **s.6(1)(a)** and thus a taxable benefit?

**Reasoning:** No. the benefit was tax-free.

- Under **s.6(1)(a)**, “lodging” would be a taxable benefit,

- EE however was **not getting any enjoyment from staying at the hotel**, and evidence showed wouldʼve rather spent time at home if his duties permitted him to do so

**Ruling: If it can be shown that there was no actual value to the EE, and only a benefit to the ER, then it is not a taxable benefit; in order for a benefit to constitute “lodging”, it needs to be shown that the TP in question actually lives in the accommodation provided by choice.**

### The Queen v. Savage [1983] SCC

**Facts:** Savage had a contract of service from his ER insurance company which included a $100incentive for each insurance course voluntarily complete; **available to all EEs** to encourageself-upgrading**.** She did 3 courses and received $300 from ER for successfully completing these work-relatedcourses**.** MNR reassessed and said it was income from office/employment**.** Savage argued it was a **prize for achievement** and since it was under $500, wasn’t income.

**Issue:** Was the payment a taxable benefit?

**Reasong:** Yes, because the money was received in respect of employment.**:**

- The words of the statute that, “Benefits of any kind whatever…**in respect of**…office or employment” is of the widest scope

- Here, even though the **incentive did not take “the character of remuneration for services”, it was a benefit because it gave some advantage to the EE**

**Ruling: Taxable benefits need not be for services rendered, but merely conferred on the TP in relation to or in connection with their employment in any way**

**Note**: had the ER merely been paying for the course, either in advance or as reimbursement, as opposed to offering a reward, there would be no taxable benefit

### Laidler v. Perry [1965] HL

**Facts:** ER used to give turkeys to all EEs as Christmas gifts; switched to 10 pound vouchers every xmas.

**Issue:** were vouchers taxable benefits or merely personal gifts?

**Reasoning:** Taxable benefits because vouchers were a form of remuneration

**Appeal:**

- Sum was **given to EEs in hope or expectation that the gift would produce good service in future**

**-was expected by the EEs because recurring practice**

- **Note**: turkeys would be okay today under **s.258 exception for gifts under 500.**

**Ruling: Where regular gifts are made to EEs by ERs in order to obtain future beneficial results for the business, the gifts are taxable as income**

### Lowe v The Queen.

**Facts:** employer ordered employee and his spouse to go on a trip. All expenses made. When he was in new Orleans couldn’t enjoy trip, had to do things to keep customers happy. It was required that Mr and Mrs Lowe go on this trip and entertain.

**Issue:** was it taxable benefit?

**Reasoning:** no. because the benefit to employer. It was primarily a business trip and the enjoyment was incidental.

**Ratio: Where employee takes a trip that is required by the employer for the benefit of the employer, it is NOT a taxable benefit. The benefit, to be taxable, must be a personal benefit to the employee. If there’s no personal benefit to the employee, then there is no tax consequence to the employee either.**

### The Queen v. Huffman [1990] Fed. CA

**Facts:** Huffman was a plainclothes officer with the Niagara Regional Police Force who examinedcrime scenes for physical evidence ; got

$500/year for the purchase ofclothing because uniformed officers were provided with their work clothes at no cost to them **Issue:** Was the $500 clothing reimbursement a taxable benefit under **s.6(1)(a)**?

**Reasoning:** No

* Main point: reimbursement of a loss that results to employee b/c of employment is non taxable.
	+ Simply being restored of where he was before and therefore effect of reimbursement.
	+ Like Huffman who bought plain clothes outfit.
* Could not be an allowance because he was accountable for this sum by showing receipt.
	+ Allowance is predetermined amount without being required to account.

**Ruling: Reimbursements of actual expenses incurred by EEs at the order of the ER, which at least partially restores an EE to his/her pre-expense economic situation is not a taxable benefit under s.6(1)(a)**

### Ransom v. M.N.R. [1967] Ex. Ct. Removal expenses confer no benefit to EEs and arenʼt taxable

**Facts:** Ransom was transferred by his ER from Sarnia to Montreal, and in the process, lost money onthe sale of his home in Sarnia because the market was saturated**.** To compensate Ransom, his ER paid him for the cost of moving expenses and any losses onthe sale.

