**Law 220: TAX I, *Michael Taylor***

**Spring 2014**

* Taxes implement policy
* Tax law is public law
* Progressive tax sys in Canada
* Raise revenue for gov, alleviate income disparity, deliver benefits, encourage econ behaviour, allocation of resources in the free market, tickling Adam Smith’s invisible hand ….
* This is a stat based course- always start with stat

**Introduction to Tax Law**

**Why Do We Have Taxes?**

* Historically/relatively, income tax is a recent phenomenon
* Great success as revenue raiser for govs (fed and prov)
* Income tax is now the primary revenue source
* What is a tax? What is the diff btwn GST and car registration fee for eg?
* **Constitution Act gives both orders of gov authority to levy taxes**
	+ **S.91(3)- fed gov; any mode of taxation**
	+ **S.92(2)- prov gov; direct taxation**
* Both govs have authority to charge various other fees
* If a charge is a tax, it must fall under const authority of that order of gov
* **Constitution Act imposes procedural reqs for imposing a tax**
	+ **S.53- any bill for taxation must originate from House of Commons**
		- No taxation w/out representation (unless you're in Washington DC)
	+ **S.90 makes s.53 applicable to prov gov**

**What is a Tax?**

***Eurig Estate, 1998, SCC* 🡪 Focus on TEST for what is a TAX:**

* + 1. **Enforceable by law**
		2. **Imposed under legis authority**
		3. **Levied by public body**
		4. **Collected for a public purpose**
* **Facts**:
	+ Probate of an estate: When a person dies w/ will, it appoints an executor. Prov law allows executor to take will to court and get grant of probate, which means court has reviewed will and satisfied that it is valid, which can then be used as proof of executor’s authority to carry out executor functions.
	+ Mr E died and Mrs E was executor and applied for letters probate (ie grant of probate)
	+ Ontario charged fee to get this letter- a % of value of assets of deceased
		- Fee was imposed by regulations
	+ Prov stat authorized prov cabinet to make regulations requiring ppl using court sys to pay fees for that use
	+ Mrs E: declaration for fee is unconst b/c
		1. It imposes an indirect tax and prov only has const authority to impose direct tax
		2. b/c this fee is imposed by regulations passed by cabinet instead of legis stat, it fails req that bill imposing tax be introduced in legislature
* **Issues before SCC:**
	1. Is this fee a tax? If no, no const restrictions.
	2. If tax, then is it indirect or direct?
	3. If direct tax, was it enacted by legislature as req by s.90 of const or not?
* **Analysis:**
	+ ***Issue #1***—**TEST for what is a tax- it must be:**
		1. **Enforceable by law**
		2. **Imposed under legis authority**
		3. **Levied by public body**
		4. **Collected for a public purpose**
	+ Application of the test to the probate fee:
		- It is compulsory ✓
		- Fee is levied by public body, i.e. court ✓
		- Fee is levied for public purpose ✓
			* Probate fees don’t *incidentally* provide revenue for general revenue, but are for that *very* purpose.
			* Amount of probate fee wasn’t set with an eye to administering costs (i.e. like a user fee) but to pay for the court sys generally- which is the essence of the tax sys; gov collects tax for everything generally.
		- [21] distinguishing fee from tax- another factor to be considered is nexus btwn amount of charge and cost of service provided. That connection isn’t here, so this charge is a tax, and not a user fee.
	+ ***Issue #2—***Diff btwn direct and indirect tax is murky- MT isn’t even sure himself
		- Here, fee is direct tax so it is const intra vires prov gov
	+ ***Issue #3***—enacting of fees was passed to Cabinet
		- If legis had said we authorize imposing tax on people and we delegate what the tax would be to the cabinet, that would be ok. But here the stat lang says, the Cabinet can impose ‘fees’ but SCC has decided this fee is actually a tax so the legis doesn’t have the authority to delegate the imposition of it to something that isn’t the legis, i.e. the cabinet.
* **Held**: Probate fee is a direct tax and is imposed by Cabinet, which doesn’t have the authority to do so, so it is ultra vires and struck down.
* ***Dissent***: s.53 doesn’t make sense applied to prov where there isn’t an unelected senate at play.

**Why an Income Tax?**

* Income tax is preferred way to raise gov revenue b/c it relates to the role of gov in the modern market econ
* Gov functions
	+ Allocation Function
	+ Distribution Function
		- Distributing income in market econ which otherwise leads to unequal income distribution
		- Empirical research shows the more market operates w/out gov intervention, the more unequal income distribution becomes and the more ossified it becomes.
			* Linked to many social ills
	+ Stabilization Function
		- Make sure gov doesn’t grow too fast (inflation) or too slow
		- Income tax is built in stabilizer
* Social and poli ideas of fairness
	+ Most fair way to spread cost of paying for gov and public services is based on ppl’s ability to pay and income is the best way of measuring how much ppl can pay and bear their share
* There are tons of other types of taxes

**Tax Policy and the Structure of the Income Tax Act**

**JURISDICTION TO TAX**

* On what basis does a state assert its jurisdiction to tax?
* **Most tax is levied on two bases:**
	+ **Connection of the person – residence, domicile, nationality, citizenship, etc.**
	+ **Connection of the income – source**
* Both bases of jurisdiction derive from the **principle of territoriality**
* Taxation is basically an enforced confiscation of a share of your property for the common good
* If you choose as state to base your tax sys on property (source basis) as opposed to persons, you can't tax it if that property leaves the territory of your state
* **Canada bases its jurisdiction to tax on residence and source**
	+ Residence connotes a sufficient degree of connection to the state that the taxpayer should contribute to the costs of operating it
		- Residence is different from citizenship or nationality
	+ Factual connections btwn the resident and the country
	+ Source is based on a state’s right to tax income earned in its territory
* **Canada taxes residents and non-residents**
	+ Canada taxes residents
		- Usually residents are liable to tax on all income wherever in the world it is earned
		- There is law around what it means to be a resident of Canada and hence liable for income tax
	+ Canada also taxes non-residents
		- Non-residents are liable to tax on certain items of income from Canadian sources
* Problem of int’l tax: ppl getting double taxed
	+ Solution: huge network of tax treaties

**CRITERIA OF A GOOD TAX SYSTEM**

**Four features of a “good” tax system are equity, neutrality, simplicity, & efficiency.**

**1. Equity**

* ***Horizontal equity***: equal treatment as between similarly situated taxpayers
* ***Vertical equity***: different treatment of differently situated taxpayers
	+ Those with more capacity to pay should pay more
	+ Essence of progressive tax sys
* General tenet of the law
* MT- horizontal equity is prob the most important thing you want in a tax sys b/c tax sys depend on taxpayer’s compliance and willingness to comply
	+ We don’t have enough gov workers to go out and collect taxes. That sys seems a tad inefficient.

**2. Neutrality**

* Tax should not unduly influence economic decision-making for ppl
* Tax shouldn’t be an interference with your econ decision making
* Unless the governments wants it to do so
* If we assume that free market provides most efficient allocation of resources and income, then you don’t want to have a tax sys that changes the way ppl would behave in a free market
* Econ most efficient thing may not be the best option (environ, social reasons) so you could use tax to not do that as the gov

**3. Simplicity**

* Is a 2,000 page Act simple?
* Our economy is very complicated and sophisticated and the tax sys is made more complex to deal with that.
* The simpler it is, the more easily it is understood by ppl who are then more likely to think it legitimate

**4. Efficiency**

* Smooth functioning, willing compliance
* Econ POV: an efficient tax sys would take min amount of resources to operate the sys and tax sys would drain min amount of money from economy

**STRUCTURE OF THE TAX SYSTEM**

**A tax system has 5 basic elements:**

* **Tax unit (who pays)**
* **Tax base (what is taxed)**
* **Accounting period (when is the tax levied)**
* **Tax rate (how much tax is charged)**
* **Credits/exemptions (special reductions)**

**TAX UNIT**

* **Possible tax units:**
	+ Individual🡪 basic unit of taxation
	+ Married couple
	+ Family
	+ Non-related economic dependents
	+ Corporations, trusts and estates are also liable to tax
* Choice of tax unit reflects value judgments
	+ Eg How to ensure equitable treatment as between tax units in similar economic circumstances but with different family situations?
	+ Eg 2006 Harper gov rule that retired ppl could pool pension income together and split it btwn them
* Which tax unit to choose depends on philosophical values- what is the family? Who should be taxed?
* **Two schools of thought:**
	+ **Benefit Principle**
		- Tax should be paid by someone who benefits from income, regardless of whether they earn it
	+ **Entitle or Control Principle**
		- Tax should be paid by someone who has control over income, regardless of whether they benefit from it
* **Economist Theory**
	+ Cost of living for married ppl is less than cost of living for two single ppl added together
	+ So the married unit has more capacity to pay
* Incentive for married person to move income from high to low income partner to pay lower taxes on a lower income
* So we can have incentives and embedded in them values and philosophical beliefs

**Structure of *ITA*- Tax Unit**

* **s. 2(1): “every person resident in Canada” must pay tax**
	+ Every person resident in Canada at any time in the year shall pay income tax.
	+ On the taxable income for each taxation year of residence
* **s. 2(3): persons not resident in Canada must pay tax as well**
	+ if the person was employed in Canada, carried on a business in Canada, OR disposed of a taxable Canadian property.
* **The tax unit is a “person”**
	+ **Basic tax unit in Canada is individual [person] + corporation [person but not individual] s.248**
	+ What is a “person”?
	+ Def- s.248(1), p.1662: inc corporations;
		- Extended def- extends ordinary meaning of a word; uses “includes”
		- =/= Exhaustive def- says “means”; narrowly defines it.
	+ Def-s.248(1), p.1657
		- Individual- means a person other than a corporation
	+ If we don’t have a definition, we go to the dictionary (~ individual human being) and consult case law
	+ S.2(1) editorial note
	+ Corporations are taxable b/c they are inc in “persons” (but not individuals)
	+ Family status is relevant to your liability for tax
* **What does it mean to be “resident in Canada”? No definition of resident in s. 248(1)**
	+ s. 250 has rules relating to residence
	+ s. 250(1) has rules deeming certain persons to be resident when they would not otherwise be
		- **s.250(1)(a) is key: person is DEEMED resident in Canada if he sojourned in Canada in the yr for a period of, or periods the total of which is, 183 days or more.**
		- Again, not defined in the Act
			* Sojourning has permanence, it is not temporary. Means staying, more than being a tourist and less than permanent.
	+ s. 250(3) has an inclusive definition- reference to a person resident in Canada inc a person who was at relevant time resident
		- MT doesn’t know what it’s called and it’s tautological
		- SCC has looked at dictionary def of resident- matter of how settled the person is to a juris
			* **EXAM**- he won’t question you on whether someone is resident. Just remember 183 sojourn rule.
* **What is “ordinarily resident”? Not defined in s. 248(1).**
	+ “The degree to which a person in mind or fact settles into or maintains or centralizes his ordinary mode of living with its accessories in social relations, interests and conveniences at or in the place in question” (***Thomson*, 1948, SCC**)
* **When is a corporation resident in Canada?**
	+ **s. 250(4)(a): a corporation is deemed to be resident in Canada if it was incorporated in Canada after April 26, 1965, OR**
	+ **Under s. 250(4)(b) and (c), corporations that do not meet s. 250(4)(a), can still be resident in Canada**
		- The sections set out conditions
		- The sections refer to these corporations being resident in Canada anyway
	+ **Common-law test of corporate residency: central management and control**
		- SCC has said where the board of directors meet and do the work of the board and make decisions is shorthand for residency. The directors could be anywhere in the world so Canada’s concerns is that they could locate offshore to say it isn’t liable for tax so we have deeming rule that says you are resident if you incorporate here you are liable regardless of where your board meets.
	+ The whole point of deeming rules is to catch entities not considered to be residents

**TAX BASE**

* What does the tax apply to?
* **In an income tax, the tax base is “income”- money coming in**
	+ You pay it when money comes in regardless of what you do w/ it
* Other taxes have different tax bases:
	+ A consumption tax- money is going out
		- You're being taxed in respect to spending money.
	+ A wealth or inheritance tax
	+ A corporate capital tax
* **Policy concerns** in determining what the tax base is
	+ Administrative issues
		- e.g., can’t value property every year
	+ Cash flow/liquidity issues
		- How to pay tax if the taxpayer lacks cash flow
	+ Philosophical issues
		- Imagine a tax on the value of domestic services

**Structure of *ITA*- Tax Base**

* **s. 2(1) – tax is payable on “taxable income”**
	+ Taxable income is the tax base
		- What is “taxable income”?
			* **s. 248(1): taxable income has the meaning assigned by s. 2(2)**
	+ s. 2(3) – non-residents pay tax on “taxable income earned in Canada”
* **s. 2(2) says taxable income is a person’s “income” for the year plus additions and minus deductions permitted by Division C**
	+ “Income” is not defined in the Act
* s. 2(2) refers to a **“taxpayer”**
	+ s. 248(1): a “taxpayer” includes any person whether or not liable to pay tax
	+ All persons are taxpayers!

**s. 3 -how to determine a taxpayer’s income for a taxation year- formula has 4 rules**

**\*\*\*\*\*\*\*\*3(a)+(b)-(c)-(d)\*\*\*\*\*\*\*\*\***

**Add:**

**income from each source (s.3(a))** [office, employment, business, property] [non-competition payments not subj to ss.5,6 (s.56.4)]

**+**

**net taxable capital gains (s.3(b))** [capital gains - capital losses]

**Subtract:**

**deductions allowed by subdivision e (of Division B) (s.3(c))**

**+**

**losses from each source (s.3(d))** [office, employment, business, property] **plus ABILs**

End up w/ positive amount? That is income (s.3(e))!

End up w/ negative amount? Then no income (s.3(f))! Can’t be zero!

* **s. 3(a) refers to income from each “source”**
	+ The **source theory** is extremely important in Canadian taxation
	+ Constantly need to characterize income receipts by source
	+ Also need to relate expenditures and other deductions to a source
	+ No source, no income!
* It is not clear whether there are other sources of income 🡪 s. 3(a) implies that there are
	+ ***Schwartz, SCC*** suggested there are, but no case since has picked up on it and vigorous dissent denied possibility of it
	+ **248(1) def business ‘undertaking of any kind whatever’ is so broad that you’ll not need to argue new source under s.3 (*Johnson*)**
* Traditionally, capital and income were viewed as separate
	+ Gains on capital were not regarded as “income”
	+ Capital gains were first taxed in 1972
	+ Only 50% of a capital gain is included in income (taxable capital gain)
	+ Only 50% of a capital loss is deductible (allowable capital losses)
	+ Capital losses are deductible only from capital gains
* **Income and losses from some sources can offset each other**
	+ i.e., business loss may be deducted against employment income
	+ The one exception is that capital losses may only be deducted from capital gains
		- Some specific capital losses can only be deducted against other particular capital gains (listed personal property)
		- Some specific capital losses can be used against other income (allowable business investment losses)
* **s. 4(1) requires us to compute the income from each source as if that is the taxpayer’s only source**
	+ Each source of income is treated as being self-contained
* ***ITA* allows four types of deductions from income:**
	+ Costs of earning income
	+ Losses from other sources of income
	+ Adjustments to recognize basic living costs and personal circumstances
	+ Incentives to engage in particular behaviours (savings, investments, charitable donations, etc.)

**ACCOUNTING PERIOD**

* Most tax systems use a yearly accounting period
* Affects taxpayers differently depending on when their income is earned
	+ More in some years, less in others
	+ Or straddling the year end
* Also creates compliance costs due to annual filing
* Incentive to defer receipts or accelerate deductions

**Structure of *ITA*- Time Period**

* What is a **“taxation year”**?
	+ **Defined in s. 249; A taxation year is:**
		- **Individual- calendar year [jan 1-dec 31]**
		- **Corporation- fiscal period [accounts of biz made up; 53 weeks; biz can choose] 249.1(1)**
* “Fiscal period” is defined in s. 249.1(1)
	+ A fiscal period is the period for which the accounts of a business are made up
		- This means the period for which financial statements are made
		- A business may choose its fiscal period
		- The fiscal period may not be longer than 53 weeks
* **NOTE: A business is not a taxpayer!**
* A business is carried on by a taxpayer (individual or corporation)
	+ An individual must have a calendar taxation year even if the individual operates a business
* **Some provisions of the Act allow “averaging” over longer periods**
	+ Basic policy question
	+ And addressed to some extent in the ITA, s.111(1)(a)+(b), which is in Div C, which means it is part of the calculation of taxable income, not in the calculation of income.
* **Losses that are not usable in a year because they would create negative income can be moved around.**
	+ Losses from office, employment, business or property in one year can be “carried forward” 20 years or “carried back” 3 years
	+ Capital losses can be “carried forward” indefinitely or “carried back” 3 years

**TAX RATE**

* The main question is rate structure: progressive vs. single rate
	+ Progressive rates increase as income level increases
	+ Single/flat rate remains the same
* This is a political/philosophical question about what is fair
* Does fairness require those who earn more to pay more?
	+ Does “more” mean a greater proportion of income or just more $ overall?
	+ Higher income-earners still pay more under a single-rate system

**Structure of *ITA*- Tax Rates**

* For income, 100% of income is taxable. For capital gains, 50% is taxable.
	+ If you make money, you want it to be capital gains so only half is taxable. If you lose money, you want it to be income b/c all of it can be deductible.
* **The applicable tax rates are set out in s. 117(2) (Division E)**
	+ The rates are progressive
		- 15% on income up to $43,561 (in 2013)
		- 22% on income from $43,562 to $87,123
		- 26% on income from $87,124 to $135,054
		- 29% on income above $135,054
* Under s. 117.1, the tax brackets are indexed to inflation
* Income is taxed in stages according to the bracket in which it falls.
* Provincial income tax is levied on top of federal income tax
	+ Provincial income taxes are levied by provincial legislation
	+ Some provinces have a surtax (a tax on the tax)

**Other Elements: EXEMPTIONS & CREDITS**

* Exemptions and Credits are two categories not essential for a tax system but are political decisions made to exempt or credit some things for tax payers
* The type of expenditure, the purpose of the expenditure, the type pf taxpayer, etc can be bases for these
* **From policy perspective, you must ask:**
	+ How to structure tax breaks and exemptions?
		- Deduction reduces income before tax is payable – value of deduction depends on income level and tax rate
		- Tax credit reduces tax payable dollar for dollar (worth the same to everyone)
		- Exemption means income not taxable – again value depends on marginal tax rate
* **How does a tax deduction work?**
	+ (Income) – (Deduction) = Taxable Income
	+ (Taxable income) x (tax rate) = Tax payable
	+ 🡪 Value of the deduction = (deduction) x (tax rate)
		- So the higher your tax rate, the more valuable the deduction is going to be for you, who are otherwise in a higher tax bracket.
			* Equity issue then. The poorer tax payer is at a disadvantage.
	+ This is a tax expenditure- spending money by gov through the tax sys instead of handing it out
* **How does a tax credit work?**
	+ (Taxable income) x (tax rate) = (Tax payable)
	+ (Tax payable) – (tax credit) = balance payable
	+ 🡪 Value of the tax credit is a constant $ value no matter what the tax rate or income level
		- Unless the tax credit is nonrefundable and the taxpayer’s tax payable is $0
* The very existence of a tax credit reduces equity b/c it brings in consideration of some other factor to distinguish how much two ppl with same income will pay in taxes

**Structure of *ITA*- Tax Credits**

* Most tax credits are found in sections 118 to 127.41
	+ Most are for personal costs borne by individuals
	+ Some are for corporations
* There are also a variety of deductions
* Most tax credits are calculated as a set amount multiplied by a particular tax rate
	+ i.e., basic personal exemption is $11,038 x 15% = $1,655 tax credit
* If a taxpayer is in a higher tax bracket, then a deduction would be worth more than a credit calculated at 15%
	+ Creates an issue of equity
* Most tax credits are non-refundable
	+ Non-refundable tax credits cannot create a refund
		- If the taxpayer’s tax is too low, will not benefit from the credit (unless it can be carried over)
	+ There are a few refundable tax credits
		- Refundable tax credits means the taxpayer gets the refund whether or not there is tax payable to credit against

**STATUTORY INTERPRETATION**

* Income tax law all derives from a statute
* It is repeatedly necessary to interpret the statutory language

**Interpretive Considerations**

**Dreider’s Modern approach to stat interpretation endorsed by SCC:**

* **The words of a statute are to be read in their entire context and in their grammatical sense harmoniously with the scheme of the statute, the object of the statute and the intention of Parliament**

5+1 things to consider:

* words, context, scheme of the stat, object of the stat, intentions of legis; and conseqs of alternative interpretations

**Words**

* Words have multiple meanings and their meaning in any case depends on their context and other words
* All rules are expressed in words
* Most words have multiple shades of meaning depending on the context
* We need to identify the right meanings

**Context**

* Words are to be read in their entire context and in their grammatical and ordinary sense
* Look at syntax of the text; look at anything which gives texts meaning other than the words
* Internal context (four corners of the Act) vs external context (lang, legal/social values, etc)
* Immediate context vs broader context of whole stat
* Canons of immediate context
	+ Associated word rule: meaning of words which perform parallel function and are associated with conjunctives ‘and’ and ‘or’ are influenced by each other
		- Eg scholarships, fellowships, or bursaries. Bursaries are going to be like the other two.
	+ Limited class rule: meaning of general word in list enumerating members of class is limited to narrowed genus suggested by that enumerated list.

**Stat Scheme**

* Meaning of provisions affected by their relationship w/ other provisions and structural components of the broader context of the stat scheme
* Closely linked to objects or purposes of the Act
* “Scheme” implies that the statute displays an internal organization
	+ Assume that each particular provision fits in the puzzle
* Courts use certain rules
	+ Some of these interpretive rules are inconsistent with parl supremacy
* Four principles of construction result:
	+ Presumption against tautology or absurdity- every word in stat is there for a reason.
	+ Presumption of consistent expression- if the same word appears multiple places, it means the same; the use of diff word means you have choice.
	+ Presumption of coherent structure
		- Eg If you could deduct child care expenses as part of cost of doing business, then the part about deducting child care wouldn’t make sense and we can’t interpret it that way.
	+ Principle of implied exclusion- If it says A, B and C then D is not included because it’s ugly. If they had wanted to let D play, then would have said so.

**Stat Purposes**

* Fulfil their poli and social purposes
* Often multiple objs
* Courts can either use preambles/Act’s own purposes section/extrinsic evi like commission reports OR when these sources are absent use the Act itself, its scheme, context and context in which it was drafted and enacted to get at stat obj
* It is very difficult to identify “the purpose” of the *Income Tax Act*
* The *Income Tax Act* serves many purposes

**Legislative Intent**

* Hard to est
* Use of *Interpretation Act*
* Use of statements made by those drafting and passing legis, legis history.
* Highly unreliable to assume legis inaction suggests legis agrees w/ that interpretation
* Based on broader social and legal norms and values
* We can't ask parl and there is an assumption that they wanted to do anything anyway

**Consequences**

* If interpretation seems absurd, unreasonable or unjust
* Alternative consequences
	+ Which interpretation has more reasonable consequences?
		- Avoid an interpretation that results in absurdity, unfairness, unreasonableness
	+ The preferred outcome can assist in selecting among competing interpretations
		- An undesirable outcome cannot override clear statutory wording
* Relied on quite commonly
* Maybe parl didn’t think the result would be bad, but we cannot override a clear interpretation
	+ We can only use this when there are competing reasonable interpretations

**Interpretive Doctrines**

* **Strict Interpretation**: literal meaning of words; resolution of ambiguities in deductions or exemptions and in taxing provisions in favour of tax payer
	+ Used to be dominant approach
	+ Taxation is the rule and exemptions are the exceptions so they should be noted expressly and interpreted strictly
	+ Eg ***MNR v. McInnes***
* **Modern Rule**: words in their entire context in grammatical and ordinary sense as well as stat scheme, stat purposes, and legis intent
	+ Eg ***Will Kare Paving***
		- Issue: can Will Kare claim both a investment tax credit and a capital loss allowance?
		- Analysis: It depends on stat interpretations of relevant provisions.

***Century Services Inc v. Canada, 2010, SCC***

**F**: *Company Creditors Arrangement Act* and *Bankruptcy and Insolvency Act* at issue.

* CCAA is like getting a stay of bankruptcy to have time to work things out with creditors and not have trustee liquidate everything upon bankruptcy.
	+ CCAA says there are no deemed trusts under its proceedings
* Keep track of secured vs unsecured creditors

*Excise Tax Act*

* If you offer goods and services, you must charge GST and it becomes a deemed trust, i.e. it holds that money in a trust for the gov. The deemed trust rule makes the gov a secured creditor.
* That deemed trust operates notwithstanding any other enactment EXCEPT the *BIA*
* So the gov has incentive not to have company go bankrupt so the gov doesn’t lose secured creditor status.
* CCAA has creditor protection measures

Ted LeRoy Trucking Ltd was in bad financial shape and facing bankruptcy. It promptly filed for protection under the CCAA. The court authorized LeRoy to dispose of certain redundant assets. They have a chunk of GST money which is in deemed trust.

Century Services Inc was one of the major secured creditors of LeRoy. In April 2008, the court authorized a payment to Century not to exceed $5 million from the proceeds of disposal. As LeRoy also owed a significant liability with respect to Goods and Services Tax, it proposed that an amount equal to the liability be held back from the payment to Century and kept in the Monitor's trust account until the outcome of the reorganization was known. The court agreed and so ordered.

In September 2008, LeRoy concluded that reorganization was not possible, and accordingly applied for an assignment into bankruptcy. The Crown applied to have the holdback released for payment and remitted to settled the GST liability. Gov wants to get their GST back before they lose secured creditor status when LeRoy goes bankrupt.