**Issue:** Was the reimbursement payment a taxable benefit?

**Reasoning:** No.

- Cost of relocating when an EE is forced to move is in the same category as other traveling expenses

- Ransomʼs financial position was adversely affected by reason of his employment relationship

- Reimbursement was purely to put him back in his original position…no “net” benefit for Ransom

- Court found that the **reimbursement** for the **capital loss** was not taxable because:

**Ruling: Relocation payments which reimburse the EE for actual losses incurred on a sale of the EEʼs house are not taxable; “reimbursement of an EE by an ER for expenses or losses incurred by reason of the employment is neither remuneration as such or a benefit of any kind whatsoever”**

### The Queen v. Phillips [1994] Fed. CA

**Facts:** P was moved by ER from Moncton, NB to Winnipeg pursuant to a relocation agreementbetween the ER and the union, P received $10,000 payment to compensate him for increasedhousing costs in Winnipeg but no restrictions were placed on use of payment

**Issue:** Was the reimbursement for the additional cost of housing a taxable benefit?

**Reasoning:** Yes

- Similar to *Savage*, Phillips **received the $10,000 payment in his capacity as an EE from the ER**

**-** While the Court endorses *Ransom*, it **limited *Ransom* to cases concerning an actual expenditure**

- In this case, **the purchase increased Phillipʼs net worth** (**conferred economic advantage)** and was therefore taxable under **s.6(1) (a)**

**Ruling: The *Ransom* principle does not extend to reimbursements for the increased cost of housing, as a more expensive house adds to the net worth of the individual**

### Campbell v. M.N.R. [1955] TAB

**Facts:** Nurse had her own car and got a $50 allowance/month for transporting nursing home patients**.** She wasnʼt required to account for the expenses, show receipts, or return any surplus**.** This responsibility was not required under her K of employment; instead she did it voluntarily

**Issue:** Was the allowance taxable under **s.6(1)(b)**?

**Reasoning:** Yes. monthly payments were income as the allowance was paid on a periodic basis and the money was absolutely Cʼs (no accounting needed).

- She voluntarily transported patients in her vehicle, it wasnʼt part of her ordinary duties

- C then alternatively argued that if the allowance was included as income, she should be able to deduct the vehicle expenses, but **since ER never obligated her to use the vehicle, expenses remained non-deductible**

- **S**: she couldʼve got a tax-free allowance if she did it on a per-km rather than per-month basis

**Ruling: Receipt of an allowance to compensate for the costs of voluntary services rendered is taxable as income and is not subject to deductions for the costs of the service**

## CHAPTER 5-INCOME FROM BUSINESS OR PROPERTY

### Graham v Green

**Facts:** guy was betting on horses at prices and made an income out of it. He was not a bookie, just making bets

**Issue:** was this income he earned from a business?

**Reasoning:** no. being a bookie would be generating income from business because their work is **systematic and they are active**. Merely being a compulsive gambler does not mean that one’s gambling is a business. “**a bet** is merely an **irrational agreement** that one person should pay another on the happening of an event” no relevance between the event and the acquisition of property.

**Ratio:**

* **Business income is distinct from property income because property income is passive and business involves activity on the part of the taxpayer.**
* **Business income also is an organized activity.**
* **Business also has a profit motive: risk and reward (this distinguishes professionals from non-professionals)**
	+ **Gambling is tax free for betters (windfall) but bookies are taxable on the service they provide**

### Walker v MNR

**Facts:** W ran racehorses and bet on races. He had access to jockey’s tents and got inside information from jockey’s on probable outcome on races.

**Issue:** is his betting income from a business?

**Ratio: gamblers who have inside information are like the odds-maker and are therefore not gambling and are generating income from a business which is taxable. This is because they have a system.**

### M.N.R. v. Morden [1961] Ex. Ct.

**Facts:** M ran racehorses for prize money. Had his own betting on the side using info from inside sources. He quit running horses and continued to bet.

**R:** betting was taxable as business income (like Walker) when he was running race horses and had inside info. Earnings when he was just betting but not running horses was tax free winnings.

**R: it’s possible for sources to change. I.e. to go from being tax-free to taxable and vice versa. It’s a question of fact.**

### Leblanc v. The Queen [2006] TCC

**Facts:** 2 guys started buying provincial lottery tickets on sports, and made $5.5 million in winnings**.** System involved taking extremely long odds, lost 95% of the time, but got big winnings**.** They bet around 10-13 million/year and made $200,000-$300,000 a week

**Issue:** Did these winnings constitute income from a business?

**Reasoning:** No, for Leblanc

- Although betting was done on a large scale, they took the odds they were given, didnʼt have inside connections or a system, and bet on impulse

**Ruling: Courts focus on the organization of the TPʼs activity in determining if there is a business (ie if gambler has inside information and system for betting, can be income from business)**

### Stewart v The Queen

**Facts:** S (experienced real estate investor) invested in 4 properties where he was getting rental income. They generated recurring losses. CRA didn’t want to let him to deduct the losses. CRA Said he didn’t have a reasonable expectation of profit so it couldn’t be income from property.

**Issue:** should reasonable expectation of profit test be applied?

**Reasoning:** No. Stewarts investment was a commercial activity so reasonable expectation of profit irrelevant. It’s good enough that he showed that he intended to make or hoped for profit.

**Ratio: Court will ask two questions:**

**1-is the activity of the taxpayer undertaken in pursuit of profit or is it a personal endeavour?**

**-If TP is in pursuit of profit or it’s a commercial activity then that is the end of the story and no reasonable expectation of profit is required.**

**-If the activity has a personal element, then ask is there a reasonable expectation of profit? (TP must demonstrate that his predominant intention is to make a profit and its been carried with indicia of business…look to activity, risk etc.)**

### Groulx v MNR

**Facts:** taxpayer vendor/creditor made an agreement for sale of farm for $395 000 payable 85 000 down. $310 000 by annual instalments 6 ½ years “without interest”. Govt looked at deal and said there is “hidden interest” because property only worth 350 000. The extra 45 000 was really interest.

**Issue:** when will the court find taxable hidden interest? Was there hidden interest?

**Reasoning:** Yes court can find hidden interest in blended payment.

**Ratio: if there is hidden interest in a payment, then the hidden interest is caught by s 16(1). 3 factors MUST BE PRESENT to find hidden interest and make it taxable:**

1. **there is an invariable practice to charge interest on this type of transaction**
2. **price greater than fair market value**
3. **taxpayer bargained higher price w/o interest v paying interest**

### Spooner v. M.N.R. (1928 PC)

**Facts:** TP owned a ranch in Alberta, and sold 20 acres of it to Vulcan Oils for $5000 cash + 25,000fully paid shares of Vulcan + royalty of “10% of all oil and gas productions**.** Although the royalty right was supposed to give oil to the vendor, the vendor accepted moneyin lieu of oil which Minister sought to tax

**Issue:** Was the royalty a capital gain or royalty income for tax purposes?

**Reasoning** The entire sale was pure **capital gain**, even the part of payment that was reliant on production of oil

Ratio: Law used to allow TPs to convert what would otherwise be fully taxable rent or royalty incomes into more favourable capital gains

- S: modified by Parliament with passage of **s.12(1)(g) which says now that % which is royalty = income from property**

### Imperial oil

**Facts:** companies ship collided and company had to pay a settlement of damages to the other ship owner. Wanted to deduct settlement paid. CRA said not deductible expense because it **didn’t produce any income.**

**Issue:** was settlement deductible business expense?

**Reasoning:** court said it was deductible because the **purpose was to earn income**. The settlement was an **operating expense “incidental to the operations of the business” or “part of the income earning process”**. It was deducted by accountants, so it met the principles of GAAP. It was a current expense, so it was currently deductible.

**Ratio: while expenditure should be for the purpose of earning income, it is not necessary that it actually earn the income. It can be deducted even if it is not productive and even if it results in a loss. It can be incidental to the operation of the business.**

* **It may properly be described as a disbursement or expense that is wholly exclusively and necessarily laid out as part of the process of earning the income from such operations\***

### The Royal Trust Co v MNR

**Facts:** company lent money out and did estate planning for people. Acted as a trustee for wills and estates.

* To attract business to the firm, Royal Trust would pay membership and club dues for its employees to join social and sporting clubs
* CRA said when members joined club, the payment of initiation fees were ‘once and for all’ and therefore capital outlays rather than “recurring” which is a current expense under s18 1 b

**Issue:** where these membership dues tax deductible expenses?

**Reasoning:** Yes.

* The payment of these memberships was connected to the business’s earning of profit**:** The company was promoting its business, drawing customers into its business by having their employees out in these clubs
* Court said there is no reason to draw a distinction between admission fees and annual fee because it was all recurring for the company since there is turnover and so many employees. It’s not really “once and for all”.
* The admission fees are similar to an advertising expense for the business

**Ratio: A causal connection between a deduction and income is not required (matching not required). It must be shown that the expense is for the purposes of the business and incidental to the operation of the business. It is deductible in the year incurred.**

### Benton v MNR

**Facts:** B operated a farm, generating income from business. Hired a domestic helper who lived in his farmhouse and divided her time between personal care of B and acting as a farm labourer. B paid her in cash 65/month and gave room and board valued at 25$ month. He tried to deduct the total amount as a business expense for farming.