**I**: Did the ETA displace the CCAA by giving priority to the Crown's deemed trust in CCAA proceedings?

Did the court exceed its authority under the CCAA by lifting the stay to allow the debtor to make an assignment into bankruptcy?

Did the court's April 2008 order create an express trust in favour of the Crown with respect to the GST holdback?

**D**/**R**: Holdings-

* the CCAA and BIA form an interrelated insolvency scheme for Canada, and the ETA is subordinate to that scheme
* the court of first instance has wide discretionary authority under the CCAA, which must be interpreted having regard to the remedial nature of the CCAA and insolvency legislation generally
* no express trust was created by the court's order

**Purpose and scope of insolvency law:**

* As this was the first time a case relating to the CCAA had been heard by the Supreme Court - which it acknowledged in its decision - a detailed analysis was given in explaining the nature of insolvency law in Canada.
* The BIA provides a more rules-based approach for resolving a corporate debtor's insolvency, which must be observed strictly. The CCAA, on the other hand, provides a more discretionary approach that is remedial in nature, which therefore must be broadly construed.
* Although the CCAA was originally enacted in 1933, extensive use of it only began in the economic downturn of the early 1980s. Recent legislative amendments of the BIA and CCAA have served to harmonize key aspects, such as the use of single proceedings, a common priority of claims structure, and encouraging reorganization over liquidation.

**GST deemed trust under the CCAA:**

* The Parliament of Canada's recent legislative activity has tended to favour the diminishing of the Crown's priority in BIA and CCAA proceedings, and both have been expressly amended accordingly. As the ETA does not contain such express language on the subject, it must be construed within the framework of the insolvency statutes.
* **Later in time principle**
	+ Excise Tax Act enacted after CCAA, and if we assume parl knew about CCAA and then saying ‘notwithstanding’ any other act in Excise Tax Act, then parl is implicitly repealing the prev act, i.e. implying that the prior stat shouldn’t apply anymore.
* **Specific exception provision vs. general rule**
	+ Principle of Implied Exclusion- this implied that if they wanted Excise Act not to apply to CCAA they would have mentioned that. It names BIA but doesn’t name CCAA.
* **The CCAA and BIA must not be viewed in isolation, as they have many features that form part of a harmonized structure**. Therefore, forum shopping is discouraged and single proceedings are preferred. Because of their harmonized nature, other federal statutes must be accordingly construed.
* A court must first interpret the text of the CCAA, and only then may the court look to fill in legislative “gaps” pursuant to its inherent or equitable jurisdiction. In exercising CCAA authority, the court is to bear in mind the requirements of appropriateness, good faith and due diligence as baseline considerations. As to appropriateness, the court is to inquire whether the order sought advances the public policy objectives of the CCAA – avoiding the social and economic losses resulting from a liquidation.
* Ottawa Senators case doesn’t apply b/c it didn’t deal with CCAA and it’s overturned.
* Hist shows parl is reducing protections for gov and treating more and more like any other creditor
* **Where it wants to keep the protection and security for gov, parl does so in the Act**
	+ Another section says another deemed trust for gov (employee paycheque tax redemption) is protected from both BIA and CCAA
	+ So they chose not to protect the GST deemed trust under CCAA then since they didn’t name it
	+ **🡪 turning principle of implied exclusion on its head and using it the other way**
* Although CCAA protects that other gov trust, act says there are restrictions on what court can do so they get less protection than a deemed trust without any restrictions under the Excise Act
* Alternative conseqs argument: the Crown will not want someone to go bankrupt so they didn’t lose their protection and this will only encourage stat shopping
* Parl intent: after enacting Excise Tax Act, parl has amended CCAA and so had the chance to resolve this conflict but they have not done so. The amendments make CCAA the most recent stat.
	+ Turning ‘later in time’ on its head again

***Dissent***

* There is a protection for the Crown’s trust.
* They use the same principles.
* **Both the majority and the dissent relied on the following considerations to reach correct interpretation of irreconcilable stat provisions:**
	+ Doctrine of implied repeal
	+ Principle of implied exclusion
	+ Internal statutory context
	+ Consequences of alternative interpretations
	+ Purpose of the statutory regime
	+ Legislative intent
	+ Subsequent amendments

**ADMINISTRATION, ENFORCEMENT, & APPEALS**

**The Minister’s Authority and Duty**

* s. 220(1) – the “Minister” shall administer and enforce the Act
	+ “Shall” means the Minister must
	+ s. 248(1) – the “Minister” is the Minister of National Revenue
* s. 220(1) – the Commissioner of the Canada Revenue Agency (CRA) *may* exercise the Minister’s powers
	+ s. 220(2) & (2.01) – the Minister may hire employees and may delegate his powers

**Filing Tax Returns**

* **s. 150(1) – every taxpayer must file an income tax return for each taxation yr**
	+ The form of return is “prescribed” (set out in Regulations)
	+ The return must be filed (i.e., mandatory)
	+ The return must be filed with the Minister
		- Eg Do NOT post your tax return on your blog. Again.
	+ The return is due without notice or demand
* **s. 150(1)(d) – An individual tax return is due:**
	+ **April 30 of the following year [default rule], or**
		- **248(1) Balance Due Day is April 30 of next yr**
	+ **June 15 if the individual or his/her spouse carried on business**
* **s. 150(1)(b) – If an individual dies, the return is due:**
	+ April 30 of the next year (before October death), or 6 months after the date of death (after October death), whichever is later
	+ Exception to the general rule- individuals who die after October
		- If you die before October then you are just ‘any other person’ and subj to general rule
* **s. 150(1)(a) – A corporation’s tax return is due 6 months after the end of the taxation year**
* s. 150(1)(c) – An estate’s or trust’s return is due 90 days after the end of the taxation year
* **s. 150(1.1) – An individual does not have to file a return if:**
	+ no tax is payable for the year, and
	+ the individual did not have a taxable capital gain or dispose of capital property
	+ There are administrative reasons to file a return even if it is not mandatory
* **What does the tax return have to say?**
	+ s. 151 – each taxpayer must estimate the tax payable for the year in the return
* The onus is on each taxpayer to file the return and report the tax payable 🡪**“self-assessing system”**
* s. 150(2) – **if a taxpayer does not file**, the CRA may **demand a return**
	+ On demand, a return must be filed even if no tax is payable
	+ CRA can set a deadline to comply
	+ Failure to comply is an offence

**Assessment of Tax**

* **s. 152(1) – the Minister is required to examine the return and assess the tax, interest and penalties payable**
	+ An “assessment” is the Minister’s determination of how much tax is payable
	+ Every taxpayer’s tax payable must be assessed for every year
	+ If no tax is payable, the Minister sends a notification that tax payable is zero
		- This is NOT an assessment b/c there is no amount.
* **Under the Act, the Minister may force the taxpayer to pay only amounts that have been assessed**
	+ A tax payer is not req to pay an amount until it is assessed and it is only the assessed amount the CRA can collect from the tax payer.
	+ If you legally owe the money but you haven’t gotten assessment, you still owe it and can be paying interest on it, but they can’t come and get it from you until that assessment is filed.
* When you file your tax return, you do two things:
	+ Report everything and fill in the lines- your ‘tax payable’
	+ Then subtract the tax deducted for amounts you’ve already paid throughout the year
	+ 🡪 results in Balance Due
	+ For Income Tax Act purposes, the magic number we’re interested in tax payable.
* **s. 152(1.1) – The Minister cannot “assess” losses**
	+ The Minister can only assess positive amounts
	+ **If a taxpayer has losses, the Minister may “determine” those losses**
	+ A determination of losses gives a taxpayer a **right to appeal the amount of losses**
* **s. 152(2) – The Minister must send a notice of assessment to each taxpayer**
	+ The notice of assessment is notice to the taxpayer – it is NOT the assessment
	+ The assessment is the Minister’s decision/determination after the assessing process
* **s. 152(3) – Liability for tax is not affected by the making of an assessment**, or failure to make an assessment
	+ Liability arises from the Act, not from an assessment
		- i.e. a taxpayer is liable for a tax, even if the Minister has not assessed that tax
	+ The Minister could change her mind and re-assess for more
* **s. 152(7) – In assessing tax, the Minister is not bound by what the taxpayer reports** (in return, in other info)
	+ The Minister may even assess where no tax return has been filed
	+ The Minister may review records and gather additional information
	+ s. 152(7) **ensures the Minister can assess for the correct amount**, and **can assess a taxpayer who does not voluntarily comply**
* ***If taxpayer doesn’t file …***
	+ Minister can:
		- send demand s. 150(2)
		- issue assessment s.152(7)
		- get additional info, eg search Land Title Office, car records, …
	+ these are safeguards in a self reporting sys- just assess it if taxpayer fails to do
	+ these are tools of equity to make sure gov gets their money
* **s. 152(8) – An assessment is *deemed* valid and binding**
	+ The assessment may be vacated or varied only on objection or appeal under the Act
	+ An assessment may be superseded by a reassessment
	+ allows Minister to collect tax that has been assessed, and *implies* Minister can change the assessment

**Reassessment of Tax**

* **s. 152(4) – The Minister may reassess at any time for a different amount than the original assessment \*\*\*authority to reassess as often as necessary**
	+ ***Except* a reassessment may not be made after the expiry of the “normal reassessment period”**
		- **s. 152(3.1) – The “normal reassessment period” is:**
			* **For an individual, 3 years after the earlier of:**
				+ The day the notice of original assessment is sent, or
				+ The day that notification of no tax payable is sent
	+ **s. 152(4)(a) is exception to the normal reassessment period, *i.e. Minister is not bound to the normal reassessment period when…***
		- **152(4)(a)(i)** – **misrepresentation or fraud** committed by person who filed the return
			* So you can’t file a fraudulent return and waltz away after the normal reassessment period
			* Sort of a strict liability
			* If you make an innocent misrepresentation, you’re fine. Must be intentional, negligent, wilfully blind
			* When s. 152(4)(a)(i) applies, the Minister has an unlimited time to reassess
		- **152(4)(a)(ii)** – **waiver** by the taxpayer
			* The waiver must be written
			* The waiver must be filed before the end of the normal reassessment period
			* Why would you ever waive your normal reassessment period?
			* Usually when there is an ongoing audit and CRA approached person right when time is about to expire and says, if you don’t sign the waiver we will assess you for X right now and then person says, no I don’t owe X so I will just waive it now and work with you later.
	+ **s. 152(4.2) is exception to the normal reassessment period, *i.e. an individual may be reassessed notwithstanding the normal reassessment period if:***
		- The reassessment is made to determine a refund or to reduce the tax payable
		- The taxpayer has applied for the reassessment
		- The application is made within 10 years of the year to be reassessed
		- Note that s. 152(4.2) says the Minister “may”, not “must”
			* The Minister has discretion whether to do this on request of a taxpayer
	+ **s. 152(4.3) is exception to the normal reassessment period, *i.e. Consequential Assessments:***
		- A reassessment or a decision on an appeal for one year may change a balance that affects other years
		- Other years will need to be reassessed to give effect to that change
		- If the normal reassessment period has expired, s. 152(4.3) permits the Minister to reassess those years within 1 year of the end of all appeal rights for the reassessment/decision
			* Note s. 152(4.3) says the Minister “may” – it is discretionary
			* But *if the taxpayer requests the reassessment* the Minister “must” do it

***Nichols v. The Queen, 2009, TCC***

**🡪 Minister making ‘net worth’ assessment (s.152(7) Minister not bound by your shitty tax return) & a reassessment outside ‘normal assessment period’ on grounds of misrepresentation under 152(4)(a)(i)**

**🡪 use for what is NET WORTH ASSESSMENT**

**🡪 Shows you things CRA can do for net worth assessment:**

* Check Land Title Office and see property he has
* Check California court records
* Check bank loan from TD
* Check old work and past income

**F**: P filed tax return for $18 for 3 yrs, then he was busted for weed smuggling in US. He also had a girlfriend who was “obviously some sort of exotic entertainer” according to MT.

P’s tax returns and GST remittances were reassessed by Minister. He was also assessed gross negligence penalties pursuant to subsection 163(2) and section 285 and a late filing penalty pursuant to subsection 162(1) in respect of his 2003 taxation year.

**I**: reassessments made by Minister (both inside and outside stat reassessment periods)

Is the net worth assessment correct?

Is there a misrepresentation that justifies the reassessment?

**D**/**R**: Minister was correct to reassess and impose penalty.

* A “net worth” assessment – the Minister is not bound by what a taxpayer reports (s. 152(7))
	+ **A net worth assessment, ignoring tax return completely, tries to determine taxpayer’s income by looking at life circumstances (assets acquired, paying down loans, expenditures, etc)**
	+ Determined: ~200G, 100G and 100G (over all that) for the 3 years
	+ If CRA can't track that source, it will assume this is taxable income
* Based on 500G income and return saying $18, they found misrepresentation too.
* P admitted the amount of 500G but said it’s not from taxable source
	+ Claimed it was from friend ‘Mr Grant’
* The facts in evidence in this case are such that the taxpayer's tax return made a misrepresentation of facts, and the only explanation offered by the taxpayer was found not to be credible.
	+ This case turns on credibility of witnesses and judge doesn’t find P or Grant credible
* Therefore, one must come to the inevitable conclusion that the false tax return was filed knowingly, or under circumstances amounting to gross negligence. This justifies not only a penalty, but also a reassessment beyond the statutory period.
	+ Hence, Minister has est misrep and is justified under s.152(4)(a)(i) for reassessment

**Payments of Tax and Interest**

* ITA doesn’t say you have to pay your tax by this date; it does it in a round-about way by saying you have to pay interest on unpaid tax
* **Under s. 161(1), a taxpayer must pay interest if the tax payable for the year exceeds the amounts paid at any time after the “balance-due day” for the year**
	+ The balance-due day is the day that tax payable must be paid for the year
	+ s. 248(1) – “balance-due day” for an individual for a taxation year is April 30 of the following year
* s. 248(11) - interest is charged daily and is compounded (i.e., interest is charged on interest from previous days)
* s. 161(11) – interest is also payable on penalties
* s. 161.3 – where a person pays all taxes for the year, the Minister may cancel interest and penalties if they are less than $25
* s. 161.4 – any balance or refund less than $2 is deemed to be nil

**Penalties and Offences**

**Civil Penalties**

* **ITAimposes a number of penalties for failure to comply with its provisions**
	+ Penalties are civil penalties
		- Monetary in nature
		- Not an offence to be prosecuted, does not require conviction
		- Not usually a *mens rea* element
	+ Usually when taxes are reassessed
* **What kinds of conduct give rise to penalties?**
	+ Failing to file tax returns
	+ Failing to report income
	+ Making false statements and omissions
	+ Failing to comply with filing and reporting obligations
	+ Various others knickknacks
* **s. 162 – Failing to file**
	+ s. 162(1) imposes a penalty for **failing to file a tax return when due**
		- The penalty is equal to:
			* 5% of the tax unpaid at the date the return was due, plus
			* 1% of the unpaid tax per month for each month up to 12 months
		- Maximum penalty under s. 162(1) is 17% of tax unpaid
		- If no tax payable, penalty for failing to file is $0
	+ s. 162(2) imposes a penalty for **repeated failure to file a tax return**
		- The penalty is higher for repeated failure to file
		- Three conditions must be met:
			* The taxpayer fails to file the return for the year
			* The Minister has demanded a return for the year
			* The taxpayer has already been penalized for failing to file in one of the 3 previous years
		- Under s. 162(2), the penalty for repeat failure to file a tax return is:
			* 10% of the tax unpaid at the date the return was due, plus
			* 2% of the unpaid tax per month that it remains unpaid, up to 20 months
			* The maximum penalty under s. 162(2) is 50% of the tax
* **s. 162(7) includes a general penalty provision**
	+ A penalty is payable for failing to file any return required by the Act or to comply with any duty imposed by the Act
	+ This is a general penalty provision – **does not apply to failing to file a tax return**
		- The specific overrides the general
	+ The penalty is the greater of $100 or $25 per day for up to 100 days
* **s. 163 imposes different types of penalties relating to failing to report income**
	+ **s. 163(1) Penalty for repeat failure to report income**
		- The penalty applies when a taxpayer fails to report income for the second time in 4 years
		- The penalty is equal to 10% of the amount not reported
		- The amount of this penalty is not connected to the tax payable, if any
	+ **s. 163(2) is a penalty for false statements or omissions in a return**
		- Payable when a taxpayer makes a false statement or omission in the tax return
		- The false statement or omission must be made knowingly or under circumstances amounting to gross negligence
		- The penalty is equal to $100 or 50% of the tax that would have been payable in respect of the unreported amount
		- **The false statement does not have to be made by the taxpayer**
			* It only needs to be made in the return
			* Sufficient if taxpayer **participates in, assents to, or acquiesces in the making of, the false statement**
		- It is open to a taxpayer to defend against this penalty

**Criminal Offences**

* **criminal offences**
	+ s. 238 and s. 239
	+ These penalties include a combination of strict liability offences and true *mens rea* offences
	+ **Under s. 238, it is an offence to:**
		- Fail to file a tax return
		- Fail to comply with various obligations including sections 230 to 232
		- s. 230 is requirement to keep adequate books and records
			* (1) and (3) Minister can order taxpayer to go under undertaking to keep records and if you don’t, it’s an offence
			* (4) you have to keep records for 6 yrs
		- s. 231.1 includes responding to requests for information from the Minister
		- s. 231.2 includes responding to requirements for information from the Minister
	+ **The penalties under s. 238 include monetary fines and up to 12 months imprisonment**
		- The monetary penalty ranges from $1,000 to $25,000
	+ Each day that the person fails to file constitutes a separate offence
		- The potential liability is up to $25,000 per day
	+ s. 238(2) – Where a person has been convicted of an offence under s. 238, the Court may make an order to ensure compliance (**a compliance order**)
		- Failure to comply with the compliance order is another offence or contempt and can result in imprisonment
	+ **s. 239 creates additional offences, including true tax evasion offences**
	+ **s. 239(1) is the core offence of tax evasion**
		- It is an offence to make false statements, evade payment of taxes, keep false books and records, conspire to evade taxes
		- s. 239(1) is a true *mens rea* offence
			* Those acts must be done intentionally, or knowingly, for the purpose of evading tax
	+ **The penalties for s. 239(1) offences are much higher than for s. 238 offences**
		- Fine equal to 50% to 200% of the tax sought to be evaded, plus imprisonment for up to 2 years
		- s. 239(2) – the AG has an option to proceed by indictment, in which case the penalties are higher
			* Fine of at least 100% of the tax plus imprisonment for up to 5 years

**Audit Powers**

* In order to verify tax payable and assess the correct tax, the CRA needs access to accurate information
	+ CRA is only told what the taxpayer discloses
	+ CRA needs the power to get more information
	+ CRA can’t be beholden to the taxpayer
* **s. 231.1 gives the Minister a general audit power** [for purpose of “administering and enforcing” ITA]
	+ The Minister has a statutory power to inspect, audit or examine books and records and documents
	+ The Minister has the statutory authority to enter into any premises or place of business
		- s. 231.1(2) –Minister cannot enter a residence without consent or a search warrant
	+ The Minister has the authority to require a person to give reasonable assistance and answer questions relating to the administration and enforcement of the Act
	+ See ***Redeemer Foundation*** below
* **Minister will usually start by requesting information under s. 231.1(1)**
	+ Then the Minister will escalate to a formal Notice of Requirement under s. 231.1(2)
	+ Then the Minister will seek a compliance order
	+ Then the Minister will seek a finding of contempt and a committal order
* **s. 231.2(1) allows the Minister to require a taxpayer to provide information [additional, escalating powers]**
	+ A Requirement for Information is a formal written notice
	+ The Minister may require any information relating to the administration or enforcement of the Act
	+ Failure to comply with a notice of requirement is an offence subject to prosecution and a compliance order
	+ Before the Minister can require information regarding “unnamed persons” she requires judicial authorization (s. 231.2(2))
		- Judicial authorization is obtained under s. 231.2(3)
* **Audit powers are wide-ranging**
	+ Audit powers can be used against persons who are not the subject of the audit
	+ Minister can require information about a taxpayer from third parties
	+ Eg ***Nichols*** case- bank, not Nichols, is legally req to provide info to CRA

***Redeemer Foundation v. Canada, 2008, SCC***

**🡪 s. 231.1 allows Minister to request information that is, or should be, in the taxpayer’s books and records (record keeping req in s.230(2)), even info re: 3rd parties**

**🡪 suggests that audit of one party to a transaction entitles Minister to legitimately obtain info about the other party**

**The tax consequences to the other party to the transaction are a necessary corollary of the first party**

**🡪 taxpayers have a low expectation of privacy in their business records**

**F**: CRA had audited the Redeemer Foundation to determine the validity of gifts made under its forgivable loan program. Donations collected by students were credited against their tuition, but most of it came from their parents who then got a tax credit. CRA was concerned that the parents were getting a tax benefit from paying this charity instead of just paying the tuition. In the course of the audit of the charity, CRA auditors requested and received a list of the foundation’s donors. These donors were subsequently reassessed. Redeemer Foundation argued that the Income Tax Act did not permit the CRA to obtain the donor list from the charity without prior judicial authorization.

**I**: whether the Charities Directorate of CRA requires judicial authorization to request certain information from a registered charity

If the donations are not valid then the CRA will have to disallow those tax returns of the parents.

**D**/**R**: The CRA did not require judicial authorization to obtain donor list.

* the donor list was clearly the type of record the Foundation was required to keep pursuant to s. 230(2) and that the CRA could obtain the list through a combination of its general audit powers contained in section 231.1 and the record keeping requirements contained in section 230(2).

***R. v. Jarvis, 2002, SCC***

**🡪 ss. 231.1(1) and 231.2(1) are available for any purpose related to the “administration” or “enforcement” of Act, which does NOT include the prosecution of s. 239 offences.**

**🡪 It is a breach of *Charter* rights to compel information using audit powers when the predominant purpose is to further a criminal investigation**

**🡪 audit function should not be impaired by the potential for criminal liability & prosecution. Auditors may continue to use audit powers as long as predominant purpose is to determine tax liability [info supplied will have no privacy interest]**

**🡪 allows criminal investigation to make full use of audit file if gathered properly**

**F**: Audit over taxes relating to some art work ensued. TJ held they effectively became an investigation, which engaged P’s Charter s. 7 rights. Auditor is using (s. 231.1) to get answers and jervis has no choice but to answer since it’s civil context (i.e. no right against self-incrimination, but then auditor turns around and gives that info to the investigator (s.24(2)) which is for crim offence prosecution and taxpayer says, this is widely unfair.

Auditor side and the Investigator side are diff sections of CRA.

**I**: CRA audit powers; admissibility of evi and Charter

**D**/**R**: Compliance audits by the CRA must be treated differently from investigations into potential offences, such as tax evasion.

* Although the *Income Tax Act* relies upon self-assessment and self-reporting, the Minister of National Revenue has broad powers for the administration and enforcement of the Act.
* The scope of *Charter* rights and freedoms will vary according to the circumstances. This case concerns both s. 7 and s. 8 of the *Charter* and the exclusion of evidence under s. 24(2) of the *Charter* from a trial for offences under s. 239.
* **A distinction can be drawn between the audit and investigative powers under the *Income Tax Act*.  By their express terms, both ss. 231.1(1) and 231.2(1) are available for any purpose related to the “administration” or “enforcement” of the Act.  Although this wording seems broad, when read in context, these sections do not include the prosecution of s. 239 offences.**
* Where the predominant purpose of an  inquiry is the determination of penal liability, there exists an adversarial relationship between the taxpayer and the state.
	+ Look at all factors relevant- no one factor is determinative
* **Wherever the predominant purpose of an inquiry or question is the determination of penal liability, all *Charter* protections that are relevant in the criminal context must apply.** When this is the case, investigators must provide the taxpayer with a  proper warning.
	+ s. 7 of the *Charter*: the constitutional protections against self-incrimination prohibit tax officials  who are  investigating the offences from having recourse to the inspection and requirement powers under ss. 231.1(1) and 231.2(1). Rather, tax officials who exercise the authority to conduct such investigations must seek search warrants under s. 231.3 of the Act or s. 487 of the *Criminal Code* in furtherance of their investigation.
	+ s. 8 of the *Charter*: taxpayers have very little privacy interest in materials they are obliged to keep under the Act or to produce during an audit.  Once an auditor has inspected or required a document under ss. 231.1(1) and 231.2(1), the taxpayer cannot be said to have a reasonable expectation that the auditor will guard its confidentiality.