**Issue:** was her total salary a deductible business expense?

**Reasoning:** court said he couldn’t deduct the full amount. He would have to apportion the business from the personal expense. He could only deduct the 325 as the expense to earn farm business income. The balance was the personal expense of his, paying her for her domestic/household help.

**Ratio: TPs need to apportion deductions of payment to workers who help with both business and personal care.**

### Leduc

**Facts:** Leduc, a lawyer, claimed $140,000 in legal expenses for hiring lawyers to defend him on sexual exploitation charges. MNR disallowed the deduction because they were personal in nature under **s.18(1)(a)**. Leduc claimed that the expenses were incurred for a business purpose, ie: to save his reputation/career as a lawyer as he could lose his licence to practice if convicted (you would hope so).

**Issue**: Are Leduc’s legal expenses incurred for a business purpose and therefore deductible?

**Reasoning**: No. expenses weren’t paid in order to try and produce income from business

 - Leduc’s expenses **were not normally incurred by other lawyers**, and he **would’ve had to pay the expenses no matter what his profession was**

**Ratio:** **If criminal charges stem from an activity carried on in the normal course of business, then the legal expenses incurred to defend those acts are deductible; however, if the activity that led to charges is not a normal part of the production of income, they are not deductible**

### Symes v The Queen

**Facts:** TP Symes (self-employed lawyer) wanted to deduct childcare expenses as a business expense because it enabled her to earn business income.

**Issue:** is childcare a deductible business expense?

**Reasoning:** no these are not business expenses.

* Under GAAP, childcare expenses are not deductible
* Parliament had already enacted **s 63** which permits the deduction of childcare expenses for **employees, self employed persons and students … it has tight restrictions and she can only deduct what s 63 permits**

**Ratio: childcare is not a deductible business expense under 18(1)(a) because Taxpayers can deduct subject to s 63.**

### Scott v MNR

**Facts:** Foot and bicycle courier, fought CRA which disallowed deduction of food and drink for couriers. Characterized the extra food and drink he needed as “fuel” similar to the “fuel” put in cars of car couriers.

**Issue:** is this food and drink needed by foot couriers a business expense?

**Reasoning:** Yes. Cost of fuel for a truck driver is tax deductible so should be the cost of fuel for couriers/rickshaw drivers etc.

**Ratio: Couriers who consume extra food and drink as fuel can deduct the extra food and drink needed as a business expense. This only applies to fuel consumption in this transportation type of occupation. Doesn’t apply to construction workers etc,**

### Cumming v MNR

**Facts:** Dr anesthetist was self-employed. He would travel from his home office to the hospital to anesthetize people. He would prepare bills etc. for patients at his home office. Wanted to deduct expenses as travelling for work. So Dr argued the home was his workplace so when he travelled from his home to the hospital and back again he was travelling for work.

**Issue:** was this commuting from the home office to hospital a deductible business expense of travelling?

**Reasoning:** Yes.

**Ratio: automobile expense for travel between home office and other place required for employment is a deductible business expense.**

### MNR v Eldridge

**Facts:** Eldridge, proprietor of call girl operation in Vancouver was fighting her income tax assessment for the profits of her call-girl operation. Argued that govt shouldn’t be able to take part in the avails of prostitution. Argued if gov could, she should be able to deduct expenses.

**Issue:** can illegal businesses deduct expenses? (including legal expenses for defending her whores)

**Reasoning:** yes. Because the expenses were arising incidentally to the business’s activities. There is no public policy element in restricting the deductions of an illegal business. You apply the same principles that you would to other businesses.

* Rent tax deductible if proven and NOT PERSONAL
* Legal fees for representing employees in legal proceedings= tax deductible
* Telephone inspections for wire-taps couldn’t be proven so no
* Assistants to the girls (to encourage payment)= tax deductible
* Protection fees to police department= not deductible because no receipts (**note now bribes are not tax deductible)**

**Ratio: Income from illegal activities is income from business and taxable. Following this,expenses of illegal businesses are tax deductible.**

**Also, an employer can deduct legal expenses to defend an employee (criminal offence committed by employee in operatiosn of employer’s business)**

### The Queen v Bronfman

**Facts:** beneficiary of trust wanted $ from trust. At this time the trust’s assets were depreciated in value. Trustees did not want to sell investments to pay her the entitlement under the trust. So they borrowed money from the bank and paid the borrowed $ to Beneficiary. Trustees claimed a deduction on the interest of money borrowed because they took out the loan in order to preserve the trust’s investments, which produce income.