**APPEALS & DISPUTE RESOLUTION**

**CRA Divisions**

* Audit
	+ Reassessments
* Appeal
	+ Look at objections and reconsider auditors
* Investigation
	+ Looking at crim activity
* Collections
	+ Enforcing end result if it involves paying
	+ Garnishing and seizing etc

**Taxpayer can do 2 things to appeal:**

* **Give Notice of Objection**
* **Go to Tax Court**

**Notice of Objection**

* **A taxpayer who disagrees with the assessment of tax may serve a notice of objection**
	+ s. 165(1) – Right to object
	+ The objection must be in writing
	+ Served on the Minister
* **s. 165(1)(a) – for an assessment for a taxation year (i.e., under Part I), the objection must be served by the LATER of:**
	+ the day that is 1 year after the filing-due date for the year, and
	+ 90 days after the day the notice of assessment is sent
* **s. 165(1)(b) – in any other case, the objection must be served within 90 days of the day the notice of assessment is *sent***
	+ Time starts running with the sending of the notice of assessment
	+ No requirement that the taxpayer receive the notice
	+ **S.152(2) Minister has to *send* the notice of assessment, and has no obligation to make sure the taxpayer actually *received* the assessment**
* S. 165(2)- send notice to your local CRA office and set out the facts and reasons why you’re objecting
* **s. 165(3) – the Minister *must* reconsider the assessment and do one of three things:**
	+ **Vacate**- Assessment is gone; nullified
	+ **Confirm**- objection denied
	+ **Reassess**
	+ The Minister must act “with all due dispatch”
		- Means reasonably quickly but nothing authoritative on its definition
	+ The Minister must notify in writing the taxpayer of her decision

***Don’t like decision on notice of objection? Go to Tax Court!***

**Appeals to Tax Court**

* **If the taxpayer’s objection fails, the taxpayer has a right of appeal to the Tax Court of Canada**
* **s. 169(1) – the taxpayer may appeal to the Tax Court when:**
	+ She has served a notice of objection under s. 165
		- i.e. taxpayer has complied w/ s. 165- must have been on time
	+ Either the Minister has confirmed the assessment or reassessed, or 90 days have passed without a decision from the Minister.
* **Under s. 169(1), taxpayer may ask the Tax Court to vacate or vary the assessment**
	+ The Tax Court may only grant relief in respect of the assessment
		- No juris to grant a remedy other than in relation to assessment (no damages, injunctions etc)
	+ The Tax Court is there to determine if the assessment is correct
* **No right of appeal after 90 days from the day that the Minister’s decision on the objection is sent**
	+ Think back to 169(1)- most tax payers are not in a rush to go to court within 90 days. You need a lawyer and that’s expensive. Most wait for CRA and try to work things out with them.
* **s. 171(1) - If the Tax Court allows an appeal, it can do three things:**
	+ Vacate the assessment
	+ Vary the assessment
	+ Refer the matter back to the Minister for reconsideration and reassessment

**Extensions of Time**

**Extensions of Time for serving Notice of Objection**

* **There are two opportunities for an extension of time to serve a notice of objection**
	+ **s. 166.1 – The Minister can grant an extension**
	+ **s. 166.2 – The Tax Court can grant an extension**
* **s. 166.1(7) sets out requirements for the Minister to grant an extension of time to object:**
	+ An application for an extension must be made within 1 year after the time limit for serving the objection expired (which is 90 days (165(1)(a))
	+ The taxpayer must meet three conditions:
		- Unable to act within the 90 days, or had a bona fide intention to object within that time
		- It would be just and equitable to grant an extension
			* Not just and equitable to grant exception if granting it would be futile.
		- The application was made as soon as possible
* **The 1-year deadline in s. 166.1(7)(a) is a final drop-dead date 🡪 NO EQUITY, NOTHING, NEGLIGENCE IF YOU’RE THE LAWYER**
	+ The Minister has no discretion to extend that time
	+ The Court cannot extend that time
	+ There is no ground of equitable relief
* **If Minister grants an extension under s. 166.1(7)(a), the objection is deemed to be served on that date**
	+ Calculate further time limits from that date
* **If Minister refuses an extension under s. 166.1, the taxpayer may apply to the Tax Court under s. 166.2**
	+ The taxpayer must apply to the Minister first
	+ The taxpayer may apply to the court within 90 days of the Minister’s denial or if the Minister does not decide in 90 days
	+ The 90-day limit is **another drop-dead due date**
* **Under s. 166.2(5), the taxpayer appealing to Tax Court must meet the same conditions as 166.1(7)**
	+ The taxpayer must have applied to the Minister within 1 year of the time limit for an objection
	+ s. 166.2(5)(b) - the taxpayer must meet the same three conditions as under s. 166.1(7)
		- (i) Unable to act within the 90 days, or had a bona fide intention to object within that time
		- (ii) It would be just and equitable to grant an extension
		- s. 166.2(5)(b)(iii) - The taxpayer must demonstrate that the application to the Minister, not to the Court, was made as soon as possible

**Extension of Time for Filing Appeal to Tax Court**

* **There is one opportunity for an extension of time to file an appeal to Tax Court**
	+ If the taxpayer misses the 90-day deadline to appeal the Minister’s decision on an objection, the taxpayer may apply to the Tax Court for an extension of time to appeal
* **s. 167 – The Tax Court can grant an extension**
	+ s. 167(5) imposes similar requirements to those for extensions of time to objection under s. 166.1 and 166.2 [90 days, if you miss that you have 1 yr, if you miss that, you’re an idiot, i.e. done]
* Under the *Tax Court of Canada Act,* the Tax Court has exclusive original jurisdiction to hear:
	+ Appeals under the *Income Tax Act*
	+ Applications for extensions of time under the *Income Tax Act*
	+ No other court may entertain these proceedings or grant relief

***Yankey v. Queen, 2012, TCC***

**🡪 Court has no discretion to extend the statutory timelines**

**🡪 Court is satisfied that Minister sent the assessments, which means the time to object started running, regardless of whether applicant received it.**

**🡪 Potential for prejudice to the taxpayer if they really didn’t know but the deadline is dead serious**

**F**: Applicant kept serving notices of objection to the assessment of his taxes, but not within the time he was supposed to, based on which Minister didn’t grant them. Applicant applied for an extension from Tax Court.

**I**: taxes

**D**/**R**: The Applicant’s application to extend the time for serving notices of objection in relation to the reassessments of the Applicant’s 2003, 2004, 2005 and 2006 taxation years is dismissed, without costs.

* The application under subsection 166.1(1) of the *Act* is the application made to the Minister to request an extension of time to serve the notice of objection which was last made by the Applicant in this case on February 10, 2012.
* As a result of the provisions of paragraph 166.2(5)(a) of the *Act*, the application to this Court to extend the time to serve a notice of objection cannot be granted unless the application to the Minister to extend the time for serving the notice of objection was made within one year following the expiration of the time within which a notice of objection could have been served without an extension of time.
	+ time within which a notice of objection may be served (without an extension of time being granted) is set out in subsection 165(1) of the *Act*.
* Applicant says he never got notices of reassessment in 2009 but Minister sent them to address he provided
* Unfortunately there is no discretion to extend the deadlines as set out in the *Act* and the provisions of subsection 166.2(5) of the *Act* are clear that no application may be granted by this Court unless both the requirements of paragraph (*a*) and (*b*) are satisfied.
	+ In this case the Applicant has failed to satisfy the requirements of paragraph 166.2(5)(*a*) of the *Act*.

**Jurisdiction of the Tax Court**

***Tax Court of Canada Act*, ss. 12(1) & (4)**

**Jurisdiction**

**12.** (1) The Court has exclusive original jurisdiction to hear and determine references and appeals to the Court on matters arising under the Air Travellers Security Charge Act, the Canada Pension Plan, the Cultural Property Export and Import Act, Part V.1 of the Customs Act, the Employment Insurance Act, the Excise Act, 2001, Part IX of the Excise Tax Act, the Income Tax Act, the Old Age Security Act, the Petroleum and Gas Revenue Tax Act and the Softwood Lumber Products Export Charge Act, 2006 when references or appeals to the Court are provided for in those Acts.

*Extensions of time*

(4) The Court has exclusive original jurisdiction to hear and determine applications for extensions of time under section 45 or 47 of the Air Travellers Security Charge Act, subsection 28(1) of the Canada Pension Plan, section 33.2 of the Cultural Property Export and Import Act, section 97.51 or 97.52 of the Customs Act, subsection 103(1) of the Employment Insurance Act, section 197 or 199 of the Excise Act, 2001, section 304 or 305 of the Excise Tax Act, or section 166.2 or 167 of the Income Tax Act.

***Federal Court Act* ss. 18, 18.1 & 18.5**

**Extraordinary remedies, federal tribunals**

**18.** (1) Subject to section 28, the Federal Court has exclusive original jurisdiction

(a) to issue an injunction, writ of certiorari, writ of prohibition, writ of mandamus or writ of quo warranto, or grant declaratory relief, against any federal board, commission or other tribunal; and

(b) to hear and determine any application or other proceeding for relief in the nature of relief contemplated by paragraph (a), including any proceeding brought against the Attorney General of Canada, to obtain relief against a federal board, commission or other tribunal.

*Extraordinary remedies, members of Canadian Forces*

(2) The Federal Court has exclusive original jurisdiction to hear and determine every application for a writ of habeas corpus ad subjiciendum, writ of certiorari, writ of prohibition or writ of mandamus in relation to any member of the Canadian Forces serving outside Canada.

*Remedies to be obtained on application*

(3) The remedies provided for in subsections (1) and (2) may be obtained only on an application for judicial review made under section 18.1.

**Application for judicial review**

**18.1** (1) An application for judicial review may be made by the Attorney General of Canada or by anyone directly affected by the matter in respect of which relief is sought.

*Time limitation*

(2) An application for judicial review in respect of a decision or an order of a federal board, commission or other tribunal shall be made within 30 days after the time the decision or order was first communicated by the federal board, commission or other tribunal to the office of the Deputy Attorney General of Canada or to the party directly affected by it, or within any further time that a judge of the Federal Court may fix or allow before or after the end of those 30 days.

*Powers of Federal Court*

(3) On an application for judicial review, the Federal Court may

(a) order a federal board, commission or other tribunal to do any act or thing it has unlawfully failed or refused to do or has unreasonably delayed in doing; or

(b) declare invalid or unlawful, or quash, set aside or set aside and refer back for determination in accordance with such directions as it considers to be appropriate, prohibit or restrain, a decision, order, act or proceeding of a federal board, commission or other tribunal.

*Grounds of review*

(4) The Federal Court may grant relief under subsection (3) if it is satisfied that the federal board, commission or other tribunal

(a) acted without jurisdiction, acted beyond its jurisdiction or refused to exercise its jurisdiction;

(b) failed to observe a principle of natural justice, procedural fairness or other procedure that it was required by law to observe;

(c) erred in law in making a decision or an order, whether or not the error appears on the face of the record;

(d) based its decision or order on an erroneous finding of fact that it made in a perverse or capricious manner or without regard for the material before it;

(e) acted, or failed to act, by reason of fraud or perjured evidence; or

(f) acted in any other way that was contrary to law.

*Defect in form or technical irregularity*

(5) If the sole ground for relief established on an application for judicial review is a defect in form or a technical irregularity, the Federal Court may

(a) refuse the relief if it finds that no substantial wrong or miscarriage of justice has occurred; and

(b) in the case of a defect in form or a technical irregularity in a decision or an order, make an order validating the decision or order, to have effect from any time and on any terms that it considers appropriate.

**Exception to sections 18 and 18.1**

**18.5** Despite sections 18 and 18.1, if an Act of Parliament expressly provides for an appeal to the Federal Court, the Federal Court of Appeal, the Supreme Court of Canada, the Court Martial Appeal Court, the Tax Court of Canada, the Governor in Council or the Treasury Board from a decision or an order of a federal board, commission or other tribunal made by or in the course of proceedings before that board, commission or tribunal, that decision or order is not, to the extent that it may be so appealed, subject to review or to be restrained, prohibited, removed, set aside or otherwise dealt with, except in accordance with that Act.

* **Sys Today: TCC 🡪FCA🡪SCC**
* S. 12 of Tax Court of Canada Act
* Used to be: tax appeal board 🡪 exchequer court 🡪 SCC then some other sys as well
* **Tax court of Canada has limited juris**
	+ To determining whether or not an assessment is correct in law
* **The taxpayer may dispute:**
	+ **The correctness of the assessment, *OR***
		- Eg you’ve charged me too much
		- Eg that wasn’t my income; it was my brother’s income. (factual)
	+ **The validity of the assessment**
		- Eg: you’ve assessed me beyond the regular period (legal)
	+ Tax Court can also consider constitutional arguments
* **The Tax Court cannot grant relief other than vacating or varying an assessment**
	+ An assessment that is incorrect will usually be varied or referred back
	+ An assessment that is invalid will usually be vacated
	+ The Tax Court cannot award damages
* **Because the Tax Court has “exclusive original jurisdiction” (s. 12(1) & 12(4) *TCCA*), no other court has jurisdiction to hear an appeal from an assessment [i.e. make findings re: validity/correctness of assessments]**
	+ An assessment may not be attacked in another court proceeding

***Ereiser v. Canada, 2013, FCA***

**🡪 fairness of the process w/ CRA or misconduct of officials NOT relevant to whether assessment is valid or correct.**

**🡪 FCA doesn’t have juris to decide if assessment is correct or valid, only Tax Court does**

**🡪 validity means whether or not assessment is issued in accordance with the procedural requirements of the Act**

* **No privacy expectation in tax assessment then (as seen in *Jarvis*, *Redeemer, Webster* [below])**

**F**: P had a business, kept goods books, did tax returns for 3 years, after which an Investigator wanted to reassess his gross income for those years and look into gross negligence penalties. There was never any separation between the investigative and audit functions of the CRA. The reassessments are based on evidence obtained by the investigators in breach of Mr. Ereiser’s rights under the Canadian Charter of Rights and Freedoms.

**I**: Are reassesements void b/c of misfeasance of officials in public office? Are they void b/c they were filed outside proper time allowed? Are they void b/c P didn’t have any unreported income during those 3 yrs any way?

**D**/**R**: Appeal and Crown’s cross-appeal are both dismissed.

* Test for striking a pleading: A claim will only be struck if it is plain and obvious**,** assuming the facts pleaded to be true, that the pleading discloses no reasonable cause of action.
* P argues the reassessments are grossly inflated to force a guilty plea on a criminal charge from him.
* **Tax Court of Canada will not vacate the reassessments under appeal in this case solely on the basis of the wrongful conduct of a tax official in authorizing them**. It follows that the allegations and arguments in the pleadings relating to the misfeasance in public office were properly struck.
	+ But tax payers have other remedies: tort actions, admin law actions
* Wrongful conduct unrelated to an evidentiary matter generally is not relevant to the admissibility of evidence.

***AG Canada v. Webster, 2003, FCA***

**🡪 Reliance on confidential info that hasn’t been disclosed doesn’t go to validity**

**🡪 If you don’t like what the CR has done, you can bring an action against them in another court. Tax Court will only decide whether the assessment is correct or valid.**

**Facts:**

* Taxpayer seeks judicial review of CRA decision to confirm assessment on basis that information from confidential informant was not disclosed to taxpayer

**Holding:**

* FCA held that taxpayer could not seek judicial review because the taxpayer’s remedy for CRA’s decision to confirm is to appeal to TCC
* The issue before the TCC is correctness of the assessment
	+ Fairness of CRA process is not relevant
* Webster’s theory was there would be no confirmation of his assessment and then go back, but court said you have to go to tax court b/c that is where right of appeal is and what you’re really after is a reassessment of your assessment.

***Domtar v. Canada, 2009, FCA* [softwood lumber dispute]**

**🡪 Domtar is really trying to void this stat to get their money back, and the stat itself gives them avenue to apply for the refund back AND a stat right of appeal which means you can go to tax court and in tax court you CAN argue constitutionality of the law, so you fail here b/c that it what you should have done.**

**F**: Taxpayer could have applied for refund and would have had statutory right to appeal an assessment; instead, taxpayer challenged constitutionality of legislation. Context: Canada-US lumber dispute. Canada cut US a cheque b/c US had lost all disputes and wanted to keep its duty and Canada said, we won’t have Canadian taxpayers pay for this so every company which gets that refund from the states must pay a share to fund that cheque. Domtar was one of BC’s biggest softwood lumber producers and they challenged stat which demanded this payment.

**I**: Does FC have juris to decide constitutionality of this softwood lumber charge?

**D**/**R**: **No, b/c**

* FCA held that the “essential nature” of the claim is for a return of money paid under the statute
	+ The statute provides a mechanism to obtain a refund
	+ The right of appeal is to the Tax Court
* The refund claim – including constitutional issue – could be the subject of an appeal in Tax Court, so no jurisdiction in Federal Court

***ConcoPhilips v. Minitsr of National Revenue, FC***

**🡪 no objection to notice of assessment filed, hence no right of appeal to TC, hence JR in FC allowed**

**🡪 Questionable reasoning**

**F**: Taxpayer applied for judicial review of decision by CRA not to consider notice of objection as it was late. Taxpayer argues that time to object has not run because the notice of assessment was not mailed. They found out about it 8 years after and CRA said, you are out of time (since time of 90 days starts running when they send it)

Taxpayer can (1) wait 90 days and go to tax court since they objected and didn’t get ans for that time OR (2) get JR of CRA decision not to hear their objection b/c it was unreasonable.

Underlying issue that the time never started running since they didn’t send it.

**I**: Whether or not taxpayer can seek JR of CRA decision instead of appealing to tax court?

**D**/**R**: FC accepted that no right of appeal to Tax Court b/c no valid objection filed, allows judicial review.

* Tax court has juris to decide matters like time running out.
	+ They have juris to find you are out of time or that assessment was never sent to you.
	+ **Issue of whether assessment has been sent relates to the validity of the assessment which can be decided in appeal to tax court.**
* FC says, tax payer can't appeal if they haven’t objected in which case we can decide whether that decision of CRA was reasonable.

* Is ***ConocoPhillips*** decision correct?
	+ Why wouldn’t Tax Court have jurisdiction to decide if pre-conditions to a Tax Court appeal are satisfied?
	+ Tax court as superior court can decide that an appeal is invalid if it is late and it has the juris to decide facts pertaining to validity such as what time assessment was sent
	+ FC is saying b/c the objection was late, tax court can't decide this since the taxpayer didn’t even get into the door.
	+ Michael thinks tax court does have juris. FCA will pronounce on this soon since it has been appealed.

**Burden of Proof in a Tax Appeal**

* **s. 152(8) deems an assessment to be valid and binding** unless vacated or varied on objection or appeal, or a reassessment is issued
* **The onus is on a taxpayer to demonstrate that an assessment is wrong**
* **The Minister is entitled to make “assumptions of fact”**
	+ The assumptions are presumed to be correct unless rebutted by the taxpayer
	+ In a court case, the Minister must state the assumptions of fact clearly in the pleadings
	+ Goes back to the idea of the self reporting sys of tax we have
* **See *Anchor Point Energy* below for principles from FCA**

**Stat and CL exceptions**

* **s. 163(3) is a statutory provision dealing with burden of proof**
	+ The Minister has the burden of proving the facts that justify a penalty under s. 163
	+ Includes penalties under:
		- s. 163(1) – Repeat failure to report income
		- s. 163(2) – False statements or omissions in circumstances amounting to gross negligence
* **The Minister also bears the burden of proving a misrepresentation that she relies on to reassess after the normal reassessment period (s. 152(4)(a)(i))**
	+ This rule is not in ITA*;* it is a common law rule

***Anchor Pointe Energy Ltd v. Queen, 2007, FCA***

**🡪 assessment is the Minister’s determination of how much tax is payable. It is the process and the final product.**

**🡪 confirmation stage is part of the assessing process and Minister may make additional assumptions at the confirmation stage**

**🡪 taxpayer bears the onus of disproving those assumptions, not just assumptions made at the original assessing stage**

**🡪 Subsequent review is all part of the assessment process and CRA is entitled to make assumptions of fact throughout this process.**

**F**: appeal from a decision of the Tax Court of Canada wherein it was held that the onus of proof with respect to assumptions of fact first made by the Minister at the confirmation stage of a reassessment pursuant to subsection 165(3) of the *Income Tax Act* was on the Crown.

The Minister confirmed the reassessment of the respondent’s predecessor companies on the basis of certain assumptions with respect to the purchase of seismic data by these companies. The respondent filed a notice of appeal with the Tax Court. In his reply to that notice of appeal, the Minister included assumptions that represented a radical change from those made at the initial stage of the assessment. The respondent moved to strike these assumptions on the basis that they could not have been assumed at the time of the assessment because the decision which was relied upon to make these assumptions had not been rendered at the time of the assessment.

The Tax Court ordered these assumptions expunged from the reply. While it affirmed that decision, the Federal Court of Appeal noted that assumptions could be included in the Crown’s reply as long as they were pleaded accurately. The Crown thus filed an amended reply, stating that the relevant assumptions had been made in confirming the reassessments.

The Tax Court expressed the view that the confirmation of an assessment is not part of the assessment process, and held that it was inappropriate to saddle the taxpayer with the onus of disproving assumptions made at the confirmation stage.

**D**/**R**: Appeal allowed.

* While the words assessment, reassessment and confirmation refer to three specific actions by the Minister under the Act in the process of determining the tax liability of a taxpayer, the word “assessment” also refers to the product of that process.
	+ The Minister is entitled throughout this period, until his final determination of amount of tax owing, to rely upon facts newly discovered or revealed by the taxpayer, and assume them, as long as they are pleaded accurately.
	+ **The Tax Court wrongly ignored this second meaning of the word assessment, as the appeal was from the product of the assessment, not simply its confirmation**.
		- The Minister could make assumptions of fact at the confirmation stage of the assessment.
* **Barring exceptions, the initial onus of proof with respect to assumptions of fact made by the Minister in assessing a taxpayer’s tax liability and quantum rests with the taxpayer.**
	+ While there may be instances where the pleaded assumptions of fact are exclusively within the Minister’s knowledge, such that the rule as to the onus of proof may work so unfairly as to require a corrective measure, this was not the case here.
	+ The purpose in buying the seismic data and the subsequent use made of that data were within the exclusive and peculiar knowledge of the respondent.

**Dispute resolution and settlement**

* **The CRA may resolve objections and appeals by settlement with the taxpayer**
* Settlement involves an agreement by both sides
* There must be a legal basis for any settlement
* Settlement may not be possible where the issue is “all or nothing” or “either/or”
* Settling a tax case at the Tax Court appeal stage has some limits:
	+ The Tax Court has jurisdiction only over the particular taxpayer for the particular year
	+ The Tax Court cannot order something beyond its jurisdiction even if the parties consent to it
* **s. 169(3) provides the Minister with flexibility to settle disputes and appeals**
	+ permits Minister to reassess any taxpayer for any taxation year for the purpose of disposing of an appeal
	+ Allows the Minster to reassess tax, interest or penalties
	+ Reassessments under this section are not bound by the normal reassessment period
* **If tax is legally payable then CRA has no legal power to let it go b/c they are bound to enforce ITA (s.220(1))**
	+ ***CIBC World Markets***
	+ 🡪 limits on its ability to settle disputes

***CIBC World Markets, 2012, FCA* 🡪 CRA cannot compromise an assessment that is correct in law**

**F:** Taxpayer offered settlement, but went to court and crown got a better settlement offer. They argue they should get costs since the crown should have gotten it.

**D/R:** Court refuses to punish crown for costs when they legally can’t take a comprise.

* The taxpayer claimed increased costs on the basis that the Minister had rejected a settlement offer that was better for the Crown than the ultimate result
* The FCA held that the taxpayer was not entitled to increased costs because the CRA could not legally have accepted the offer
	+ The Minister cannot agree to a reassessment that is not supported by law

**Minister’s Discretionary Powers**

* **Minister has the authority to relax some rules in the Act through discretionary powers**
* s. 220(3) & (3.2), Minister may **extend time** for filing returns and elections
* s. 220(3.1), Minister may **cancel interest and penalties** that have accrued in the past 10 years
	+ Waiver/cancellation of interest under s. 220(3.1) must be requested by the taxpayer
	+ Minister will consider whether to grant it on a case by case basis
* s. 152(4.2), Minister may **reassess a taxpayer notwithstanding the normal reassessment period** in order to reduce tax payable or to increase a refund for one of the past 10 years
	+ A reassessment under s. 152(4.2) is done at the request of the taxpayer, therefore with the taxpayer’s consent
* **Discretionary powers are not subj to appeal to tax court (since they are not about the assessment), but rather subj to JR to FC to review whether it is lawful & reasonable in admin law sense**
	+ The Court can quash the decision but it cannot enter its own decision

**INCOME FROM OFFICE & EMPLOYMENT**

**INTRODUCTION**

**Income from Office and Employment**

* Most Canadians are employees of someone else so very important for policy
* Office and employment are two of the named sources in para. 3(a)
* **Office and employment are different things but the same tax rules apply**
	+ Subdivision a (ss. 5 to 8)
* **Income is a net concept**: income from a source is (Inclusions – Deductions)
* **What is an “office”?** Defined in **s. 248(1)**
	+ **A position of an individual, Entitling the individual to a fixed or ascertainable stipend or remuneration**
	+ Include judicial offices, MP, Senator, Minister, corporate director
* **What is employment?** Defined in **s. 248(1)**
	+ **The position of an individual “in the service of another person”**
* **Office and employment apply only to individuals**
* Office relates to a position; employment relates to a relationship

**Characterization: employment vs. business (i.e. independent contractor)**

* **No statutory test to distinguish between an employee and an independent contractor**
* **The courts have developed a common law test**
* ***Wiebe Door Services 🡪* leading TEST to distinguish employee vs ind contractor*;* endorsed in *Sagaz Industries***
	+ **Multiple Factor Test (4 in 1 test OR total relationship test)**

**(1) Control**

**(2) Ownership of tools and equipment**

**(3) Chance of profit & risk of loss**

**(4) Integration**

**+ other factors\*\*\* + some weight to intention (*Royal Winnipeg Ballet*)**

* If not an employee, a worker is usually to be considered an independent contractor (self-employed)
* **For tax purposes, self-employed = carrying on business**
* **Two key tax differences between employment and business tax conseqs:**
	+ Business has more generous deductions
	+ Employment income is subject to source deductions (i.e. EI, etc)
	+ Eg. Business characterization reduces your deduction obligations as employee. For employer, if you characterize as contractor, you keep more money but then you haven’t contributed to pension and won’t get any.

***Wiebe DoorServices, 1986, FCA* 🡪 leading case on TEST to distinguish employee vs ind contractor**

**F**: Workers, installers, had signed contracts saying they are independent contractors. CRA says actually they are employees and sues Wiebe for the employment deductions they should have been taking.

**I**: Who is employee or contractor?

**D**/**R**: The workers are …

* Most important factor for distinguishing employee and ind contractor had been degree of control
	+ Hiring and firing
	+ Restrictions and reqs imposed on employees
	+ Ultimately about, if you don’t do what I say, I can fire you.
* Court held:
	+ Contract btwn parties does not determine relationship.
	+ Control (hist important) is NOT determinative on its own
		- b/c some employees are hard to control
		- b/c absence of control isn’t enough to say someone is a contractor
	+ **Multiple Factor Test (4 in 1 test OR total relationship test)**
		- **(1) Control**
		- **(2) Ownership of tools and equipment**
		- **(3) Chance of profit & risk of loss** (chance to make profit for your business, risk of losing one job b/c you took too long on another vs you work 8 hours and get paid anyway and your employer bears risks of loss)
		- **(4) Integration** (how important is work done to operation of whole sys)
			* Must look at it from POV of worker, not that of overall business, for tax purposes
		- *Other relevant factors (from case cited in judgment) \*\*\*\*\*\*\*\*\*\*\*\*\**
			* Ability to subcontract or hire helpers
			* Engagement to perform a specific task vs. provision of ongoing services
			* Whether the worker works for multiple employers
			* Where the employee principally works
			* Nature of remuneration
			* No one factor is usually determinative
			* Each case is fact-specific and interrelationship of diff criteria will be diff in every case
			* The intention of the parties is beginning to receive some weight:
				+ ***Wiebe Door (1986)***: the parties’ label is not significant
				+ ***Royal Winnipeg Ballet (2006)***: intention should receive some weight
				+ **Still unclear how significant intention should be**

**Personal Services Business, i.e. Incorporated Employee**

* + - * **Sometimes employees interpose a corporation between themselves and the employer**

Employer ----k1------corporation------k2-----employee

* + - * **The corporation is the service provider, i.e. the personal services business**
			* **The employee now works for the corporation, not employer**
				+ Income from k1 is business income
				+ Income from k2 is employment
* **Personal services business is defined in ss. 125(7)**
	+ A business where **an individual performs services on behalf of the corporation**
	+ The **individual or a related person is a “specified shareholder” of the corporation**
		- “Specified shareholder” means 10% (s.248(1))
	+ **Absent the corporation, the individual would reasonably be regarded as an employee** of the person to whom the corporation provides services
* *Exceptions to personal services business*
	+ The business will not be a personal services business where the corporation employs more than 5 full-time employees throughout the year, or
	+ The corporation’s income is received from an associated corporation
		- Associated corporations have to share the $500,000 business limit
* **Personal services business restrictions**
	+ para. 18(1)(p) – a personal services business may not deduct any expenses except the salary of the “incorporated employee”
	+ ss. 125(7) – a personal services business is not an “active business” and does not receive the small business deduction
		- small business deduction is not applicable to non active business
* Why set up a personal services business?
	+ Corporation can't be employee; its income is business income
	+ Business can make deductions
	+ No need to pay payroll tax etc
	+ Small business deductions that corporations get that individuals don’t get (s.125(1))
		- $500,000 @ 13%
	+ Choice of fiscal period & deferral (s.249.1)
	+ Tax planning

***DYNAMIC INDUSTRIES v. CANADA [2005] FCA* 🡪 long-term relationship isn’t determinative & the whole history matters when characterizing person as independent contractor or employee in service of a personal service business**

**🡪 Application of *Wiebe Doors* Test**

**Facts:**

• Dynamic provided steelwork services. Shares were owned, at all times, by Martindale.

• He transferred all of his shares to her for business purposes, so as to avoid problems with the union that said he otherwise couldn’t contract with non-union companies.

• Through Dynamic, Martindale began to work fro SILL Maintenance.

• Later, Martindale took a position with Fording, who was working with SILL.

• From 1995-99, Dynamic’s only business was with SILL and SILL provided office space and some equipment. They also paid Martindale by the hour, though he was accountable for his mistakes, overhead and any lost bids he couldn’t obtain.

• Dynamic was reassessed under 18(1)(p) to disallow certain deductions made by Dynamic and deny them a low corporate tax rate.

• CRA argued that Dynamic was a personal services business under 18(1)(p) and that Martindale’s wife was a specified shareholder.

• They also argued that Martindale was an employee of SILL, not Dynamic.

**Issue:** Is this business or employment income? Is Martindale an employee and therefore subject to 18(1)(p)? Is it reasonable to regard Martindale as an employee of SILL but for the existence of Dynamic?

**Reasoning:**

• Central question is whether Martindale is providing services to another as an employee, or as a person in business on his own account.

• The CRA utilized the 4-part test from ***Weibe Door*** to find that he was an employee.

• The FCA, however, favors an examination of the totality of the relationship.

• The control test reveals that Martindale is an independent contractor.

• Regarding profit and loss, Martindale and Dynamic were responsible for mistakes and he wasn’t compensated for lost contracts.

• On ownership of tools, Martindale didn’t do too much work at SILL and overwhelmingly, his “brain” was his tool.

• On the integration test, a four year monopoly on Dynamic’s work isn’t determinative.

• The court looks before and after and finds that he was going where the work was, even if it meant for a 4 yr period. History matters.

**Ratio:**

• 18(1)(b) applies to employees, not IC’s.

• The court examines the totality of D’s relationship. A long term contract with one employer isn’t determinative. History matters.

**125(7) “specified investment business”**, carried on by a corporation in a taxation year, means a business (other than a business carried on by a credit union or a business of leasing property other than real or immovable property) the principal purpose of which is to derive income (including interest, dividends, rents and royalties) from property but, except where the corporation was a prescribed labour-sponsored venture capital corporation at any time in the year, does not include a business carried on by the corporation in the year where

(a) the corporation employs in the business throughout the year more than 5 full-time employees, or

(b) any other corporation associated with the corporation provides, in the course of carrying on an active business, managerial, administrative, financial, maintenance or other similar services to the corporation in the year and the corporation could reasonably be expected to require more than 5 full-time employees if those services had not been provided;

**TYPES OF EMPLOYMENT RECEIPTS- Inclusion in Income [employment + office]**

**There are 5 named types of employment receipts: salary, wages, remuneration, gratuities and fees**

* **The main rule is s. 5(1): include salary, wages and other remuneration, including gratuities**
	+ Under para. 6(1)(c), include director’s and other fees
* **Salary** tends to be a fixed amount payable on a periodic basis (weekly, bi-weekly, monthly, etc.)
* **Wages** tend to be in the nature of hourly pay or pay for production
* **Gratuities are not limited to tips**
* **Interpreting “other remuneration”**
	+ Apply the principles of statutory interpretation
		- First rule is ordinary meaning of those words
	+ “Salary, wages and other remuneration” suggests a payment for services, in money or equivalent
* **Salary & wages are received for performing services**
* **Fees are generally fixed amounts for performing a service or holding a position**
	+ e.g., a corporate director

**Gratuities**

* **Gratuities included as employment receipt under s.5(1) [‘any remuneration, inc gratuities]**
* **More than just tips – any gratuitous payment not made under an enforceable obligation.**
* Distinguishing gratuities from windfalls:
	+ A gratuity is connected to the employment.
* **Voluntary payments can be gifts, but they are not necessarily gifts**. Where both parties intended for the money to be paid as remuneration for services rendered it was accrued in virtue of his office; it does not matter whether it was voluntary or compulsory (***Goldman)***
* **Strike pay is not income** (***Fries***). Strike pay is usually not taxable.
* ***Goldman* 🡪 Voluntary payments *can* be gifts, but they are not necessarily gifts.**
	+ **Where both parties intended for the money to be paid as remuneration for services rendered it was accrued in virtue of his office; it does not matter whether it was voluntary or compulsory.**
	+ Taxpayer worked for company getting reorg. Involved in committee negotiating reorg and found out he is not getting paid for work on reorg, negotiation and then litigation and then settlement where he got payment.
	+ Taxpayer then got payment.
	+ payment was voluntarily made but was made for a remunerative purpose and was received in connection with the employee’s duties, so it was NOT a gift.
* **Strike pay is usually not taxable** 🡪 gratuitous but not connected to employment (not performing services)
	+ It is paid not to compensate for performing services, but for not performing services
	+ b/c they’re not employees of union
* ***Fries****:* **SCC held that strike pay was not income.**
	+ FCA had found strike pay to be income from an unenumerated source under para. 3(a)
	+ **Hinting at whether there can be other sources beside those. Provision says ‘without restricting generality of the following’ which is lang that implies there can be other sources.**
* Strike pay is not legally income although it displays the economic characteristics of income

**DEEMED REMUNERATION- Extended reach of remuneration**

* **s. 6(3) deems certain payments not necessarily made to remunerate an employee for services to be remuneration, and hence taxable as employment income under s. 5(1)**
* **s. 6(3) applies to**
	+ **payments received from the employee during a period of employment, or in relation to an agreement between employer and employee**
	+ **to payments that can “reasonably be regarded” as:**
		- **(c) Inducements**
		- **(d) Remuneration for services**
		- **(e) Consideration for a covenant**
* What kinds of things does s. 6(3) apply to?
	+ Inducement payments
	+ Non-competition payments
	+ Signing bonuses
	+ Payments for breach of contract, possibly including termination or dismissal
	+ Payments for restrictive covenants

**56.4(1) “restrictive covenant”**, of a taxpayer, means an agreement entered into, an undertaking made, or a waiver of an advantage or right by the taxpayer, whether legally enforceable or not, that affects, or is intended to affect, in any way whatever, the acquisition or provision of property or services by the taxpayer or by another taxpayer that does not deal at arm’s length with the taxpayer, other than an agreement or undertaking

(a) that disposes of the taxpayer’s property; or

(b) that is in satisfaction of an obligation described in section 49.1 that is not a disposition except where the obligation being satisfied is in respect of a right to property or services that the taxpayer acquired for less than its fair market value.

**Inducements/ Payments before employment**

* **Inducement payments are not paid “for services” but to encourage a worker to enter into an employment relationship**
* ***Curran* 🡪 inducement payment was not captured by s. 6(3) because it was not made by the employer.**
	+ **Facts**: C worked for Imperial Oil and was earning $25,000 a year with the expectation of a raise and the guarantee of a good pension at 65.
	+ Brown approached C to lure him away from Imperial Oil to work for a company that Brown owned.
	+ If C left Imperial Oil, however, he’d lose his pension and future opportunities.
	+ C entered a contract whereby C would quit his job and Brown would pay him $250,000 for the loss of his pension.
	+ There was no guarantee he would go work for Federated (Brown’s company).
	+ C quit, received the $250,000 and joined Brown’s company Federated and then Home Oil. He resigned after one year.
	+ **Holding**: Not captured by s.6(3). However, the SCC agreed that the payment was income from another source under s. 3.
* **Payments that compensate an employee for breach of contract or waiver of contractual rights are not “for services”, but can be captured under s.6(3) even if not *literally* inducements (*Moss*)**
	+ For para. 6(3) to apply to that payment, it must:
		- (b) relate to an obligation arising from an agreement between employer and employee, AND
		- (c), (d) or (e) – derive from consideration for accepting the employment, remuneration for services, or compensation for a covenant
* ***Moss* 🡪 amount paid to employee to surrender a contractual right was captured by s. 6(3)**
	+ **Facts**: Owner of company paid Moss $$ to release company from obligations, right of first refusal and taxes
		- **Issue**: Is this kind of payment in lieu of giving up contractual rights considered income?
		- He says, I’m not being remunerated. I’m giving up rights, capital assets.
	+ **Analysis**: The payment was subject to para. 6(3)(b) because it was made in satisfaction of a contractual obligation
		- Contract of employment has obligation on employer to let him get company. They didn’t do that but rather paid him in satisfaction of it.
	+ The payment satisfied para. 6(3)(c) because the right being satisfied was given to Moss as consideration for accepting the job.
		- The 34,000 was paid to give up his rights, BUT the rights were given to him get him to take the job, i.e. inducement, so it is consideration for it. doesn’t matter that payment wasn’t literally made for inducement.
	+ The payment itself was not consideration for accepting the job but it was made to satisfy the obligation agreed to as that consideration
	+ **Taylor says Payments to induce employees to give up contractual rights are prob going to be seen as inducements**

**Non-competition payments**

* **It is relatively common for employees and business owners to be paid to agree not to compete after leaving their employment/selling their business**
* **Payments to a former employee for a non-competition agreement are within para. 6(3)(e) – deemed to be remuneration**
	+ Payments to a former business owner are not subject to s. 6 – not paid to employee
* ***Manrell FCA* held that non-competition payments outside employment context are not taxable**
	+ Creates incentive to structure business purchases to weight non-competition payments more heavily
	+ Creates unequal treatment as between employment and business income
* **New s. 56.4 makes non-competition payments taxable as income from another source**
	+ s. 56.4 applies only to payments not already subject to ss. 5 and 6
	+ s. 56.4 was only passed in October 2013 but it applies to payments back to October 7, 2003

**Payments after Termination**

* **Payments after termination of employment include:**
	+ **Retiring benefits**
	+ **Severance pay**
	+ **Damages for wrongful dismissal**
* It is difficult to characterize these payments as being “for services”
* **reasoning in *Quance* [catching salary in lieu of notice under s.6(3) as remuneration] led to amendments to subpara. 56(1)(a)(ii) and s. 248(1) – “retiring allowances”**
	+ S.56 is part of subdivision d under Div B of part – miscellaneous income
	+ Basically s.56 says that in addition to s.3 you have to inc all these other things
* **Subpara. 56(1)(a)(ii) requires a taxpayer to include any amount received as a “retiring allowance”**
	+ **Retiring allowance is defined in s. 248(1)**
		- a) any amount received on retirement or in recognition of long service, and
		- b) an amount received in respect of a loss of employment
	+ 56(1)(a)(ii) “**a retiring allowance**, other than an amount received out of or under an employee benefit plan, a retirement compensation arrangement or a salary deferral arrangement,”
* **S.56(1)(a)(ii) does NOT req that retiring allowance be given from employer (*Ovarin*-** payment came from gov and counted as retirement allowance**)**
	+ Juxtapose w/ ***Curran*** case (payment must come from employer under s.6(3))
* **As long as you’re not employed, you’re retired and can potentially claim what you’re making as retirement allowance** (***Henderson***)
* **To the extent the payment relates to loss of employment income, it is a retiring allowance; To the extent the payment relates to other matters, it is not a retiring allowance (*Mendes Roux*)**
* **Loss of employment (s.56) is NOT same thing as loss of intended employment (*Schwartz, SCC*)**

***Quance* 🡪Payments by employer as “salary in lieu of notice” were remuneration under s. 6(3) because they were made in satisfaction of an obligation in the employment agreement (obligation to give notice- notice based off salary)**

**🡪 THINK: Q would get damages if he sued, which would be for severance, which is based off salary so same thing**

**F**: taxpayer didn’t negotiate a settlement properly so he was fired on the spot by employer, and was offered 6.5 months of pay in lieu of notice. He wanted one year and he kept refusing. But the employer said 9 months and kept sending him cheques. So he decided diff btwn 9 and 12 months wasn’t worth litigation. Then that 9 months was inc in his income for assessment and he says, no you can’t.

**I**: payments after termination.

**D**/**R**: Payment falls under s.6(3)(b).

* Payments by employer as “salary in lieu of notice” were remuneration under s. 6(3) because they were made in satisfaction of an obligation in the employment agreement
	+ The obligation was an implied obligation to give reasonable notice of termination
	+ Salary in lieu of notice serves the same function as damages
	+ Damages are neutral for tax purposes
* Company failed to give him reasonable notice which entitled him to damages, which can be severance or damages. The damages which he would have received if he had sued them would be based on the salary he would have earned during his notice (which is also the basis for severance).
	+ Even though he and company didn’t agree on the 9 months, the company was still satisfying their obligation to pay him damages in lieu of notice.
	+ Obligation to give him reasonable notice.
	+ Look at what the hole the damages are filling is.
* Court is only concerned with what the 9 months represents.
* Note: this is not damages for wrongful dismissal.
* Even if these payments were straight up damages, you can argue that they are still replacing entitlement to receive salary for a while.
* Note ***Atkins****-* Does the opposite thing as ***Quance***!
	+ FCA held that a settlement payment related to termination of employment was not income
		- Held that the payment was not salary, not covered by s. 6(3), not a separate source under s. 3
		- Looked at s.6(3)(b)(c)(d)
		- Analysis must go further and say does it fit under one of those
* **This reasoning led to amendments to subpara. 56(1)(a)(ii) and s. 248(1) – “retiring allowances”**
	+ New provision then
		- S.56 is part of subdivision d under Div B of part – miscellaneous income
		- **Basically s.56 says that in addition to s.3 you have to inc all these other things**
	+ Subpara. 56(1)(a)(ii) requires a taxpayer to include any amount received as a “retiring allowance”
	+ **Retiring allowance is defined in s. 248(1)**
		- a) any amount received on retirement or in recognition of long service, and
		- b) an amount received in respect of a loss of employment
	+ doesn’t matter if this is paid pursuant to any court order which means it doesn’t matter if it’s part of settlement
	+ s.56(1)(a)(ii)- you have to inc any amount received in lieu of payment of or in satisfaction of a retiring allowance
		- this is broad lang and it’s the same lang as in s.6(3)(b) like satisfaction of contract
		- 🡪 parl intends to count this type of money under income under its own miscellaneous head of source

***Henderson* 🡪 as long as you’re not employed, you’re retired!**

**F**: Taxpayer, Mr H, was employed by company which owned drugstore his father owned. After his father, he owned it but then sold it to Shoppers Drug Mart, but the company which used to own the drug store remained. He kept it and did some stuff for company without being paid and worked PT for Shoppers. After a while, the company he owned paid him some money over some time and he wanted it to be retirement allowance so he can put it in RRSP tax free.

**I**: payments after termination; what is retirement?

**D**/**R**: An amount can still count as retirement allowance even if it doesn’t match ordinary perceptions of retirement.

* “Retire” ordinarily means to withdraw from employment or business in order to enjoy leisure
* Retire ordinarily connotes voluntariness and permanence
* TJ says this is not retirement allowance b/c you didn’t retire.
	+ Judge doesn’t say what the reason for payments were.
* Court looks at defs of retirement: Mr H didn’t withdraw and it wasn’t voluntary. His company changed what it did. But he did retire b/c he didn’t have an ongoing relationship with his company and he wasn’t getting paid.
	+ Court didn’t deal with other elements of retirement.
	+ Judge says there was long service and he got it for long service but judge doesn’t point to any evi of why this was so.

***Mendes- Roux* 🡪 splitting of award based on what it represents**

**F**: Ms M was lawyer who went on mat leave and she was told her office was closed and you either move to Fredericton now or you are considered to have quit. She claimed wrongful dismissal and damages. They ended up settling.

**I**: Was settlement she got in respect of loss of employment, or in respect to something else (mental distress, emo harm etc); phrase ‘ in respect to loss of income’

**D**/**R**: Court split the payment 50-50 btwn personal injury and loss of income

* If there is evi that settlement is for things other than loss of employment, then it isn’t retirement allowance.
* **To the extent the payment relates to loss of employment income, it is a retiring allowance**
* **To the extent the payment relates to other matters, it is not a retiring allowance**
* “loss of employment” is interpreted with a view to the income loss
* The phrase ‘in respect’ is very broad and SCC has held it captures basically any relationship
* ***Ovarin***: Taxpayer worked for bankrupt company and lost job and was compensated by prov gov
	+ Was that payment being from gov as opposed to employer matter?
		- Court said no, nothing reqs in section that retiring allowance be given from employer.
		- Important b/c s.6(3) talks about payment from employer to employee and given the ***curran*** case (paid by company A to go from B to C when C owns A) where court held that didn’t count b/c it wasn’t from the employer
		- So it depends on which section you're under.

***Schwarz, SCC* 🡪 loss of employment is NOT same thing as loss of intended employment**

**F**: Taxpayer is lawyer who was partner of law firm; offered position with new company; signed K and told other partners he’s leaving; then new company yanked offer; he left law firm any way; new employer offered him settlement for breach of K and issue of what he should receive; settled for 400,000 (360 in compensation and 40 in legal costs). CRA came along and inc whole 400,000 in income.

**I**: Was employment lost?

**D**/**R**: --

* Minister argued
	+ 56(1)(a)(ii)- retiring allowance
		- Fail, court says he wasn’t retired.
	+ 6(1)(a)- benefit
		- TJ No, he didn’t retire.
		- Dropped at CA level.
	+ S.3- just another source of income
* TJ then refused to split the 360,000 into components
	+ FCA- no we have enough evi to split it
		- 342,000 and 18,000
		- So this was error of TJ
	+ FCA takes 342,000 and says that is income under s.3 b/c the source is the contract with the new company
* SCC- FCA can't make those divisions. It is only one big blob.
	+ You can't apply s. 3 b/c this is not income
	+ **S. 56 loss of employment is distinguished from loss of intended employment**
	+ Presumption of consistent meaning
		- S.80(4.1) specifically uses intended employment so parl would have said so if they meant it
* **The payment was not related to the loss of an employment because no employment ever commenced**
	+ “in the service of” an employer connotes active service
* court considered s. 3
	+ The FCA said the employment contract was a source of income even if the employment did not commence
	+ The SCC held that there could be other sources under s. 3
		- No case has found one since
	+ It cannot be another source in this case because it is impossible to allocate the payment between lost income and other damages that are not income

*Minority, Major J.*

* Totally disagree with majority to even talk about s.3
* All cases have only ever recog office, employment, and other two and they have not recog any other source of income
* Michael Taylor- Major J is very anti tax.

**EMPLOYEE BENEFITS- Inclusion in Income [employment + office]**

**TAXABLE BENEFITS- Intro**

* **The general rule for taxable benefits in para. 6(1)(a) 🡪 BROAD LANG!**
	+ **Include the value of board, lodging and any other benefit of any kind whatever received or enjoyed by the taxpayer in respect of, in the course of, or by virtue of an office or employment**
* **3 kinds of exceptions to this broad general rule**
	+ Income arrangements dealt with somewhere else in s. 6 or s. 56 (specific rules prevail over general)
	+ Other benefits specifically addressed under s. 6 (e.g., disability insurance, automobile benefits)
	+ Benefits from contributions to private health services plan or counselling services (exempt)
* **3 conditions to the application of para. 6(1)(a)**
	1. **A benefit must be received**
	2. **The benefit must be sufficiently related to the employment**
	3. **The value of the benefit must be ascertained**

**1. Characterization- What is a BENEFIT?**

* What makes something **a benefit**?
	+ Task for statutory interpretation
		- Ordinary meaning is “advantage”, “profit”, “fruit”, “privilege”, “gain”
		- “any other benefit” is part of a list that starts with “board” and “lodging” (associated words rule)
			* But the section says “of any kind whatever”
		- Need a wide scope to attain the purpose of the section
* ***Lowe***🡪 **TEST for what is benefit: a material acquisition which confers an economic benefit on the taxpayer, and any personal element to the benefit must be incidental to business element**
* Office parties, social events, transportation to and from work are benefits
* CRA adopts an administrative position that excludes many *de minimis* things that would technically be benefits
	+ Eg office parties under $100

***Lowe*🡪 TEST for what is benefit: a material acquisition which confers an economic benefit on the taxpayer, and any personal element to the benefit must be incidental to business element**

**F**: Mr L is a sales rep for insurance company, which intro special broker thing where brokers got New Orleans trip. Taxpayer then has to get brokers to buy his company’s insurance and the company said he had to go with them and he took his wife, and said he thought it was required. CRA assessed him to inc 62% of the trip as a benefit and taxed him for it.

**D**/**R**: Tax court found only 20% was taxable.

* **The test for a benefit is a material acquisition which confers an economic benefit on the taxpayer**
* **There may be a personal element as long as it is incidental to a business element**
* When there are two competing elements to trip (business and pleasure) you have to see which one is primary
* Evi here showed primary purpose of trip was for employer’s business and any personal benefit he got was merely incidental and they extended that to his wife too.
* What if the employer requires the employee to accept the benefit? Not determinative
	+ It doesn’t change the fact that the benefit has a material value

**2. Relationship of the Benefit to Employment**

* **The benefit must be received or enjoyed “in respect of, in the course of, or by virtue of” the employment**
	+ benefit is still taxable even if paid by someone other than employer (***Waffle***)
* ***Savage***: **“in respect of” is very broad; the payment does not have to be remunerative in nature, but must be received *qua* employee**
	+ Taxpayer had passed insurance certificates which weren’t req for her insurance work and didn’t give her any promotion. She got a prize for each once she passed.
	+ **Anything received in relation to your employment counts.**
	+ The thing you receive doesn’t have to be remuneration
	+ It is only exempt if it is a personal gift
	+ CRA administrative exception for non-cash gifts to employees – up to $500 per person per year if employer does not deduct them
	+ ***Phillips*** *–* Some debate over how to treat benefits that appear to be conferred under collateral contracts
	+ ***Waffle****–* benefit is still taxable even if paid by someone other than employer
	+ ***Giffen*** – frequent flier points are taxable benefits.

**3. Valuing the benefit**

* **FCA decisions (*Schroter* and *Spence)* suggest that fair market value is the preferred method**
	+ Fair market value is the highest price that someone will pay in an open market
	+ Divorced from any specific individual factors such as what the benefit costs employer to provide or whether it has particular value to the employee.