**Issue:** is this interest deductible?

**Reasoning:** No. The purpose for borrowing the $ and the use was to pay out the beneficiary. Borrowed money was not directly used to earn income. **Ratio: in order for interest to be a deductible expense, the borrowed money has to be used for the purpose of earning income from business or property. To asses this, courts will trace the use of the borrowed funds to see if they are being used for earning income. Look to current use not what they were originally taking it for.**

### Singleton v The Queen

**Facts:** partner in law firm took money from the firm and used this money to buy a house. Then went to bank and borrowed money to repay the partnership took mortgage on his house, put the $ into the partnership. Said his mortgage interest was tax deductible.

**Issue:** was the mortgage interest tax deductible?

**Reasoning:** Yes. The use of the borrowed funds was for the business/productive use…it was put into the law firm.

* It was an error to treat what he did as 1 transaction. The transaction should be viewed independently
* Court did not find that this was a sham
* Respondent does not have to demonstrate a bona fide purpose

**Ratio: in order for interest to be a deductible expense, the borrowed money has to be used for the purpose of earning income from business or property. To asses this, courts will trace the use of the borrowed funds to see if they are being used for earning income. If a direct link is shown between borrowed money and eligible use, it meets the test and is tax deductible. (Looks to form not substance EVEN IF decision is TAX MOTIVATED)**

## CH 6- COMPUTATION OF PROFIT AD TIMING PRINCIPLES FOR RECOGNITION OF REVENUE AND EXPENSES

### Canderel v The Queen

**Fact:** Landlord was trying to attract tenants into his building. In order to attract them to take leases, he offered a deal by giving prospective tenants a rent-free period at beginning of lease or pay their moving expenses or give them cash to move in: **tenant inducement payment.** He paid “tips” to induce tenants to move into his building.

Ex: C says Tony ill give u 100 000 to be our tenant and sign a 10 year lease. What does C do with this expenditure for tax purposes? (in accounting you would spread the 100 000 so there’s 10 000 paid each year)

**Issue:** when does C deduct the TIP inducement?

**Reasoning:** The full inducement amount is **fully** deductible in the current year **incurred**. Matching not required. But you have the choice. Profit = question of law **ita s 9**

**Ratio: There is no matching principle for tax purposes unless a specific provision in the act says so [18 (9)]. You can deduct the full amount in the year the expense was incurred, but you don’t have to. You can defer it as you please as long as you follow GAAP principles. Has to be consistent year to year.**

**What is the situation for the tenant receiving the “TIP”? do you have to correspond with the landlord?**

**Section 12 1 x**:tenants must report TIP and other inducements must be recorded as income in the current year

## Chapter 10: Dispute Resolution, Statutory Interpretation and Tax Avoidance

### *Jarvis*

**Facts:** CRA investigating man’s report of income, started off a civil investigation but at a certain point decided to make the investigation a criminal one. They did not inform Jarvis that he was being investigated criminally, however they got a warrant to get evidence from him and have access to his stuff. When he was charged he said the evidence was taken in violation of his charter rights.

**Reasoning:** Court found that **any information found when CRA is undergoing civil investigation is usable in court**, but when the purpose **becomes a criminal investigation** **Charter rights apply** and the person needs to be informed of charter rights or warrant must be got to investigate. To determine this, court looks into whether the investigative authority was acting in such a way that insinuated a criminal investigation. The **information taken before the investigation became criminal was admissi**ble and so was the rest cause of the warrant. However he was eventually acquitted because of a lack of *mens rea* which is required for tax evasion.

\*note that he would still likely have to pay the taxes and might face civil penalties.

**Ratio: When the predominant purpose of the investigation becomes to charge a person criminally with tax evasion (criminal investigation), the taxpayer is entitled to *Charter* rights. However, information gathered during the audit process before the purpose becomes criminal can be used in tax court to prosecute a person for tax evasion.**

### *Cohen*

**Facts:** Gov't agreed to a settlement with Cohen not to appeal assessments made from 1961-1964 as long as profit from the sale of a property for 1965 was treated as a ½-taxable capital gain**.** Gov't then reneged on the agreement, saying it was not bound by any compromise settlement

**Issue:** Is the government bound by past agreements made with taxpayers during settlement negotiations?

**Reasoning:** No, …settlement doesn't bind MNR

**-** Following *Galway*: "the Minister has **a statutory duty to assess the amount of tax payable on the facts as he finds them in accordance with the law as he understands it**. It follows that he cannot assess for some amount designedto implement a compromise settlement"

- Therefore, “split the difference” settlements are not binding on the CRA

**Ratio: An settlemebt whereby the Minister would assess income tax otherwise in accordance with the law is an illegal agreement and is therefore not binding**