**Specific Rules- Auto Benefits**

* Fairly common for employers to provide an employee with a vehicle, or to pay vehicle expenses for employee’s personal vehicle
* **Para. 6(1)(a)(iii) excludes any benefit in relation to the use of an automobile from the general rule of 6(1)(a)**
	+ **Auto benefit gets its own rule- see below!**
* **Automobile is defined in s. 248(1)**
	+ Motor vehicle designed to carry driver and not more than 8 passengers
	+ Does not include emergency vehicles, taxis, buses, hearses, vans or pick-ups used primarily to transport goods or equipment
* **There are three types of automobile benefits:**
	1. Standby charge (represents value of having a vehicle available for use)
	2. Operating expense benefit (represents value of actual usage)
	3. Parking benefit

**1. Standby charge 🡪 ‘benefit’ according to special car rules**

* **Para. 6(1)(e) requires inclusion of a “reasonable standby charge” where the employer makes an automobile available for the employee’s use**
	+ Reasonable standby charge is 2% of capital cost to purchase, or 2/3 of monthly leasing cost, for each month that automobile is available.
	+ When vehicle is not licensed or insured, it cannot be legally drivable. It can only become ‘available for use’ once it is legally drivable (i.e. licensed and insured) (***Hewitt***)
* **The benefit is equal to:**

**(reasonable standby charge)**

***minus***

**(any payment to employer by employee for use of the vehicle)**

* **The standby charge is reduced if:**
	+ (a) the employee is required to use the vehicle in connection with employment and the distance travelled is primarily in connection with employment;
	+ (b) the total personal use is less than 20,000 km per year; or
	+ (c) the employee is employed principally in selling property or negotiating contracts

***Hewitt* 🡪 When vehicle is not licensed or insured, it cannot be legally drivable. It can only become ‘available for use’ once it is legally drivable (i.e. licensed and insured).**

* One man company (incorporated himself) and company had car uninsured and unused and unlicensed in his garage
* **Issue**: Does it count as “available for use”?
* **An unlicensed, uninsured vehicle is not available for use by the employee**
	+ Even if the employee has control over whether the vehicle is licensed and insured
* A standby charge benefit begins as soon as insurance is effective
* When vehicle is not licensed or insured, it cannot be legally drivable. It can only become available once it is legally drivable (i.e. licensed and insured).
	+ There is no practical benefit for him which is sitting there
* If vehicle was crashed and not able to move, it would be absurd to say he has benefit of it sitting in garage b/c he can make it drivable by fixing it.

**2. Operating expense benefit 🡪 ‘benefit’ according to special car rules**

* **Two types of operating expense benefits:**
	+ **(1) The employee uses the employer’s vehicle (6(1)(k))**
	+ **(2) The employer pays expenses related to the employee’s personal vehicle (6(1)(l))**
* **(1) Para. 6(1)(k) applies where the employee uses the employer’s vehicle (which means there is already stand-by charge and 6(1)(e) applies)**
	+ The benefit is based on a prescribed amount per kilometre driven
	+ “Prescribed” means prescribed by regulations
	+ The amount is in Regulation 7305.1
* *The benefit is reduced if:*
	+ a) the employee reimburses the employer;
	+ b) the employee uses the vehicle primarily in performing their duties; or
	+ c) the employee is employed in selling vehicles
* **(2) Para. 6(1)(l) applies where the employee uses their own vehicle (but employer is paying the costs)**
	+ The benefit is equal to the cost of the personal use km that are paid for by the employer
	+ Calculated as a pro-rated portion of all costs paid by the employer:
		- (personal use km)/(total km) x (costs paid by employer)

**3. Parking benefit 🡪 ‘benefit’ according to general benefit rule 6(1)(a) [FMV of parking pass]**

* s. 6(1.1) excludes parking benefits from “benefits in respect of the use of a motor vehicle”
* This means parking is not excluded from the general rule in para. 6(1)(a) by subpara. 6(1)(a)(iii)
* ***Schroter*, FCA** – value of benefit is fair market value of parking pass

**Specific Rules- Insurance Benefits**

* **Employer-provided insurance for the employee could create two kinds of benefits:**
	+ **Benefit of having insurance coverage that is paid for by the employer**
	+ **Benefit when insurance proceeds are received**
* **The Act recognizes five types of employer-provided insurance:**
	+ Group sickness insurance
	+ Group accident insurance
	+ Group disability insurance
	+ Group term life insurance
	+ Private health services plan
* **For group sickness, accident and disability insurance, the scheme is:**
	+ No benefit in respect of employer contributions (para. 6(1)(a)(i))
	+ Benefits paid out by the plan are taxable (para. 6(1)(f))
	+ These plans are called **“wage loss replacement plans”**
* **For group life insurance, scheme is:**
	+ subpara. 6(1)(a)(i) excludes any benefit in respect of employer contributions, but s. 6(4) requires the inclusion of a benefit determined by regulations
* **For private health services plans, there is no benefit inclusion.**
* **Para. 6(1)(f) requires an inclusion for benefits received under employer-provided insurance plans**
	+ The amounts received must be **payable on a periodic basis**
		- means the entitlement to be paid was periodic
		- Even if paid later as a lump sum, the amounts were still *payable* on a periodic basis
	+ The amounts must be payable **“pursuant to” a plan**
		- Payments made under the plan qualify
		- What about payments made to compensate for benefits not paid under the plan?
			* Meaning less clear
		- payments for past benefits that had been denied were taxable as being paid “pursuant to” the insurance plan *(****Tsiaprailis-*** surrogatum principle***)***
	+ The **employer must have made a contribution or paid a premium to the plan**
* **NOTE s.6(1)(e.1):** payments by employer into insurance plan for **group sickness or accident**, the amount of those payment will be benefit if payments under the plan wouldn’t be a benefit to the employee under s.6(1)(f)
	+ So if they are not payable periodically and not for wage loss (i.e. loss of employment income)
	+ So it catches more basically to make it taxable

***Tsiaprailis* 🡪 payments for past benefits that had been denied were taxable as being paid “pursuant to” the insurance plan**

**🡪 The settlement funds were paid to satisfy the obligation to pay benefits**

**🡪 surrogatum principle: settlement takes on character of that which it replaces, i.e. periodic plan payments**

* **Facts**
	+ Taxpayer was on disability insurance
	+ Employer benefit plan kicked in to provide her with benefits
	+ The insurance company cut her off- ‘you’re not disabled any more. Go back to work’
	+ They litigated and settled and she got lump sum of $105,000.
* Court found the money represented:
	1. Money she had been entitled to that they hadn’t paid her
	2. Settled for liability of insurance company for the future
	3. Costs
* **Issue**: Whether the portion of the payment that reflected the past benefit she hadn’t gotten until the settlement is taxable
	+ Tax Court- no, it is not paid in pursuant to the plan, none of them.
	+ FCA- portion 1 was paid pursuant to the plan and was a benefit.
	+ SCC- two ways of looking at it
		- Settlement is payment for past periodic payments so taxable
		- OR
		- Settlement is releasing insurance Co from paying payments
* **Analysis***:* payments for past benefits that had been denied were taxable as being paid “pursuant to” the plan
* The settlement funds were paid to satisfy the obligation to pay benefits
* The settlement funds had the character of payments that would be taxable under para. 6(1)(a) – ***surrogatum* principle 🡪 The settlement takes on the character of what was replaced.**
	+ Settlement is tacit recog that she was entitled to periodic payments under her insurance plan. So it’s a benefit.
* A lump sum payment for future benefits is not taxable – not paid “pursuant to” the plan as no obligation exists until some time in the future
* *Dissent*: the settlement isn’t replacing anything. It is a separate transaction and distinct from contract of insurance. They see things separately while majority view them as interrelated.
	+ Note: is accepting payment for releasing future liability giving up legal right which has value?
		- unclear

**Specific Rules- Employee Loans and Debt**

* **Employment benefits may arise where an employer makes a loan to an employee, or where an employer forgives a debt owed by the employee.**
* Arises often in the context of housing
	+ Employers make loans to employees to cover costs of relocation and finding new housing
* **s. 80.4(1) deems an individual to receive a benefit in relation to a loan when:**
	+ It is received because of, or as a consequence of, a previous, current or intended office or employment
		- s. 80.4(1.1): a loan is deemed be received because of an employment **where it is reasonable to conclude that but for the employment, the terms would be different or the loan would not have been made**
	+ Also when it is received because of the services of a personal services business
* **s. 6(9) then requires an employee to include any benefit under s. 80.4(1) in income from employment**
	+ **The benefit under s. 80.4(1) is equal to:** 🡪recog benefit of lower interest on the loan basically

 (a) interest calculated at the prescribed rate [based on gov of Canada T-bills (tied to prime rate)]

 *plus*

 (b) interest paid or payable by the employer

 *minus*

 (c) interest paid in the year or by 30 days after year-end

 *minus*

 (d) interest paid or payable by employer that is reimbursed by employee

* **exception to s. 80.4(1)- s. 80.4(3): s. 80.4(1) does not apply if**
	+ (a) the interest paid by the employee is a commercial rate (even if less than the prescribed rate), or
	+ (b) any part of the loan was included in income
* **s. 6(15) states when part of a loan which is forgiven will be included in an employee’s income**
	+ s. 6(15) deems a benefit to be received when an obligation is settled or extinguished
	+ A loan is forgiven where it is settled/released, or where the limitation period for collecting on it expires
		- The limitation period is a matter of provincial law
	+ Value is forgiven amount at the time in relation to the obligation

**Specific Rules- ALLOWANCES**

**General Rule**

* Allowances can be a significant source of employment benefits
* **para. 6(1)(b) requires an employee to include all amounts received as allowances in income**
	+ very broad provision
	+ There are numerous exceptions in s. 6
* **What is an allowance? TEST from *McDonald*, FCA**
	+ **an allowance has three characteristics:**
	1. **An arbitrary amount that is predetermined without reference to an actual cost**
	2. **Usually paid for a specific purpose**
	3. **To be used at the recipient’s discretion without accounting for it**
* CRA distinguishes between an **allowance**, a **reimbursement** [amount paid by employer to employee for amounts employee spent on employer’s business], and an “**accountable advance**” [amount given by employer to employee for amounts to be incurred by employee for employer’s business]
	+ Allowances are taxable benefits while reimbursements and accountable advances are not usually
	+ Why? Principled reason to distinguish? What about tax equity? What about the children?
* ***Huffman***🡪 dealing with a clothing allowance
	+ If employee spends 400 on clothes, they get 500. CRA attempted to tax 80 when employee spent 420 and got 500. Court allowed it to be allowance.
* ***Verdun*** 🡪 dealing with a meals allowance; didn’t allow meals for evenings at second job location to be deducted from income as a reimbursement; held them to be taxable benefit of allowance
* ***McDonald*, FCA 🡪 test for allowance which counts as benefit for employee (inc in employment income)**
	+ **Facts**
		- RCMP officer paid housing subsidy upon city transfer, regardless of where he lived and what he paid and he wasn’t req to show any evi for it.
	+ **Issue**: whether this was an allowance.
	+ **Analysis**: YES.
		- The housing subsidy has all the legal characteristics of a taxable allowance.
		- The amount was arbitrary, it was for a specific purpose and the respondent had the sole discretion to deal with the amount.
		- It should be treated as income.

**EXCEPTIONS**

**Travel Allowance Exceptions**

* **key exceptions to the allowance rule in para. 6(1)(b): subparas. 6(1)(b)(v), (vii) and (vii.1)**
* **exceptions for travel allowances** 🡪 **i.e. do not include them in income from employment/office**
* **subpara. 6(1)(b)(v)**: do not include reasonable allowances for travel expenses of an employee employed in connection with selling property or negotiating contracts
* **subpara. 6(1)(b)(vii)**: do not include reasonable allowances for travelling away from the municipality where the employee normally works in the performance of the duties of employment
	+ Must also leave the metropolitan area, if there is one
	+ Allowances for the use of a motor vehicle are excluded from 6(1)(b)(vii)
* **subpara. 6(1)(b)(vii.1)**: do not include reasonable allowances for the use of a motor vehicle for travelling for the performance of the duties of employment
	+ subpara. 6(1)(b)(x) establishes what is a reasonable motor vehicle allowance
	+ Must be based on mileage (i.e., per km driven)
* ***BUT*** **subpara. 6(1)(b)(xi) provides that an allowance is not excluded from income if** employee receives both an allowance and a full or partial reimbursement of motor vehicle expenses

**Special Sites and Remote Work Locations**

* **ss. 6(6) is another exception to allowance rule in 6(1)(b): special work sites and remote work locations**
* 🡪 **i.e. do not include them in income from employment/office**
	+ ss. 6(6) is a general exception to the inclusion of benefits and allowances in respect of board and lodging
	+ Relates to:
		- Special work sites – employee works temporarily somewhere where it is not reasonable to expect him to return home daily
		- Remote work locations – a location so remote from an established community that the employee could not reasonably be expected to maintain a home

**Special Rules for Benefit- STOCK OPTIONS**

* Stock options are a significant form of employee compensation for executives and in certain industries
* **Options give employees the right to buy shares of the employer at a fixed price, and sell at higher FMV later**
* **governed by s. 7—Three key provisions:**
	+ **ss.7(3), 7(5) and 7(1)**
	+ **7(1)(a) [exercise stock option] and 7(1)(b) [dispose of stock option] create income inclusions**
	+ Also s. 110 is relevant (deductions in computing taxable income)
* **ss. 7(3) deems there to be no benefit from a stock option except as provided by s. 7**
	+ This excludes stock options from the general benefit rules in s. 6
	+ Employer could argue there is a potential benefit to the employee just by having the option but that is not recog by the Act. What the Act recog is that money you make, i.e. when you as employee of apple get share for 2 bucks and sell it on the market for 600 bucks. Act cares about that 598.
* **ss. 7(5) provides that s. 7 does not apply unless the benefit of the stock option agreement was received “in respect of, in the course of, or by virtue of” the employment**
	+ The same connecting test as in s. 6 rules for other benefits
		- ***Savage***: **“in respect of” is very broad.**
* **\*INCOME INCLUSION\*para. 7(1)(a): An employee who exercises a stock option is deemed to receive a benefit equal to the difference between the fair market value of the shares acquired and the amount paid for them**
	+ **The amount paid for the shares is the option price plus any amount paid to acquire the option itself**
		- eg if you have to pay $5 to have the option and $2 to buy the share.
	+ opening words, ‘qualifying person’ def as corporation or mutual fund that gives its employee the right to buy a share.
		- Mutual fund- trust that is held by trustee and people buy units of the fund but get no ownership.
	+ **benefit is deemed to have been received b/c of the employment & is included in employment income**
	+ **benefit arises at the time of exercising the option, not at the time of selling the shares**
		- potentially creates a **cash flow problem** for the employee
		- The employee has a taxable benefit but received no money to pay the tax
		- The benefit is not “realized” until the shares are actually sold
		- It is undesirable policy if the tax treatment of stock options practically forces employees to immediately sell the shares
* **When the employee sells the shares, there may be other tax consequences**
	+ If the shares have increased in value, there could be a capital gain
		- Under para. 53(1)(j), the amount of any benefit under s. 7 is added to the “adjusted cost base” of the shares to reduce the capital gain and avoid double taxation
	+ If the shares have decreased in value, there could be a capital loss
* **🡪 Nothing that happens after the shares are acquired affects the s. 7 benefit – it is locked in.**
* **ss. 7(1.1) provides some relief for stock options of Canadian-controlled private corporations (CCPCs) granted to arms’ length employees**
	+ “Canadian-controlled” means non-residents of Canada hold 50% or less of the voting shares (i.e., not enough votes to control)
	+ “Private corporation” means a corporation not listed for trading on a public stock exchange
	+ Until they have the liquidity to pay it as the employer
	+ Under ss. 7(1.1), an employee is deemed not to realize the stock option benefit until the shares are sold
* **\*INCOME INCLUSION\* para. 7(1)(b): deems a benefit to be received when the employee disposes of options (w/out exercising them) and receives compensation**
	+ **The benefit is the difference btwn the compensation received and the amount paid to acquire the option rights**
	+ para. 7(1)(b) applies only when the options are disposed of to **an arm’s length person**
* **Under s. 248(1), a “disposition” includes:**
	+ Any event or transaction that entitles a taxpayer to proceeds of disposition
		- Under s. 248(1), “proceeds of disposition” include the sale price of property that has been sold
	+ Any event or transaction where an option to acquire property expires
	+ Options are disposed of for purposes of para. 7(1)(b) where they are sold, transferred, gifted, or when they expire
	+ ***Buccini*** - disposition is when taxpayer voluntarily exchanges option w/ some other consideration.
* **It is not clear whether a disposition occurs when the employee surrenders the options**
	+ Even if the employee is paid to do so
* **Under ss. 7(1.7), where payment is received in exchange for an option ceasing to be exercisable, the employee is deemed to have disposed of the option [to satisfy ‘disposition’ under 7(1)(b) and trigger benefit]**
	+ This applies where there would not otherwise be a transfer or disposition
	+ Where ss. 7(1.7) applies, the amount that the employee is deemed to have paid for the options is:
		- (amount actually paid) – (compensation for surrender)
* **ss. 7(4) extends the operation of s.7**
	+ s. 7 continues to apply where the employee ceases to be an employee before all things have happened that would make s. 7 apply
	+ This provision ensures that options not exercised until the employee is no longer an employee will still be subject to s. 7
	+ Ensures uniform tax treatment regardless of when the stock options are exercised
* **s. 110 provides some tax relief relating to employee stock options**
* paras. 110(1)(d) & (d.1) – deduct 50% of the stock option benefit from taxable income in some circumstances
	+ para. 110(1)(d) applies only if the exercise price of the option was equal to or greater than the fair market value of the shares at the time the option was granted, and the employee deals with the employer at arm’s length
	+ para. 110(1)(d.1) applies only for shares of a CCPC that are held for 2 years before being disposed of
* para. 110(1)(d.01) and ss. 110(2.1) provide additional deductions from taxable income where stocks acquired with options, or the proceeds of those stocks, are donated to charity
	+ The other 50% of the benefit may be deducted under these provisions
* ***Taylor v MNR, TCC*** **🡪 T received stock options as consideration for services he would go on to perform as director, so he got them qua director, i.e. by virtue of his employment, so the benefit is taxable (under employment income) under 7(1)(a)**
	+ **Facts:** T was director of 2 corporations, from both of which he received stock options.
	+ CRA inc those stock options as taxable benefits inc in employment income on grounds that they were received by virtue of T’s employment as director of these corporations under 7(1)(a)
	+ **Analysis:**
	+ T argues- director isn’t controlled by corporation and is not an employee.
		- Rejected. Director is an office, officer in an employee of corporation.
	+ T argues- even if he is employee, he didn’t receive stock options ‘by virtue’ of his employment
		- b/c directors aren’t really engaged in employment (narrow 248(1) def of ‘in service of another’
			* Rejected. All employees are engaged in employment; need this to make s.7 make logical sense.
		- b/c benefit he got was not result of remuneration but rather result of Co wanting to enhance its reputation in being associated w/ T
			* rejected. Co’s reputation goes up not b/c of a name on prospectus but b/c shareholders will think T will do good job in duties as director
			* connection needed to employment is not substantial.

**DEDUCTIONS from EMPLOYMENT + OFFICE INCOME**

* **Under s. 3, “income” from a source is a net concept [income inclusions minus applicable deductions]**

**Employment + Office Deductions- GENERAL RULES**

* **Under ss. 8(2), no deductions from employment income are permitted except as allowed by s. 8**
* **Most deductions from employment income are found in ss. 8(1)**
	+ **ss. 8(1) permits expenditures to be deducted to the extent that they are partly/wholly applicable to an office/employment source of income**
	+ This principle permits pro-rating expenditures that are partly related
* There are some additional rules in ss. 8(12) (forfeiture of securities) and 8(13) (home office expenses)
* **Deductions under s. 8 are subject to various general limitations**
	+ **ss. 8(10) – certain deductions only allowed if the employer signs a certificate**
	+ **s. 67 – no deductions ever allowed if they are unreasonable**
	+ **s. 67.1 – any deduction for food & beverages or entertainment is always limited to 50% of actual cost**
* **Not all of an employee’s expenses are related to earning income from employment 🡪 many are implicitly personal**
* Personal costs of employment receive tax recognition through a minor tax credit under ss. 118(10) (Employment Tax Credit)
	+ ss. 118(10) allows a nonrefundable tax credit equal to 15% x $1,117 = $168 in tax savings

**Specific Deductions- Employment & Office**

**Travelling Expenses- Specific E&O Deduction**

* **Travel expenses generally include transportation, accommodation, meals**
* **para. 8(1)(h) applies to travel expenses, except motor vehicle expenses**
* **para. 8(1)(h.1) applies to motor vehicle expenses**
* **ss. 8(4) creates special limits for meals expenses**
* **Under para. 8(1)(h), travel expenses are deductible when two conditions are met:**
	+ **(1)** The taxpayer was ordinarily required to carry on the duties of employment away from the employer’s place or business or in different places;
	+ *AND*
	+ **(2)** The taxpayer was required, under the contract of employment, to pay the travel expenses incurred in performing the duties
	+ **no deduction is available if:**
		- the employee receives an allowance for travel expenses that is not included in employment income under para. 6(1)(b)(v), (vi) or (vii)
		- *OR,*
		- the employee claims a deduction under paras. 8(1)(e), (f) or (g) in respect of the expenses
			* paras. 8(1)(e), (f) or (g) are special rules for railway employees, salespeople and transport company employees
* **Para. 8(1)(h.1) has the same conditions for motor vehicle expenses as travel under para. 8(1)(h)**
	+ **NOTE- paras. 8(1)(h) and (h.1) are subject to ss. 8(10): the employee must file a certificate signed by the employer**
* **For meals expenses, there is a further limitation under ss. 8(4)**
	+ Meals are not deductible unless the taxpayer was away from the municipality in which the employer’s “establishment” to which the taxpayer reports for work is located, for at least 12 hours
	+ If there is also a “metropolitan area”, the taxpayer must be away from it for 12 hours
* **para. 8(1)(j): if a deduction is available under s. 8(1)(h.1), then a taxpayer is also entitled to deduct:**
	+ interest on money borrowed to purchase a vehicle
		- The borrowed money must be used to purchase the vehicle
		- The vehicle must be used in performing the duties
	+ capital cost allowance in respect of the vehicle

**Issues arising from Paras. 8(1)(h) and (h.1)**

**(1)** Is taxpayer ordinarily required to perform the duties away from the employer’s place of business?

What does “ordinarily required” mean?

What is the employer’s “place of business”?

**(2)** Is the taxpayer required to pay the travel expenses under the contract of employment?

**(3)** Was the travel undertaken in the course of performing the duties of the employment?

**(4)** Did the taxpayer receive a travel allowance?

* **Meaning of ‘employer’s place of business’? 🡪 issue #1**
	+ **CRA position: “Place of business” means an establishment of the employer**
	+ ***Nelson***: **The employer’s place of business is the employer’s establishment where the employee was hired to work and where he ordinarily reports to work.**
		- **Facts**: Nelson- architect- lived in Ontario- hired to oversee construction project in a site to which he went in another town
		- Head office of company is in Toronto and he is arguing that is the place of business where he ordinarily worked and since he is away from that since he is in another town, he should be able to claim meals and such as deductions from employment income.
		- **Analysis**: Court disagreed. Place where particular employee was hired to work and ordinarily works
		- Nelson doesn’t get the deduction then.
		- Court recog that many employers have many places of business.
* **Meaning of “ordinarily required to perform duties away” 🡪 issue #1**
	+ **CRA position: “ordinarily” means “customarily” or “habitually”**
		- Not continually
		- CRA is not focused on numeric frequency
	+ **It is not clear that ordinarily requires any minimum frequency**
	+ ***Ronchka***: a 4 ½ month assignment to a different location did not constitute “ordinarily”
		- Normally vs. rarely, exceptionally, temporarily
	+ Contrast ***Ronchka*** with ***Tremblay****:* an 8 month language training assignment was “ordinarily” working away from the employer’s place of business
	+ Other case of detective going to court and court saying he has to travel for that but that is part of his job and there isn’t a way of knowing how many times he has to do it per week or whatever
* **Meaning of “required to pay the travel expenses under the contract of employment”🡪 issue #2**
	+ **CRA position: “Required” means travel is necessary in order to perform the duties satisfactorily**
	+ **Required could mean specified in employment contract, OR practically necessary in order to fulfill employment duties**
	+ ***Cival*🡪 employee has to be bound; something that can be enforced; FCA applies contractual principles**
		- **Facts**: Employee of fed gov who was union member.
		- Side agreement with manager that gov would reimburse travel costs which wasn’t in the collective union agreement.
		- He’s not disqualified from getting travel expenses b/c he hasn’t gotten an allowance but rather a reimbursement.
		- **TJ**- reimbursement was too low so he can get it.
		- **FCA**- contract is the collective agreement btwn union and gov and that doesn’t say you’re req to use your own car. FCA construed this as a unilateral contract (offer to the world).
			* This isn’t a binding agreement by which employer can force him to use his own car.
		- taxpayer was not required by collective agreement to use his own car; arrangement with employer was a unilateral contract
	+ Not always followed!!
		- contrast with ***Rozen*** where Tax Court accepted an implied term of employment requiring the taxpayer to use a personal vehicle
			* Even though the contract of employment was silent about using his car, practically he had no choice so the court found implied term which req him to pay his own expenses.
* **When is the travel carried out “in the course of” the employment? 🡪 issue #3**
	+ **Travel from home to work is traditionally viewed as personal**
	+ ***Luks* 🡪 Travelling between home and work was not travel “in the course of” the employment**
		- Even though the employee had to transport tools that were required to perform his duties
		- His tools were valuable so he didn’t want to leave them at work.
		- Still pretty much followed mostly today.
	+ Compare ***Evans****:* a school board psychologist was allowed to deduct travel to and from home because he went to different schools each day.
* **If employee gets travel allowance, she is not allowed to deduct travel expenses 🡪 issue #4**
	+ **Despite *Yurkovich,* CRA views a mileage-based payment as an allowance**
		- Recall ***MacDonald***: an allowance is not typically determined by reference to actual costs
	+ ***Yurkovich* 🡪 A per-km payment was not an allowance but a reimbursement**; **taxpayer is still eligible to deduct expenses under para. 8(1)(h.1)**
		- He received less than the actual cost to himself of the traveling so he tried to deduct the difference as a travel expense.
		- CRA- what you received was arbitrary amount in advance w/out eye to actual costs which is an allowance which is a benefit which has to be inc in employment income.
		- Court found CRA was full of crap and amount employee got was reimbursement.
		- Taylor- case doesn’t est any rule; more of an eg of what this section is
	+ ***Gauvin:* if the allowance is reasonable, there is no deduction even if the allowance is inadequate**

**Meals Expenses - Specific E&O Deduction**

* **There are two restrictions on employees deducting meals expenses**
	+ **ss. 8(4)** – away from the municipality in which the employer’s establishment to which the employee “ordinarily” reported for at least 12 hours
		- ***Healy***: “ordinarily” reported in ss. 8(4) means usually, commonly, in most cases, as a general rule
	+ **s. 67.1** – expenses for food & beverages are limited to 50% of the actual cost

**Salesperson Expenses - Specific E&O Deduction**

* salesperson is Taylor’s shorthand- the Act doesn’t use that phrase
* **para. 8(1)(f) applies to taxpayers employed in connection with selling property or negotiating contracts**
	+ para. 8(1)(f) confers a broad right of deduction
* **para. 8(1)(f) applies when 4 conditions are met:**
	+ (1) employee is required under the contract of employment to pay his own expenses
		- employment contract just needs to require employee to pay their own expenses
		- It does not need to require the employee to incur any *specific* expenses
		- How to spend money in order to generate sales is at the employee’s discretion
	+ (2) employee is ordinarily required to carry out his duties away from the employer’s place of business
	+ (3) employee is remunerated in whole or in part by commissions or similar amounts
	+ (4) employee does not receive a travel allowance that is exempt under s. 6 (a reasonable travel allowance)
* **🡪 When para. 8(1)(f) applies, the taxpayer may deduct all amounts expended for the purpose of earning employment income**
* **There are 3+1 specific restrictions in para. 8(1)(f):**
	+ No capital expenditures
	+ No deduction for amounts that would be prevented by para. 18(1)(l) for a business (recreational facilities and membership dues)
	+ No expenses that would reduce a standby charge under para. 6(1)(e) (i.e., a reimbursement of auto expenses paid to employer)
	+ deductible expenses may not exceed the amount of commission income in the year
		- Could be significant if the employee is remunerated only partly by commissions
		- Would prevent a salesperson from reporting a loss from employment
* **para. 8(1)(f) is subject to the same three general restrictions as all expenses under s. 8:**
	+ The expense must be wholly or partly applicable to the employment (ss. 8(1))
	+ The expense must be reasonable (s. 67)
	+ Food and beverage expenses are limited to 50% (s. 67.1)
* **A salesperson may choose to deduct travel and motor vehicle expenses under paras. 8(1)(h) and (h.1) instead of para. 8(1)(f)**
	+ 8(1)(h) and (h.1) are not subject to the commission limitation of 8(1)(f)

**Legal expenses - Specific E&O Deduction**

* **para. 8(1)(b) – legal expenses may be deducted only if incurred to collect, or to establish a right to collect, amounts that would be required to be included in income under subdivision a (income from office and employment)**
	+ **Employees cannot deduct legal expenses incurred to collect amounts that are not included in income from employment/office (*Bongiovanni*)**
* **The purpose [to est right to amount that would be income from employment/office], not the result, of the legal action, is determinative *(Werle*)**
* para. 8(1)(b) was amended in 2013, applicable retroactively to 2001
	+ Previously it referred to collecting salary or wages owed by an employer or former employer
* ***Werle* 🡪 The purpose, not the result, of the legal action, is determinative**
	+ the expenses are deductible if incurred to collect wages even if the claim is unsuccessful
	+ As long as purpose of legal claim was to get salary
	+ **Even though the section has been changed, this principle is still good law**
	+ Now the section allows amounts that are employment income but are not wages and salary
* Employees cannot deduct legal expenses incurred to collect amounts that are not included in income from employment.
	+ ***Bongiovanni*****🡪 legal expenses incurred to collect worker’s compensation benefits were not deductible because they were not salary or wages.**
		- would be decided the same way now because WCB benefits are not included in income under subdivision a (they are included under s. 56 in subdivision d).

**Professional membership & union dues- Specific E&O Deduction**

* **Dues to maintain a professional membership status, and union dues, are deductible.**
	+ subpara. 8(1)(i)(i) – annual dues to maintain a professional membership status are deductible
		- E.g., Law Society membership, College of Physicians and Surgeons
	+ subparas. 8(1)(i)(iv) & (v) – annual dues to a union are deductible
	+ subparas. 8(1)(i)(vi) & (vii) – dues paid to other bodies required by provincial law are deductible

**Supplies Expenses - Specific E&O Deduction**

* **subpara. 8(1)(i)(iii) – an employee may deduct the cost of supplies consumed in the performance of the duties of employment**
	+ The employee must be required by the contract of employment to supply and pay for the supplies
	+ subpara. 8(1)(i)(iii) is subject to ss. 8(10) – needs an employer’s certificate
* **“Supplies” are things produced for use or sale, goods, merchandise, produce; “Consumed” means things are used up in the course of employment and then are unfit for further use *(Martyn*)**
	+ Tools are not supplies (***Luks***)
	+ special deduction for an apprentice mechanic’s or tradesperson’s tools under paras. 8(1)(r) and (s)
* **Clothing is traditionally viewed as non-deductible b/c they are not supplies, not consumed, and just personal.**
* ***Martyn* 🡪 “Supplies” are things produced for use or sale, goods, merchandise, produce; “Consumed” means things are used up in the course of employment and then are unfit for further use**
	+ a pilot’s uniform was not considered a “supply” or to be “consumed”
* **Clothing is traditionally viewed as non-deductible b/c they are not supplies, not consumed, and just personal.**
	+ But special clothing, uniforms, work outfits can create challenging cases; some inconsistency
	+ ***Fardeau****:* TCC allowed an RCMP officer to deduct clothing items as supplies consumed
		- Clothing items like socks and stuff
* ***Luks* 🡪 tools are not supplies consumed even though they wear out**
	+ He wanted to deduct cost of tools on basis that they were worn out by use.

**Office expenses - Specific E&O Deduction**

* **subpara. 8(1)(i)(ii) allows a deduction for office rent and for salary paid to an assistant or substitute**
	+ Those expenses must be required by the contract of employment
	+ subpara. 8(1)(i)(ii) is subject to the certificate from employer requirement in ss. 8(10)
* **CRA now accepts that fuel, electricity, light bulbs, cleaning materials, minor repairs are “supplies” for purposes of subpara. 8(1)(i)(ii) and hence deductible**
	+ As long as taxpayer is req by their contract to have home office
* **ss. 8(13) governs deduction for some types of home office expenses which get special treatment**
	+ ***Drobot***🡪 costs of operating a home office were not “supplies” but were “office rent”
	+ ***Prewer***🡪 followed ***Drobot***; suggested “home office” expenses are generally deductible under 8(1)(i)(ii)
	+ ***Felton*** 🡪 held that “office rent” can only arise from legal relationship of landlord-tenant
	+ 🡪 employees often have some kind of office space at home and have historically tried to fit that under office rent and/or supplies to get it under a deductible heading and sometimes it works and sometimes it doesn’t.
* **ss. 8(13) prevents a deduction for amounts that would otherwise be deductible under subpara. 8(1)(i)(ii) and (iii) (office rent and supplies) if those amounts relate to the employee’s home**
	+ **prevents any deduction in relation to a “self-contained domestic establishment” in which the employee resides unless:**
		- The work space is where the employee principally performs the duties of the employment
		- *OR*
		- The work space is used exclusively for the purpose of earning income AND on a regular and continuous basis for meeting customers or other persons in the course of employment
	+ **When ss. 8(13) is met, the employee may deduct expenses relating to the home 8(1)(i)(ii) and (iii)**
		- Usually home-related expenses are pro-rated based on square footage of the work space
	+ **Under ss. 8(13), the deductible home office expenses are limited to the amount of income from the employment**
		- para. 8(13)(b) – the amount deducted in respect of the work space in the home may not exceed the employee’s income from the employment
		- para. 8(13)(c) – excess home office expenses may be carried and applied to another year

**Other Income & Deductions**

* **Subdivisions d and e of the Act provide for:**
	+ **Income inclusions from sources other than office/employment, business, property and taxable capital gains**
	+ **Income deductions for things unrelated to those sources**
* **Inclusions are mainly listed in s. 56**
* **Deductions are mainly listed in s. 60**
	+ Also s. 62 (moving expenses) and s. 63 (child care expenses)
* **s. 56 says certain amounts must be included in income “without restricting the generality of s. 3”**
	+ This cautionary language suggests that s. 56 is not intended to definitively establish all “other sources” for purposes of s. 3

**OTHER INCOME INCLUSIONS- ~s.56**

**Pension income**

* **clauses 56(1)(a)(i)(A) & (B) apply to pension income**
* **Pension income is taxable**
* Pension income is not considered to be income from the prior employment
* Pension income **qualifies for a nonrefundable tax credit** under **ss. 118(7)**
	+ The first $2,000 of pension income is tax-free
	+ On top of the $11,000 personally
* **Taxpayers over 65 may split pension income with a spouse or common-law partner**
* Pension splitting is permitted under para. 60(c) and s. 60.03
	+ para. 60(c) allows a deduction for a “split-pension amount”
	+ s. 60.03 determines how the “split-pension amount” is calculated
		- A resident of Canada over 65 may split up to half their pension income with a spouse or common-law partner who is also a resident of Canada

**Death benefits**

* **Death benefits are included in income under subpara. 56(1)(a)(iii)**
* **“Death benefit”** is defined in ss. 248(1)
	+ Contemplates benefits paid to survivors of a deceased employee
* Death benefits have a $10,000 exemption

**Social benefits**

* **ITA includes social benefits in income but allows a deduction from taxable income for some**
* **Include the following in income:**
	+ Employment insurance benefits – subpara. 56(1)(a)(iv)
	+ Social assistance & welfare payments – para. 56(1)(u)
	+ Worker’s compensation benefits – subpara. 56(1)(a)(v)
	+ Universal child benefit – ss. 56(6)
		- Universal child benefit is $100 per month per child under 18
* **Deduct from taxable income under ss. 110(1):**
	+ Social assistance & welfare payments
	+ Worker’s compensation benefits
* No deduction from taxable income for employment insurance benefits or universal child benefit
* **Inclusion in income deduction from taxable income is important**
	+ Inclusion of benefits in income can affect entitlement to various credits and benefits that are based on “income”
* EI is taxed but others are not taxed in the end but deducted from taxable income. So it’s a mixed bag.

**RRSP income**

* **Any receipts from an RRSP are included in income under para. 56(1)(h)**
	+ paras. 56(1)(h.1) & (h.2) require inclusion under RRSP Home Buyer’s Plan and Lifelong Learning Plan

**Scholarships, bursaries and prizes**

* **Scholarships, fellowships, bursaries and prizes are included in income under para. 56(1)(n)**
	+ **Must include any amount received on account of a scholarship, fellowship or bursary, or any prize for achievement in a field of endeavour ordinarily carried on by the taxpayer**
	+ **para. 56(1)(n) does not apply to any scholarship, fellowship, bursary or prize received in the course of a business or in respect of, in the course of or by virtue of, an office or employment**
		- This is a response to the SCC decision in ***Savage*** [prize for insurance quizzes in employment]
* **Scholarship income enjoys an exemption under ss. 56(3)**
	+ The “scholarship exemption” is a minimum of $500
	+ It also includes any amount received as a scholarship, fellowship or bursary in connection with enrolment at an educational institution for which the taxpayer may claim the monthly education tax credit
		- This generally refers to post-secondary institutions
		- para. 56.3(1)(a): to be exempt, it must be reasonable to conclude that the scholarship, fellowship or bursary is intended to support the taxpayer’s enrolment in the educational program
		- If not, the scholarship, fellowship or bursary is not considered to have been received in connection with enrolment at the institution

**Spousal support & child support**

* Generally, after May 1, 1997, **child support is not taxable or deductible** but **spousal support is taxable and deductible**
* **para. 56(1)(b) requires the inclusion of “support amounts” and para. 60(b) allows the deduction of “support amounts”**
	+ **The amount included or deducted is generally equal to (all support amounts) – (child support amounts)**
* **“Support amount” is defined in ss. 56.1(4)**
	+ An amount payable or receivable as an allowance on a periodic basis for the maintenance of the recipient and/or children, if the recipient has discretion as to the use of the amount
	+ The payer and recipient must be spouses or former spouses (or common-law partners) living separate and apart because of the breakdown of the marriage or common-law partnership
	+ The amount must be payable pursuant to a court order or written separation agreement
* **To be a support amount, the amount must be *payable* on a periodic basis**
	+ **Not *paid* on a periodic basis; i.e. when it’s actually paid it not important**
	+ ***McKinnon* 🡪 lump sum payment of support arrears keeps its character as payable on a periodic basis**
		- It is payment of many amounts at one time – each of those amounts was payable on a periodic basis
		- Lump sum was for periodic support payments which were not paid on time, so it retains the character of it.
* **Support amounts are treated as child support (and therefore exempt- not taxable) unless they are specifically identified as spousal support**
* **ss. 56.1(1) *deems* an amount payable for the benefit of the recipient to be payable to and receivable by the recipient**
	+ addresses payments made to third parties (rent, mortgage, etc.) as support
	+ For the amount to qualify as a support payment, the payment must be on a periodic basis, and the recipient must still have discretion
		- Discretion of what to do with it is key to def, but also problematic since a lot of the times there is broad support going to spouse under a broad support plan
* **ss. 56.1(2) allows payments made to third parties to qualify as support payments**
	+ Where the agreement or order requires a person to pay expenses for the maintenance of the recipient and/or children, the parties may elect to have the inclusion/deduction rules apply
		- The amount will be deemed to be payable to the recipient as an allowance on a periodic basis
		- The recipient will be deemed to have discretion as to the use of the amount
	+ Opt in/opt out way through which spouses can decide whether they want payments to qualify or not
* **There are parallel rules to ss. 56.1(1) and (2) in ss. 60.1(1) and (2)**
* ***Veilleux, FCA*** 🡪 ***Armstrong* approach to ss. 56.1(2) and 60.1(2) was rejected**
	+ **as long as the agreement is clear that the parties intended and understood the tax consequences of deduction-inclusion, not necessary to specifically mention the statutory provisions**

***Armstrong 🡪* payments of rent directly to the recipient spouse’s landlord were not an allowance because the recipient did not have discretion as to their use [REJECTED in *Veilleux* by FCA]**

* **F:** One spouse paying support to other; instead of giving it to the spouse, he paid direct to the landlord for rent, court said when he tried to say that it is deductible to him and taxable to her, that she has no discretion so it does not count as allowance.
	+ ss. 56.1(2) and 60.1(2) will apply only to deem there to be discretion only if the court order or written agreement specifically mentions those provisions
* Contrast ***Armstrong***reasoning re: allowance issue with cases like ***Arsenault, Hak, Carmichael***
	+ Those cases view the paying spouse as an “agent” of the recipient spouse
		- Under the law of agency, a principal has control of an agent
	+ The recipient spouse retains discretion to control where the paying spouse pays the money
	+ Michael Taylor- not sure about soundness of that reasoning

**EXAM** If you get spousal support situation: Look at who the payment is to, is there discretion, court order, written agreement. Usually, payor is seeking to deduct it OR payee is arguing it is not support so it’s not inc in income and not taxable.

**Other Deductions, ~s.60**

* **s. 60 allows for a variety of deductions**
	+ para. 60(b) – support amounts paid
	+ para. 60(c) – pension splitting
	+ para. 60(j) – contributions to an RRSP
	+ para. 60(j.02) – contributions to a registered pension plan
	+ para. 60(o) – legal expenses for objecting to or appealing an assessment under the Act
* s. 62 is moving expenses

**Child care expenses**

* **s. 63 permits a deduction for child care expenses**
	+ expenses must be paid to enable the payer to be employed, to carry on business, to carry on research, or to attend an educational institution
	+ The child care must be provided by a resident of Canada other than a parent of the child, a spouse or common-law partner of the parent, or a minor relative of the taxpayer
	+ Child care may be deducted only for **children under 16 unless they are disabled**
* total deduction is limited to $7,000 per year per child for children under 7, and $4,000 per for older children
	+ For disabled children, the limit is $10,000 per year
* Where the person paying for child care is married or in a common-law partnership, the child care deduction must be claimed by the spouse with the lower income
	+ Recall that a deduction is worth more to a higher tax-bracket taxpayer
* ITA says that receipts must be filed but the CRA does not enforce this

**INCOME from BUSINESS & PROPERTY**

**Introduction to business and property**

* Business and property are distinct sources of income
* Each is mentioned in para. 3(a)
* Computation of income from business and property is governed by Division B, subdivision b
	+ ss. 9-37 of ITA
* **Basic rules are in s. 9**
* **ss. 9(1) – a taxpayer’s income from a business or property is their “profit”**
	+ Profit is a net concept
	+ deductions from income are allowed
	+ Deductions are allowed as a matter of accounting and commercial practice
* **ss. 9(2) – a taxpayer’s loss from a business or property is the loss computed in accordance with ITA**
	+ safeguard to ensure losses claimed meet conditions since they reduce tax base
	+ losses only exist to the extent that the Act recog them
* **ss. 9(3) – income or loss from a property does not include any capital gain or capital loss from disposing of the property**

**Characterization of Business and Property Income**

* Characterization:
	+ Main characterization questions are:
		- Business vs. property
		- Business vs. non-taxable source (windfall)
		- Business income vs. capital
* Taxpayers want receipts to be non-taxable or capital (50% taxable), Crown wants them to be business income (100% taxable)
	+ Incentives are reversed for losses
* Whether an activity is a business or a property is generally less important

**Characterization: meaning of business**

**What is a business?**

* Ordinary meaning of “business” includes virtually anything
	+ **Anything that occupies a person’s time, attention, labour and capital in pursuit of profit**
	+ Employment can’t be business for tax purposes, so we don’t inc it even though it may be inc in the def of business in other defs
* **Under ss. 248(1), “business” includes:**
	+ **An undertaking of any kind whatever**
	+ **An adventure in the nature of trade**
	+ “business” specifically excludes an office or employment

**Characterization: meaning of property**

**What is a property?**

* **Ordinary meaning of “property” is the right to possession, use or disposal of anything**
	+ Could be anything tangible or intangible, real or personal
	+ Includes rights
	+ Includes money
* **The definition of “property” in ss. 248(1) is exhaustive**
	+ **“Property” *means* property “of any kind whatever”**
	+ **explicitly includes rights and money**
	+ Statutory definition does not add much to ordinary meaning
* Income from property is usually received by virtue of owning the property
	+ Egs: Dividends from owning shares, rent from owning house etc.

**Characterization: business or property**

* Many receipts could often be income from a business or income from property
* **difference lies in the degree of organization and activity**
	+ **As the degree of organization and activity increases, they change from a property source of income into a business source**
* **Passively receiving income from owning property 🡪 more likely property**
* **Actively earning income from management 🡪 more likely business**
* Eg I loan $100 to friend and get 10% interest, that extra $10 is prob income from property since you get it from money which is property. Bank of Montreal lends to a whole bunch of ppl in money lending business in structured way, that is prob not income from property anymore.
* Eg I rent one house; prob property, but if I own and manage 10 properties with diff units and rent them all then it starts to look like business.

**Characterization: EXISTENCE OF SOURCE OF INCOME, i.e. business/property or Windfall**

* **Windfall is a receipt that doesn’t come from source of income and is not taxable.**
* **TEST for existence of source of income [business/property] (*Stewart*)**
	+ **(1) Is the activity undertaken for profit or is it a personal venture?**
		- If undertaken for profit, it is a source of income.
	+ **(2) If the activity is a source of income, is it a business or a property source?**
* Activity with **a personal element** may still be a source of income if it is undertaken in a **“commercial manner” (*Stewart*)**
	+ look at subj intention to make profit + business-like behaviour to support that intention
* Some calls for addition of reasonableness req to this test (proposed s.3.1 to ITA)- See discussion below
* ***Morden*** 🡪 **examines the distinction between business and a windfall**
	+ **Look at Organization + Profit purpose**
* **Useful list of factors to determine if income is from a source or a windfall (*Johnson*** [applies ***Stewart*** test])

(a) The recipient had no enforceable claim to the payment.

(b) There was no organized effort on the part of the recipient to receive the payment.

(c) The payment was not sought after or solicited by the recipient in any manner

(d) The payment was not expected by the recipient, either specifically or customarily.

(e) The payment had no foreseeable element of recurrence.

(f) The payer was not a customary source of income to the recipient.

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

* Two possible approaches:
	+ Reasonable expectation of profit
	+ Source of income approach
* Eg you buy rental prop w/ intention to rent it out
	+ But you know that mortgage is more than rent and you will not be making money
	+ CRA would argue that it is foregone conc that you will lose money so it is not deductible loss
* Taxpayers objected to this since CRA was second guessing why they were doing things and so it came to ***Stewart***

***Stewart* 🡪 articulated a new “source of income” approach; formulated a two-stage approach**

* + **(1) Is the activity undertaken for profit or is it a personal venture?**
		- If undertaken for profit, it is a source of income.
	+ **(2) If the activity is a source of income, is it a business or a property source?**
* **Facts**: taxpayer bought condos for being rental properties but w/out down payment so the interest on mortgage was so high it exceeded rental income. He argued it was advertised that he would make money and CRA argued any obj person would see you couldn’t make rental money and your real motive was to keep these properties and sell them later to make capital gain. CRA didn’t want him to get tax subsidy by claiming loss deductions for holding them and get tax break when he sells them at higher price.
* **Analysis**: reasonable expectation of profit is not a viable stand-alone test for a source of income
	+ there must be evidence that the activity is undertaken for a profit
		- Statements of a taxpayer’s intention are subjective evidence and not always enough
* an activity with **a personal element** may still be a source of income if it is undertaken in a **“commercial manner”**
	+ “In order for an activity to be classified as commercial in nature, the taxpayer must have the subjective intention to profit and there must be evidence of businesslike behaviour which supports that intention”
	+ Multiple factors to consider in determining commerciality
	+ Reasonable expectation of profit is one of the factors
* Questions raised by ***Stewart****:*
	+ Should there be a reasonableness requirement, or objective safeguard, to the existence of any source of income?
		- Should taxpayers be allowed to deduct losses and claim a tax subsidy from the public when the activity is objectively unreasonable?
	+ Should capital gains be included in “profit” for the purpose of determining a “pursuit of profit”?
	+ Possible for taxpayer to have source of income but expenses they’re claiming that generate the loss are seen as unreasonable
		- Eg taxpayer claiming loss on rental property which they actually weren’t renting out

***Johnson* 🡪 adopts/applies *Stewart* TEST; 248(1) def business ‘undertaking of any kind whatever’ is so broad that you’ll not need to argue new source under s.3; list of factors to diff. btwn INCOME vs WINDFALL**

* **Facts**: Taxpayer took part in Ponsey scheme; Ms J was nurse who bought into one of these schemes and gave him money over years; he gave her cheques and she cashed it; she thought he was investing in future contracts etc and ultimately it collapsed
	+ She was early enough in chain to have made a lot of money- $1.3 mil of profit
	+ He had said that money was earned by trust and she didn’t need to report this for tax
* **TJ**: this was not business, but a scam. Just shuffling money.
	+ CA overturned this.
* **FCA**: Income from participation in a Ponzi scheme was viewed as income from a source.
	+ The source was contracts between the investor and the promoter
	+ Does not matter that the funds advanced were not invested or that the underlying business was a scam
	+ The investment contracts generated the promised return
* **Comments that “undertaking of any kind whatever” in ss. 248(1) definition of “business” is exceedingly broad**
	+ May not ever need to identify additional sources under s. 3, everyone will try to fit under ‘business’
* **Useful list of factors to determine if income is from a source or a windfall (see above)**
* **Short application of *Stewart* test**: when she gave him the money, she was after profit and not anything else, so when she makes money off it, that is income from a source.
	+ Important that court held what the promoter did with the money doesn’t matter.
	+ She did something for profit, it was binding legal contract, and that was fulfilled and she was paid. That’s it.
* **Reform?**: In 2013, finance dept has proposed s.3.1 to ITA so a proposed amendment to introduce some sort of obj req into this test
	+ It would create life time reasonable expectation of profit test, taxpayer must demonstrate that over life time of their enterprise they would be able to generate profit
	+ Finance dept didn’t like the ***Stewart*** case outcome

***Morden* 🡪 examines the distinction between business and a windfall (not source of income)-**

**🡪 Organization + Profit purpose**

* **Facts**: compulsive gambler
* Court finds: Gambling income is non-taxable
	+ The court focused on two tests for a business:
		- **Presence of organization**
		- **Presence of an intention to earn profit**
* Court cites ***Smith v. Anderson*** (UK) from which it derives the two elements
	+ **Organization- occupies time, attn of person**
	+ **Purpose of getting profit**
* Court seemed to say that since the odds always favour the house, no one wins in the long term and so gambling can basically never be org
* There are cases that courts look at gambling and decide that it is so organized that it looks like a business and makes the traditional non taxable gambling wins taxable
* Anything that occupies time attn. labour capital of person is business, and you’d think gambling would match that
* In US, gambling is taxable and falls under income. Not here, despite parl recommendation over 20 yrs ago.

**Characterization: business income vs capital 🡪 \*\*\*flagged by MT as important\*\*\*\***

* Often necessary to determine whether the sale of a property is actually a business or a trading venture.
	+ can transform capital gains into business income (what was only %50 taxable into %100 taxable)
* Classic egs: house flipping, buying/selling shares on stock market [usually capital investment when you buy shares but not when you buy w/ intention to sell soon since price is going up]
* **An “adventure in the nature of trade” is included in a ‘business’ under ss. 248(1)**
	+ Most often an isolated maybe speculative transaction, undertaken for profit (although it doesn’t have to be undertaken for profit) (***Taylor***)
* **If present at the time of acquisition of a property, an intention to resell at a profit nearly always indicates an adventure in the nature of trade, i.e. business income 🡪 \*\*\*\*IMPORTANT\*\*\*\***
* **A secondary intention to resell also turns an investment transaction (capital) into an adventure in the nature of trade (business income) (*Regal Heights*) 🡪 \*\*IMPORTANT\*\*\***
	+ Secondary intention means that the prospect of reselling at a profit was an **“operating motivation”** at the time the property was acquired- more than tacit understanding that if price is right later you’d sell
* **Principles from *Taylor***
	+ **“Adventure” implies a single, isolated transaction**
	+ ***Positive indicators:***
		- A transaction carried out in the same manner as a dealer in the property would indicate an adventure in the nature of trade
		- Some kinds of subject matter are unlikely to be investments or personal property, probably an adventure in the nature of trade
			* Eg toilet paper, no one needs that much so if you stockpile you want to resell.
		- Property can only be disposed of through trade
	+ ***Negative indicators:***
		- An adventure in the nature of trade is not necessarily organized in the way a business would be
			* Often it is isolated and a one-off transaction
		- It is not *necessary* to have an intention to resell property at a profit (MT- Problematic)
		- Intention to make a profit may be an indicator, but its absence is not determinative
* ***Regal Heights***
	+ when they bought land, they weren’t fully sure they could resell but they were pretty sure they could resell at profit even though that wasn’t their primary motivation
	+ Original purpose was to build mall and lease it out so this came as surprise for taxpayers
* Be very clear about what you need for this:
	+ Everyone who buys property, at some point they contemplate selling it and for a lot of types of property this means you can resell it at a higher price.
	+ That is not a secondary intention and doesn’t mean when you sell your house after 10 yrs, that is business income.
	+ Secondary intention is more than the tacit understanding that if the price is right in the long term I can and will resell the property

***Taylor* 🡪 examines adventure in the nature of trade; important principles**

* **Facts**: Taylor was president of Canadian Co subsidiary of American parent Co.
	+ Rule of US Co: stock pile of lead allowed for 30 days.
	+ T thought Co was better off buying more b/c prices were going up, but US Co said no, you can buy it yourself.
	+ So he did and then sold it to the Canadian Co which he was president of at a profit.
* **Issue**: Is his gain from the sale of that lead to his Co business income or capital?
	+ Note- at the time capital gains were not taxable at all
* Crown argues this was an adventure of a business like nature
* Important principles:
	+ “Adventure” implies a single, isolated transaction
	+ *Positive indicators:*
		- A transaction carried out in the same manner as a dealer in the property would indicate an adventure in the nature of trade
		- Some kinds of subject matter are unlikely to be investments or personal property, probably an adventure in the nature of trade
			* Eg toilet paper, no one needs that much so if you stockpile you want to resell.
	+ *Negative indicators:*
		- An adventure in the nature of trade is not necessarily organized in the way a business would be
			* Often it is isolated and a one-off transaction
		- It is not necessary to have an intention to resell property at a profit
			* MT- thinks this factor is problematic. Other cases tell us that if taxpayer has intention to resell something at profit, that is a very strong indicator.
			* Necessary finding for judge to make- Taylor’s goals was to assist Co in keeping costs of lead down
		- Intention to make a profit may be an indicator, but its absence is not determinative
			* Taylor did not set out to make a profit, but he did

**BUSINESS INCOME- INCLUSIONS**

* **basic rule is ss. 9(1): the income from a business is the “profit” from the business**
	+ **ITAlargely defers to business/accounting principles for determining profit**
		- Those principles are the starting point
		- Some sections provide specific rules (e.g., s. 12)
* **Make two distinctions in determining business income**
	+ **Basis of accounting: cash vs accrual**
	+ **Capital v. Income**

**Cash Basis vs. Accrual Basis Accounting**

* **Cash basis accounts for income and expenses when money is received and paid out**
* **Accrual basis accounts for income and expenses when the business is entitled to be paid and is liable to pay**
	+ Not based on what it actually gets
	+ Usually when they issue invoice, and they record that even if they haven’t been paid yet
* **Most businesses are required to calculate profit using the accrual method**
	+ Accrual method believed to more accurately match income with expenditures for a given time period
	+ Only farming and fishing do cash basis

**Specific Stat Rules**

* **Incurred expense s.18(1)-** In computing income from business/property, no deduction shall be made in respect of: long list of incurred expenses
* **Incurred income S.12(1)(b)-** amount for providing services in business becomes receivable when services are performed (or would have been performed had there not been delay)

**Capital vs. Source of Income**

* **Capital is used/held to generate income**
* Receipts of a capital nature are generally not included in source of income
	+ They may be a capital gain
* **Property held by a business is either inventory (held for resale) or capital property (held to generate income)**
	+ **Proceeds from inventory are business income.**
	+ Whenever you dispose of property, you need to see how to deal with that receipt.
* **SEE BUSINESS INCOME vs. CAPITAL above**

**Business Income INCLUSIONS: Special Cases**

**Gains from illegal activities *🡪 Included!***

* **Gains from illegal activities undertaken in pursuit of profit are generally taxable (*No 275*)**
	+ ***No. 275* 🡪 it does not matter whether the activity is illegal or immoral.**
		- Facts: prostitute
		- Whether or not prostitution is business for tax purposes?
		- It’s generating income and so it is income
	+ Today we would apply ***Stewart*** approach: undertaking for purposes of making profit so it doesn’t matter if it is criminal, it’s source of income, then we categorize it as which source (not property, not office, not employment, so business)

**Damages and other compensation *🡪 Depends!***

**\*\*\*Taxability of damages depends on the facts\*\*\***

* **Damages and other compensation are taxable if they replace a receipt that would have been taxable**
	+ ***surrogatum* principle- damages/compensation take on character of whatever they are replacing (*Manley*)**
* ***surrogatum* applies only when a payment is received pursuant to a legal right**
	+ UK cases say compensation received pursuant to legal right will take on the character of what it replaces
	+ Damages by def are received pursuant to a legal right
	+ Other compensation must be pursuant to a legal right (eg contract) so they are voluntary payments.
* **damages can be capital**, depends what they relate to (***TM case*** [damages replaced TM rights🡪capital])
* **Compensation for loss of property which is inventory will be taxable as income**- generally held in case law
* **Insurance money is usually treated like damages**
	+ Common for taxpayer to claim under insurance policy in loss
	+ Insurance proceeds could be one or the other, just like damages.

***Manley* 🡪 adoption/application of Surrogatum Principle re: damages**

**Facts:** Manley was hired to find someone to buy Co and the owner of Co didn’t give him the promised fee on basis that person who promised didn’t have authority. Manley sued and won and got damages.

**Issue:** Are damages taxable?

* Manley argued damages are generally not taxable.
* Court denied this general principle and adopted surrogatum principle.

**Analysis**: Damages are taxable if they replace an amount that would be taxable.

* Court- this is adventure in the nature of trade and his fee would have been business income, so the damages replacing that fee are treated like business income which is taxable so they are taxable.

***Case* (no name-ok) 🡪 Damages replace income lost due to IP rights infringement; damages could replace capital eg restoring TM b/c TM is a right and rights are property**

* taxpayer sues for TM infringement and passing off
	+ damages were treated as income b/c they related to income lost by Co whose IP rights were infringed.
	+ If damages had related to restoring TM, they would have been capital asset since TM is right so property

**Voluntary payments *🡪 Generally not included!***

* **Voluntary payments received in the course of a business are generally not taxable**
* **Key fact is whether the payment is received pursuant to a legally enforceable right or obligation**
* ***Federal Farms*: disaster relief is in the nature of a gift (gratuitous) and hence not taxable.**
	+ Farmer received money to repair farm and replace inventory
	+ CRA accepted that compensation to rebuild farm is capital b/c it went to restore capital/property but compensation to replace inventory which would be sold for profit should be treated as income b/c it replaced business income
		- Application of surrogatum principle
	+ Court- NO, surrogatum only applies to compensation pursuant to legal right, and disaster relief is gratuitous.

**Prizes and Awards *🡪 Not included!***

* **Prizes received in the course of a business are generally not taxable**
* **Element fo chance in getting prize is key factor (*Abraham*)**
* **Para. 56(1)(n) covers prizes generally, but excludes prizes received in the course of a business.**
	+ Para. 56(1)(n) only applies to prizes for achievement in a field of endeavour
	+ Suggests it would not apply to prizes won by chance
* ***Abraham* 🡪 the element of chance is the key factor**
	+ **Facts**: grocer buys merchandise and every time he buys he is automatically entered into draw which he eventually wins and gets cash prize
	+ **Issue**: is this business income?
	+ Court: No, this was not remuneration for work/service/goods that his business provides but rather b/c of chance.
	+ Generally, prizes and awards received in relation to businesses aren’t taxable
* **Para. 56(1)(n) covers prizes generally, but excludes prizes received in the course of a business.**
	+ Para. 56(1)(n) only applies to prizes for achievement in a field of endeavour
	+ Suggests it would not apply to prizes won by chance
* Recall ***Savage*** (employee got $100 each time she passed insurance test and prizes were inc in employment income- SCC said they are not inc b/c there is specific section which gives her $500 and afterwards provision passed to say it doesn’t apply anymore to prizes gotten in course of employment)

**PROPERTY INCOME - INCLUSIONS**

* **Income from property includes income received by virtue of owning the property**
	+ Interest on money
	+ Rent for use of land or other property
	+ Royalties for use of or production from property
	+ Dividends on shares of a corporation

**Income from Property: Interest- s.12(1)(c)**

* **12(1)(c): include in income from business or property any amount received or receivable in the year as, on account of, in lieu of, or in satisfaction of interest**
	+ Interest is taxable when received or receivable
	+ Taxable if received as interest or as a replacement for interest
* **Interest is NOT defined in ITA**
* **Interest has 3 characteristics est by case law:**
	1. Interest is compensation for the use of money belonging to another
	2. Interest relates to a principal sum
	3. Interest accrues day to day (Does not have to be charged every day, just calculable to the day)
* 🡪 A payment that meets these criteria will be treated as interest even if the taxpayer labels it differently (***Perini Estate***)
* **Interest can be taxable as income (either business or property), or can sometimes be capital!**

***Perini Estate* 🡪 no interest if principal is unknown and contingent on future event occurring**

* **Facts**: Arrangement under which no one knows what the interest would be since it is on deferred payments which are unknown.
	+ Basically deal made it unknown.
	+ Taxpayer ended up getting interest
	+ principal (and associated interest) was retroactively created upon the happening of a future event
* **Issue**: is this actually interest? No.
* There can be no interest on a non-existent principal
	+ FCA- rejected.
* There is no principal until future event happens and the Co’s income is known.

**Income from Property: Royalties, s.12(1)(g)**

* **A royalty is compensation for the use of a property**
	+ Usually determined as a percentage of receipts or as a fixed on a per-unit/per-use basis
* **12(1)(g): include in income from business or property any amount received in the year that is dependent on the use of or production from property.**
	+ Para. 12(1)(g) applies even if the amount is part of the sale price of property (see ***Huffman*** for eg)
	+ Doesn’t have to be under the word ‘royalty’ for the section to apply
	+ Compare 12(1)(c) which req interest to be inc when it is received OR receivable, whereas royalties are req to be inc only if they are received
* **royalties must vary with use or production from property (*Morrison***- not really Royalties case)
* **If taxpayer sells property and sale price depends on what the purchaser does with the property, those are still payments which depend on the use of the property and are still inc as royalties (*Huffman)***

***Morrison*** 🡪 **royalties must vary with use or production from property; not a royalty case at all**

* **Facts**: Co wanted to build road and asked Morrison if they could use rock from his land and the price was set per tonne. They built the road and took the rock but they didn’t pay him per tonne. Instead they paid a lump sum to him.
* **Issue**: did these payment depend on the use for production of the land?
* **🡪 royalties must vary with use or production**
	+ **“Dependent on use” refers to the length of time the property is used**
		- Might also refer to how often the property is used
	+ **“Dependent on production” refers to the amount of production from the property**
		- Could be in units produced or in sales
* ***Morrison***was not a royalty case at all, but a damages case
	+ More like paying him to compensate
	+ Key was that even though K called for royalties, the actual payments were not in form of royalties
	+ So s. 12(1)(g) doesn’t apply. It says nothing about payment in satisfaction of anything.

***Huffman* 🡪 If taxpayer sells property and sale price depends on what the purchaser does with the property, those are still payments which depend on the use of the property and are still inc as royalties**

* **Facts**: taxpayer sold gold mining leases- purchaser had to pay %25 of value of gold produced for the year until a total of $25,000 is paid. Purchaser paid the 25% every year but it never made it to the 25,000 total.
* **Issue**: were payments royalties b/c they depended on the production of property?
* **Analysis**: Yes, they’re royalties.
	+ Payments were installments of the purchase price of a property, paid according to amount of gold produced
	+ Payments were included in income under para. 12(1)(g) because the amount received each year depended on production from the property
* Para. 12(1)(g) specifically includes payments that are the sale price of property
	+ Payments that would have been capital in nature became taxable
* Court- these payments clearly depend on the production from mines.
* If taxpayer sells property and sale price depends on what the purchaser does with the property, those are still payments which depend on the use of the property and are still inc as royalties then
* Selling taxpayer POV- the amount of money he gets depends on what purchaser does with land, i.e. how much gold is produced, so it is logically fitting with what 12(1)(g) is supposed to capture.

**Income from Property: Rent- no specific s.**

* **Rent is compensation for the use of another’s property for a specified time period**
* No specific section in the *ITA* deals with rental income
* **Rent is included under ss. 9(1)**
* **Arguable-included under para. 12(1)(g) b/c it varies with the length of time that the rented property is used**
* Rent is generally fairly easy to identify
	+ You have landlord and tenant and contract

***Pitman* 🡪 Payments of rent did not retroactively become capital payments of purchase price when a lessee exercised a purchase option in the lease.**

* **Facts**: Lease-purchase option at issue
	+ You lease and rent then you choose to exercise option to buy and then the prev rent is applied to the purchase price
* **Issue**: Landlord argues the prev rent payments were transformed into payments for purchase and so were not taxable at all
	+ Doesn’t fly w/ court.
	+ **Holding**: Amounts were rent and they stay rent even if option is exercised.
* **Analysis**: Payments of rent did not retroactively become capital payments of purchase price when a lessee exercised a purchase option in the lease
* The prior payments remained rent even though they were applied against the purchase price

**Income from property: Dividends, s. 12(1)(j) & (k)**

* **Any dividend received in relation to share is income from property and s.12 req it to be inc in income**
	+ Dividends are included in income from business or property under 12(1)(j) (corporations resident in Canada) & 12(1)(k) (corporations not resident in Canada)
* **Allocation of corporation’s profits to shareholders 🡪 dividend**
* Dividends are pro-rata allocations of corporate after-tax earnings
* Dividends are declared by the Board of Directors
* Dividends are received by shareholders by virtue of their ownership of shares

**BUSINESS & PROPERTY - DEDUCTIONS**

**Basic Principles**

* **Reference to “profit” in s. 9(1) presumes the deduction of reasonable expenses**
	+ Calculating business income is done through generally accepted accounting principles (GAAP)
* specific rules
	+ **s. 18 denies certain deductions- you can’ deduct the things listed here**
	+ **s. 20 allows certain deductions- gives back some deductions to taxpayers**
* **Three general principles to cover:**
	1. **Business vs. personal**
	2. **Capital expenditures vs Current expenditure**
	3. **Reasonable vs. Unreasonable expenditures**

**(1) Business vs. Personal**

* **Para. 18(1)(a) prohibits the deduction of any amount except to the extent that it was paid or incurred to *produce income* from the business or property**
	+ **No personal expenditures are allowed; must pass purpose/income producing TEST**
	+ Expenses may be apportioned or pro-rated if there are multiple purposes- b/c of ‘to the extent’
* **Para. 18(1)(h) expressly disallows “personal or living expenses”**
	+ **“Personal or living expenses” are defined in s. 248(1)**
		- Includes expenses of properties maintained for the use or benefit of the taxpayer or a relative and not in connection with a business
		- Includes the cost of a life insurance policy
		- ‘inc’ means it adds to the ordinary meaning of ‘personal’
	+ Does not include travel expenses incurred while away from home in the course of business
* **Expenses may fail under para. 18(1)(a) even if they do not meet the definition of “personal or living expenses” for para. 18(1)(h)**
	+ An expense that fails the income-producing test under para. 18(1)(a) is generally referred to as “personal”
* **Personal expenses are expenses that would have been incurred anyway even if the taxpayer was not in business (*Symes, SCC*)**
	+ Not necessary for an expenditure to be one that would be incurred anyway *in order to be* personal though.
	+ Look at obj evi, beyond what taxpayer says.
* **Expenses that make a taxpayer available to carry on business are personal (*Symes, SCC*)**

***Symes, SCC* 🡪 Authority for BUSINESS vs PERSONAL Expenses**

**🡪 Personal expenses are expenses that would have been incurred anyway even if the taxpayer was not in business; Not necessary for an expenditure to be one that would be incurred anyway in order to be personal though**

* In determining purpose of expenditure, look beyond what taxpayer says; obj evi.

**🡪 Expenses that make a taxpayer *available* to carry on business are personal**

* **Facts**: Mrs Symes is a lawyer (can be either employee or business [running own business; partner]. She was earning business income for practising law and she needed child care. She paid for child care
* **Issue**: deducting cost of child care as a business expense under s.9 which would reduce her business income
	+ Special provision in act deals with child care expenses s. 63
		- Allows deduction if childcare is necessary to carry on business
		- But it says there is limit to how much can be claimed in a given yr, and when there are two parents, the one w/ lower income is req to claim it.
			* Value of tax deduction varies depending on tax rate. High income and high rate, they will save more if they can deduct something from their income.
		- S.63 often means actual tax savings are less
	+ She wanted to claim it as business income instead of s.63 b/c it meant less tax
* **Analysis**: Personal expenses are those which would be incurred even if taxpayer wasn’t carrying on business
	+ Food, shelter, clothing
* When determining purpose of expenditure, you look beyond what taxpayer says.
	+ It is obj stat thing- look at obj evi of what the purpose of the expenditure was
* **Holding**: Court conc there are arguments both ways for if the childcare is business expense or not. **Court deferred to s.63**.
	+ No legis room for business person to deduct childcare as a business expense.

**(2) Current vs. capital expenditures**

* **Para. 18(1)(b) prohibits any deduction for capital expenditures or outlays except as permitted by Part I**
	+ **s. 20(1) allows a deduction for some capital outlays**
* Unless deductible under s. 20(1), a capital outlay gets no tax recognition
	+ This is the flip-side of the rule that capital receipts are not taxable
* **Capital expenditures are paid for the stuff used to earn an income**- capital is what you use to generate income.
	+ Inappropriate to deduct full value of that expenditure in today’s time period if the benefit extends to other time period b/c under accrual accounting, we want to identify the gain under that time period.

**(3) Reasonableness**

* **s. 67 is an over-riding provision that no deduction is allowed except to the extent that it is reasonable in the circumstances**
	+ How to measure reasonableness?
	+ Quantum of expenditure vs. wisdom of incurring the expenditure at all
* ***Sypeloni*** [spelling is most likely wrong]
	+ Was it reasonable for taxpayer who made no money to incur a pile of money for travel?
	+ Was travel a good judgment given you don’t make any money?

**Specific B&P Deductions- ILLEGAL PAYMENTS**

* **Income from an illegal business is taxable; therefore, deductions must be allowed in order to determine “profit” (*Espie Printing*)**
	+ Recall prostitution case (***No 275***)
* **s. 67.5 prevents deductions for certain payments that would be a crime under the *Criminal Code***
	+ Also foreign bribes
	+ The restriction on deductibility extends to expenses incurred pursuant to a conspiracy to commit those offences
* ***Espie Printing*****🡪 the legality of a particular expenditure is not relevant to deductibility.**
	+ Facts: taxpayer paid wages to employees which were illegal under some war time regulations
		- So the wage payment itself is illegal
	+ Court rules that legality of the wage expenditure isn’t relevant
		- Under s.9, we’re driving at the taxpayer’s profit. It doesn’t matter legality of what they’re doing. It matters what your econ position is.
	+ ITA is generally value-neutral on this point

**Specific B&P Deductions- DAMAGES**

* **As a deduction, damages are treated differently than as an income inclusion: you can deduct some damages as expense arising from, or incidental to, ordinary operation of business**
	+ Income inclusion is governed by *surrogatum* principle
* **New 18(1)(a) – “wholly, exclusively, necessarily” requirement is no longer present for expenses incidental to income earning operations, inc liabilities paid.**
* ***Imperial Oil* imports a remoteness element into the deductibility analysis**
	+ If the conduct that gives rise to the damages is remote enough from business activity, then the damages are not deductible.
	+ It doesn’t tell us how far you need to go to make it non-deductible
* ***Imperial Oil 🡪* expenses that are “wholly, exclusively and necessarily” incidental to the income-earning operations are generally deductible**
	+ That principle extends to liabilities that arise in the normal course of operations

**Specific B&P Deductions- FINES & PENALTIES**

* **S.67.6: No deduction for fines/penalties imposed under a law of a country or a political subdivision of a country.**
	+ **There is an exception for “prescribed” fines and penalties.**
	+ ***Eggs case*** led Parliament to enact s. 67.6
* ***CIBC*** 🡪 **FCA held that moral characterization of taxpayer’s behavior is irrelevant to whether damages are deductible.**
	+ **The income producing purpose test in para. 18(1)(a) is all that matters.**
	+ Rejects argument that s. 9 contains inherent restriction against deducting fines for egregious or reprehensible conduct (which SCC had endorsed in ***Eggs***)
* **Since s. 67.6 applies only to public law fines, not to damages for breach of contract or tort, logic from *CIBC* applies to damages paid for breach of contract and tort (like *Imperial Oil* above)**

**Development of this case/stat law**

* **BEFORE: fines and penalties are deductible if incurred in order to earn income (*Egg case, SCC*)**
	+ **If you could have done your business/ earned your income w/out breaking the law, then you can’t deduct a fine.**
	+ **You have to convince court that you had no other choice**
* Traditionally, fines and penalties were not deductible for two reasons:
	+ The business could have been conducted without incurring the fine, so the fine was regarded as not incurred to earn income
		- This implies a necessity element
	+ Public policy dictates no deduction
		- Concern about undermining other statutory regimes

***65302 B.C. Ltd (Egg case)* 🡪 fines and penalties are deductible if incurred in order to earn income; invoke tax equity and tax neutrality**

* **Facts**: taxpayer was a farmer who produced eggs. Egg production is regulated by stat inc quota.
	+ They had business reason for producing more than quota: would lose customer if they didn’t produce enough for it.
	+ They had opportunity to buy additional quota (quotas are licenses and can be resold). They decided not to buy expensive one out of region and wait to buy one in their region.
		- Very business oriented decision to break the law.
	+ They get slapped for over quota fine.
* **Issue**: Can they deduct this over-quota penalty as business expense?
	+ Yes!
* **majority reasons:**
	+ No statutory basis for looking at whether the fine or penalty could have been avoided
		- That approach would treat fines and penalties differently from other expenses
	+ Overarching statutory policy is to tax based on net income, which requires deductions
		- **The court raises tax neutrality and tax equity**
		- Neutrality- if parl wanted to exclude ALL fines/penalty, they would have, but they chose to list the ones they wanted so if you didn’t put it in, you didn’t mean it.
		- Equity- SCC’s view; means that taxpayer should be taxed based on their ability to pay tax
			* If you ignore the fine/penalty, you mis-measure their ability to pay from econ POV
	+ Enactment of s. 67.5 indicates that Parliament could have denied a deduction for fines and penalties if it wanted to
* Minority: it will undermine effect of other stat regimes
	+ But in some cases the fines aren’t punitive, so then they are deductible.
	+ They say here the fine isn’t punitive, but charged to make up for costs of administering this regime.
	+ So this one is fine but generally fines and penalties shouldn’t be deductible.
* ***Eggs****.* creates confusion with the rationale for damages in ***Imperial Oil***
	+ SCC said cases under the old version of para. 18(1)(a) (wholly, exclusively, necessarily) are not relevant
	+ SCC rationale would apply equally to damages – ***McNeill***applies ***Eggs***reasoning to breach of contract
		- Considered in ***CIBC*** case
		- Court says damages for breach of contract should generally be deductible under ***Eggs***
		- Courts seem to be shifting from imperial oil approach to eggs case approach
	+ **s. 67.6 applies only to public law fines, not to damages for breach of contract or tort**
		- logic of eggs case which was applied to fines should apply the same way to breach of contract and tort
		- suggests any damages as result of action to run business should be deductible if they satisfying income-earning purpose test.
			* There’s no remoteness thing
* In ***Eggs****.,* SCC suggested that there could still be some conduct that is so egregious and reprehensible that a fine or penalty would not be deductible 🡪 Leads to ***CIBC*** case

**CIBC 🡪 FCA held that moral characterization of taxpayer’s behavior is irrelevant to whether damages are deductible**

**🡪The purpose test in para. 18(1)(a) is all that matters**

**🡪Rejects argument that s. 9 contains inherent restriction against deducting fines for egregious or reprehensible conduct**

* **Facts**: CIBC was connected to Enron; had financed some Enron transactions so CIBC was named as D in some actions based on that they knew so they were liable. CIBC paid $3 billion to settle.
* **Issue**: under 18(1)(a), can the $3 billion be deducted as business expense
	+ Crown argued that CIBC’s conduct was so egregious that the money wasn’t deductible
	+ Preliminary case- should they strike crown’s argument from pleadings b/c it has no chance of making it in law?
* Court said they don’t think SCC would agree with that anymore.
* Discussion of McNeill case
	+ FCA reiterates that Eggs case logic applies to damages
	+ Was the action undertaken to earn income? If yes, the damages should be deductible.
	+ We don’t care about necessity, avoidability or morality.
* S.9 argument logic
	+ S.9 contains reasonable well accepted business practices and breaking the law is inherently not acceptable business standard.
		- Crown raised this as backup to s.18(1)(a) purpose test argument.
	+ This argument was rejected by FCA
* **Basically, put the blinders on morally.**

**Specific B&P Deductions- LEGAL DEFENCE COSTS**

* **expenses incurred to defend against legal actions (civil or crim)**
* **legal costs incurred to preserve the operations that earn income are deductible, regardless of outcome (*Rolland Paper*)**
* **Remoteness is relevant🡪 legal action must relate to the activities that generate income, not to unconnected activities.**
* **Legal costs could be personal expenses** – depends on the facts and connection to the business
	+ ***Neeb***: drug dealer wanted to deduct legal fees and court said no, you’re just trying to stay out of jail, not keep your business going.
	+ ***Border Chemical*** (stock fraud)
	+ ***William F. Koch Laboratories*** (libel)
	+ Tax evasion?
* **ss. 60(o) allows a deduction for legal fees incurred to dispute a tax assessment.**
* ***Rolland Paper*: legal costs incurred to preserve the operations that earn income are deductible**
	+ Fees paid to contest action about competition offences.
	+ Narrow issue was whether the outcome of the legal action matters – the outcome does not matter
	+ ***Caulk***- taxpayers charged w/ same kind of competition offences and their fees had been deductible.
	+ If Rolland Paper had been convicted, they would have had to change their operations, so paying the legal fees to stem that was done for the purpose of remaining doing their business.

**Specific B&P Deductions- RECREATION, MEALS & ENTERTAINMENT**

* **Relevant provisions are para. 18(1)(a) [no personal expenses], (h) and (l), and s. 67.1**
	+ inherent personal element in these; big litigation area.
* **18(1)(l)(i) NO deduction for use or maintenance for yacht, camp, lodge, golf course or facility, unless it’s provision of those things for business.**
* **18(1)(l)(ii) NO deduction permitted for membership fees or dues for a club whose main purpose is to provide dining, recreation, sporting facilities to members.**
* **s. 67.1(1) limits the deduction in respect of “human consumption” of food or beverages, or enjoyment of entertainment**
	+ **maximum deductible is 50% of actual cost or a reasonable amount if the actual cost is unreasonable**
	+ **Key exceptions in s. 67.1(2):** include food, beverages and entertainment acquired for resale; for charitable fundraisers; and to provide to all employees at a special event
		- No more than 6 special events per year.
	+ Nothing in s. 67.1(1) requires the taxpayer incurring the cost to partake- still not deductible (***Stapley***)
* ***Stapley*: the cost of gift certificates for restaurants and tickets for sporting events is subject to s. 67.1 even though the taxpayer did not personally consume any food or enjoy any entertainment**
	+ Nothing in s. 67.1(1) requires the taxpayer incurring the cost to partake
	+ Some of the exceptions in s. 67.1(2) assume that the taxpayer incurring the cost does not partake
		- Would be unnecessary if Mr. Stapley is right

**Royal Trust 🡪 OVERTURNED by 18(1)(I)(ii)!!**

* **Facts**: employees that dealt w/ clients had to join social clubs as a business development model.
	+ Evi that this was common policy for competitors in same industry and that it actually worked and generated income for it
* **Issue**: are expenses employer paid for employees to join these clubs and groups deductible?
	+ Yes they are deductible.
* **expenses to buy club memberships for employees were deductible because they accord with well-established principles of business practice and they were incurred to earn income**
	+ Evidence indicates that the expenses did generate income
* emphasizes the relationship between sections 9 and 18
* eg of how logic allows Cos to deduct these things. But what matters for us is that parl has dealt with this.

**Specific B&P Deductions- CLOTHING**

* **Clothing provides a personal benefit**; **this is the case most of the time. It takes a very creative argument or sympathetic judge to get it deducted.**
	+ **Presumption that taxpayer must rebut (*Hans Rupert*)**
	+ ***Symes*** *–* some form of clothing expense would be incurred anyway
	+ Even special uniforms and work clothes provide a personal benefit if they obviate the need to buy other clothing
	+ Eg: ***No. 360*** 🡪clothing acquired for TV and stage appearances was not deductible for actress
* **Not all clothing is personal; Sometimes it can be apportioned (*Riley)***
* ***No. 360***: clothing acquired for TV and stage appearances was not deductible
	+ Taxpayer was actress. She argued that this clothing was special work uniform.
	+ Appears in part to be because the taxpayer admitted to wearing the clothing personally sometimes
		- Not clear how much weight was on this fact
		- But despite that, clothing is personal and non deductible.
* Some cases, judges are willing to prorate business clothing expense if the clothing is also used personally
	+ Every case depends on the facts

***Hans Rupert***

* Mr R was a financial planner. He deducted as business expenses cost of clothing all purchased at Zania shop. He argued that he needed designer clothes to impress his clients and only wore them to work.
* Court- clothing is prima facie a personal expense.
	+ Taxpayer must rebut that argument.
	+ Expenses about one’s personal appearance are the very essence of personal expenses.

**Specific B&P Deductions- HOME OFFICE EXPENSES**

* **s. 18(12): no deduction in respect of a “self-contained domestic establishment” in which the individual resides unless:**
	+ **The work space is the principal place of business, or**
	+ **The work space is used exclusively for business and on a regular and continuous basis for meeting clients**
	+ Same conditions as 18(13) [deduction for home office expenses for employment/office]
	+ 🡪 very high threshold for taxpayer to meet
* **Home office rule applies to expenses that are otherwise deductible**
	+ Restriction on expenses that meet the requirements of s. 9(1) and paras. 18(1)(a), (b) and (h)
* **A business may deduct expenses such as utilities, rent, heat, mortgage interest, property taxes**
	+ These are apportioned on a square footage basis
* An employee’s deductions are restricted to those amounts allowed under s. 8
	+ Office rent, supplies
	+ Mortgage interest and property taxes would be deductible only to sales employees under para. 8(1)(f)
* **Paras. 18(12)(b) and (c) create restrictions on losses**
	+ **Deduction for home office expenses may not exceed income from that business**
	+ Any unused home office expenses may be applied in a future year- rolling account notionally of home office expenses
		- Similar to rules in s. 8(13)
* ***Locke* 🡪office at home was mainly for personal convenience, costs were not deductible; SUPERSEDED!!**
	+ Lawyer claimed expenses for home office.
		- He had a law office as well.
	+ He took percentage of area of house occupied by office, and then took that percentage from home expenses.
		- Potential problem- claiming personal expenses basically.
	+ Court- this is not discrete enough to be an office created for purposes of earning an income.
		- You should have things like separate phone line, sign on the home about office in there, etc
		- Court compared home office- that it should be a branch of his business.
* ***Locke* case has been superseded by amendments to ITA**
	+ MT- today we have 18(12) so not clear how this case would go far today
	+ 18(1)(h) also bars deductions for personal or living expenses
* Home office expenses are now governed by s. 18(12)
	+ Similar conditions to s. 8(13) for an employee
		- Criteria to deduct an expense that relates to your home btwn the two sections are very similar
		- More about the range of expenses you can claim once the criteria are met

**Specific B&P Deductions- TRAVEL**

* **Deductible Travel Expenses: Transportation + accommodation + meals**
* **Para. 18(1)(h) excludes travel expenses from non-deductible “personal or living expenses”**
	+ This allows for expenses that may be personal to be deductible when they’re incurred during the course of travel, otherwise they’d fail 18(1)(h) reqs
	+ The Act overlooks the personal element of those expenses while the person is traveling in the course of business
* **Expenses for travelling away from the base of operations in the course of business are deductible (*Cumming*)**
* **distinguish btwn multiple bases of operations and discrete businesses**
	+ Travel from one place of business to another is deductible
	+ Travel from one business to another discrete business is not deductible

***Cumming* 🡪 Expenses for travelling away from the base of operations in the course of business are deductible; doctor allowed to deduct costs of going to and from the hospital and his home office as travel**

* Dr C didn’t have admin room or office at hospital, so he would finish his shift at hospital, go home to do admin work and then go back to hospital
	+ The key fact is where the doctor’s base of operations is
	+ UK case law: traveling to work and then back again is generally presumed to be personal
		- Store, office, etc how you get to work and get back home is personal expense
			* We say this w/ employees too
		- Canadian court accepts this UK law as valid, but to allow Dr to get around it, court construed home as base of operations.
			* His home is base of operations. He is at work already and goes somewhere else for work.

**Specific B&P Deductions- INTEREST**

* **Interest is what taxpayer pays to borrow money- cost of borrowing money**
* **Interest is deductible under para. 20(1)(c)**
* **Para. 20(1)(c) has 4 elements:**
	+ **Interest must be paid or payable in the year the deduction is claimed**
	+ **Must be payable pursuant to a legal obligation to pay interest on borrowed money**
		- Must be enforceable
		- Correlates to what we saw in cases about interest as income inclusion
	+ **The borrowed money must have been used to earn income 🡪 most important element (*Bronfman Trust*)**
		- Two important concepts:
			* Money was “used”
			* Money was used for “purpose of earning income”
		- direct & current (not indirect and original/historical) use of borrowed money is determinative (***Bronfman Trust***)
	+ **The interest must be a reasonable amount in the circumstances**
		- Hasn’t been looked at a lot in the cases
* **Para. 20(1)(c) applies only to interest on borrowed money (i.e., interest on principal)**
	+ Called simple interest
* **Para. 20(1)(d) allows a deduction for interest on interest (i.e., compound interest)**
	+ Under para. 20(1)(d), interest on interest is deductible only in the year that it is paid, not when payable
* **s. 20(3) – when money is borrowed to repay borrowed money, the new borrowed money is deemed to be used for the same purpose as the original borrowed money** 🡪taxpayer friendly

***Bronfman Trust, SCC* 🡪 leading case on 3rd req for ‘interest’ – the use of the borrowed money to earn income**

**🡪 direct & current (not indirect and original/historical) use of borrowed money is determinative! TRACE that shit!**

**🡪 sig. of ‘true commercial nature’ of transactions; concern around formality/order of transactions getting around tax law [this element has since been abandoned pretty much by SCC]**

* **Facts**
	+ trust created by Mr B for benefit of his daughter, Ms P
	+ trust has property assets, stocks, bonds, and generates income that goes to the trust
		- 50% of the income is paid to Ms P each year
	+ Trustee decided to give a portion of capital of the trust to Ms P- capital allocation
		- Trustee did this twice, for total of $2.5 mil
		- Exercised discretion
	+ Trustee believed at the time that it would be bad idea to sell 2.5 mil of property and what he did instead is to give it to Ms P
		- Normally they would have to sell the property and cut a cheque to Ms P
		- But instead, they asked bank to loan the trust $2.5 mil, and then trustee gave that loaned money to Ms P
	+ The trust then paid interest on the loan to the bank. They eventually sold some trust property and repaid the bank loan.
* **Issue:**
	+ Can the trust deduct interest it paid to the bank as an expense each year until the loan is paid off?
	+ CRA- no, b/c the borrowed money has to be used to earn income from property, but here it was used to pay the daughter which doesn’t earn any income
	+ Trust- I gave the money to the daughter, but that still generated income for me, b/c it allowed me to keep assets which I would otherwise have to sell, so indirectly it helped me gain income.
	+ Trust also argued that if it used money to sell and buy other property, then I could deduct the interest, and CRA says yes if you did it in that order it would be fine, but trust says why should order matter when end result is the same?
* **Analysis**: Went to SCC
* First- borrowed money must be used for an eligible purpose.
* **The direct use of the borrowed money is determinative**
	+ SCC rejected an argument based on indirect use
	+ The money directly went to daughter and wasn’t used directly to generate income for the trust
* **The current use is what matters, not historical or original use**
	+ The taxpayer must trace the borrowed money to a direct eligible use
	+ If there have been multiple different uses, must trace borrowed money through each use
* the purpose of para. 20(1)(c) is to encourage the accumulation of income-producing capital
	+ encourage you to invest and accumulate capital
* Concern about equity and sham if taxpayers arrange affairs based solely on legal relationships
	+ Actual transactions are the ones we need to attach our tax law to- MT
	+ SCC- not sure if Crown should have conceded that the order of the transaction was going to make it deductible; not sure that’s a good thing
	+ That would be inequitable
* **Significance of “true commercial and practical nature” of transactions**
	+ Purpose behind everything here is to pay capital to the daughter
	+ SCC is hinting that even if the trust had done it other way (diff order), we would look at the true commercial and practical nature of the transaction
	+ We would recog this and that is not an eligible use of the money, no matter what order they do their transactions.
	+ Concern around arranging things in way to get around tax law
* Interest is traditionally viewed as a capital expenditure (***Canada Safeway***)
	+ Interest is the cost of borrowing money which is usually done to increase the capital of the business
	+ Most businesses borrow money and have an interest expense
* Interest would be barred from deduction by para. 18(1)(b)
	+ Para. 20(1)(c) allows a deduction that would otherwise not be available
	+ Subsection 20(1) operates “notwithstanding paragraphs 18(1)(a), (b) and (h)”
		- It is a sort of over-ride

**Specific B&P Deductions- INTEREST 🡪 *ISSUES***

**Tracing**

* ***Tennant*** (note 17)
	+ $1,000,000 was borrowed and invested, $999,000 was lost and $1,000 was re-invested
	+ The taxpayer could still deduct interest on the entire $1,000,000 principal
	+ The SCC traced the entire $1,000,000 into the new shares worth only $1,000
	+ The first investment was deductible. Lost almost all of it. Another eligible use investment with what little is left. Then our issue arises.
* ***Hills*** (note 18)
	+ Interest on borrowed money used to buy a mixed-use personal/rental property is pro-rated in proportion to how much of the property was used as rental to earn income.
		- b/c you can only deduct the interest you used to earn rental income

**Interest deduction when no source of income**

* ***Emerson*** (note 19)
	+ Taxpayer lost all borrowed money on shares when sold, borrowed more money to repay the first loan
	+ s. 20(3) deems the use of the new borrowed money to be the same
	+ But there are no shares anymore so no source of income to deduct the interest against

**Use of student loans**

* ***Leslie*** case (note 20)
	+ Interest on student loans is not deductible on basis that borrowed money was used to earn income from business/employment
		- Now there is a nonrefundable tax credit for student loan interest (s. 118.62)
* ***Sinha*** case (note 21)
	+ Interest on students loans was deductible when loans were used to buy income-producing property instead of for education
	+ The purpose of the use of the borrowed money, not the purpose for borrowing, is what matters

**‘True Commercial and Practical Nature of Transactions’ Doctrine of *Bronfman Trust***

* Lower courts did apply this doctrine (***Mark Resources***, ***Canwest Broadcasting***, ***Robitaille***)
	+ The doctrine does create confusion
* **The SCC discarded the doctrine in *Shell Canada* and *Singleton***
* ***Shell Canada* 🡪 Clear rejection of the spirit of *Bronfman Trust*; no concern w/ equity among taxpayers**
	+ featured “weak currency borrowing”
	+ **FCA** held true purpose of borrowing NZ$ and converting them to US$ was to obtain a tax savings
	+ **SCC**: held that the true purpose of all transactions was to borrow money for business purposes
		- allowed what many saw as overt tax avoidance using the interest deduction
		- clearly stated that taxpayers with more resources can plan better than others
* ***Singleton* 🡪 an attempt to make home mortgage interest tax-deductible; “earth shaking” for tax community; arguably allows a tax deduction for personal consumption; is what *Bronfman Trust* said would be a sham**
	+ **Facts**
		- S was lawyer and became partner. Every partner has to make investment and has capital account.
		- Partners get share of profit in the balance of their capital account every year.
		- Mr S wants to buy a house. He knows if he goes to bank to borrow money and buy house, the interest won’t be deductible.
		- So, instead, Mr S who has money in the law firm, takes that money out of the law firm and buys a house with it. Then he went to the bank and borrows money which he returns to the law firm to retain amount of capital. He gives the bank security in form of mortgage and pays bank interest on the borrowed money.
	+ **Issue**:
		- Is that interest Mr S is paying deductible?
		- Mr S- yes since it is being used to earn income from law fir
		- Crown- no since you are trying to get around this and the purpose behind everything is to buy a house which is personal and is what ***Bronfman Trust*** court said you cannot do.
	+ **Tax Court:**
		- True commercial and practical purpose of transaction here is to buy a house which is personal consumption.
		- Effectively allows a tax subsidy to buy a house.
		- If the borrowed money was used directly for house, you couldn’t deduct the interest.
	+ **FCA**- taxpayer lost again. ***Bronfman Trust*** tells us you can't do this!
	+ **SCC**:
		- focused on the legal effect of each discrete legal transaction in sequence
		- rejected sham/equity arguments of FCA and TC
		- Abandoned the “true commercial and practical nature” approach

**Meaning of “income”**

* ***Ludco*** held that:
	+ **“income” in para. 20(1)(c) means gross income that would be taxable; means revenue that’s taxable, not profit 🡪 Does not require a profit or a profit-seeking purpose**
	+ **Interest on borrowed funds is deductible as long as the funds are used in a way that has a reasonable expectation of some gross income**
* **Arguable that *Ludco* directly contravenes the Act!**
* MT-S.9(1) says income from property means profit. That means income used in s.20 should be read as profit.
	+ But SCC reads income as meaning diff things in diff provisions, which seems to violate the consistent meaning rule of stat interpretation.
* ***Ludco*** also considered “for the purpose of” gaining or producing income in para. 20(1)(c)
	+ Does not matter that the taxpayer’s primary purpose was to generate capital gains
	+ The SCC held that “for the purpose of” is satisfied when there is at least an ancillary purpose of earning gross income
		- For *the* purpose of = for *a* purpose of
			* Pursuant to statutory magic!
* **In *Ludco,* SCC did not reconcile the multiple purposes theory with the opening words of s. 20(1) which says a taxpayer may deduct:**
	+ Amounts that are wholly applicable to a source, or
	+ Such part of the amounts that are partly applicable to a source
	+ 🡪 Arguable that these words mandate pro-rating the interest deduction when there is more than just a property income purpose
* ***Ludco*** **creates open season**: no matter what your main purpose, if you show an ancillary purpose to get some *gross* income, you can deduct your interest payments!
* ***Bronfman Trust*** is high point for policy and equity and purposes and then we go downhill to cases that are mechanistic and are not concerned with equity or policy.
* ***Ludco, SCC***🡪 **came out on same day as *Singleton* and made CRA even more sad. D’aww.**
	+ **Facts**
		- Ludco gets money from bank to buy stocks and obv pays interest to bank.
		- Stocks generated some dividends. Dividends are income from property (stocks), so based on that Ludco argues he can deduct interest.
		- BUT, Ludco specifically bought stocks w/ as little dividend as possible and wanted to make capital gain when they sold.
		- Over 8 years, paid $6 million in interest to earn $600,000 of dividends and $9 million of capital gains
		- Recall that only 50% of the capital gains is going to be taxable.
	+ 20(1)(c)- interest is deductible if purpose was to earn income from business or property
		- CRA says you can’t deduct any of this then b/c s.9(1) says taxpayer’s income from business or property equals their profit, and you’re not even trying to make a profit. Your income from your property isn’t even close to exceeding your costs b/c of the type of stocks you’re buying. So you have no income from property, so you aren’t using borrowed money to earn income, so you can’t deduct interest as an expense.
	+ **SCC held that interest was deductible because the money was used to earn income.**
		- Even though every year they have loss from property and even though it wasn’t their purpose to earn income from property (!)
* **“income” in para. 20(1)(c) means gross income that would be taxable; means revenue that’s taxable, not profit 🡪 Does not require a profit or a profit-seeking purpose**
	+ Dismisses argument based on s. 9(1) that income from business or property is the “profit”
* **Interest on borrowed funds is deductible as long as the funds are used in a way that has a reasonable expectation of *some* gross income**
	+ Even if they never got dividends, they would still be fine if they showed track record of those stocks producing some dividends and a reasonable expectation that they would produce some in the future.
	+ If they picked stocks that had never posted dividends and had no reasonable expectations, then maybe not.

**Interest as a current expense**

* ***Gifford*, SCC**
	+ The taxpayer was a sales employee who borrowed $100,000 to purchase a client list
	+ Sought to deduct interest under para. 8(1)(f)
		- 8(1)(f) does not permit a deduction for capital expenditures
	+ **Held**:
		- **interest is a capital expense when the borrowed money is capital (i.e., used to expand the borrower’s capital) 🡪 Then deductible only under para. 20(1)(c)**
		- **Interest is a current expense deductible under s. 9(1) and 18(1)(a) where the borrowed money is itself inventory (i.e., borrowed for resale/re-lending)**

**BUSINESS AND PROPERTY INCOME: TIMING ISSUES**

* **Computation of income includes two components:**
	+ What to include or deduct
	+ When to include or deduct it
* Taxpayers generally have an incentive to defer income inclusions and to accelerate deductions
* The CRA has an incentive to accelerate income inclusions and to defer deductions
* **Cash basis accounting** makes timing issues relatively straightforward
	+ Always include or deduct money when paid
	+ Employment income is largely computed on a cash basis
* **Accrual basis accounting** creates timing difficulties
	+ When an entitlement to receive revenue arises or a liability to pay expenses is created
	+ Receipt and payment of money does not always match the time period when income is earned or expenses incurred
* **Timing issues are resolved by a combination of:**
	+ General principles and presumptions:
		- Matching principle – income and expenditures should be matched. They should be reported in the period in which they arise.
		- Realization principle- when taxpayer receives a payment which is free of conditions or restrictions, it is receivable right away.
		- Contingency principle
	+ Specific statutory provisions, e.g., s. 9, 12, 18, 20
	+ Ordinary business/accounting principles (includes GAAP)
		- We fall back on these if the other sources don’t tell us much (***Canderel***)
* **🡪 The overriding goal is to find an “accurate picture” of a taxpayer’s income**

**Timing Issues- B&P INCLUSIONS**

**General principles**

* ***West Kootenay Power & Light* 🡪 discusses general principles; see throughout**
	+ **Facts:**
		- Taxpayer delivered electricity to customers and billed them every 2 months.
		- Co’s tax year ended in the middle of one of those billing months, i.e. it had delivered electricity for a month w/out being paid.
	+ **Issue:**
		- What to do with that unbilled revenue? Inc it in income?
		- Past practice was no, but they had recently started to estimate how much that would be and inc it in income, then they changed again. They no longer reported the unbilled revenue for tax purposes, but continued to do so for other purposes (banking, shareholders etc)
		- Can they follow two diff types of accounting then?
	+ **Analysis:**
	+ **Consistency/conformity**: the taxpayer does not have to use the same method of accounting for financial statement purposes and for tax reporting
	+ **Where there are multiple acceptable methods of reporting income, s. 9 requires the taxpayer to use the method that gives a “truer picture” of income**
		- The matching principle usually gives the truer picture of income
	+ amounts not yet billed were still “receivable” because the taxpayer had a clear legal right to receive them
	+ **Receivables must be included in income under para. 12(1)(b) (specific rule)**
		- Reqs businesses to inc receivable amounts in their income, even if they hadn’t been received
	+ **“Receivable” is different from “due”**
	+ Taxpayer had argued they couldn’t inc it b/c they couldn’t estimate it.
		- Bad argument- they’re already inc it in financial statements and so on so obv they can estimate some of it.
* **The application of a specific statutory rule displaces any other acceptable approach under GAAP**
* **Principles like “matching” and “realization” operate only in the context of determining profit under s. 9**
* ***Canderel* 🡪 SCC discussed accounting and tax principles:**
	+ **Tax law prevails over accounting standards and principles**
	+ The “matching” principle is just an interpretive aid, not a rule of law
* ***Ikea* 🡪 SCC applied the “realization” principle over ‘matching’ principle**
	+ Landlord gave Ikea, looking to lease space, a payment to induce them to lease
	+ Ikea wanted to take payment and inc part of it throughout all yrs of the lease on basis that they wanted to match payment received to the time period
	+ Income was “realized” when a payment had the “quality of income” (the taxpayer’s entitlement to the payment was absolute)
	+ **the realization principle overrode the matching principle**

**Specific rules**

**12(1)(a) *🡪 Include amounts not yet earned in income***

* **Para. 12(1)(a) – include amounts received in the course of a business for services not yet rendered or goods not yet delivered**
	+ The Act considers these amounts not to be “earned”
	+ Also include any other amount that is not “earned” for any reason
	+ Ordinary accrual accounting principles suggest not to include income until the earning event has occurred
	+ earned when the goods are delivered or the services are performed.

**20(1)(m*)🡪 reserve yet-to-be-earned s.12(1)(a) amounts and inc in next yr’s income under s.12(1)(e)***

* **Para. 20(1)(m) allows a reserve (a deduction) for amounts “described” in para. 12(1)(a) for goods to be delivered, or services to be rendered [i.e. not earned], after year-end; flip sides then**
	+ Amounts claimed as a reserve under para. 20(1)(m) must be included in income next year under para. 12(1)(e)
		- Any amount brought back into income under 12(1)(e) can again be claimed as reserve if it isn’t delivered/performed, ie. Not earned, and then it goes under 12(1)(e) again in the next year and goes back and forth until it’s earned.
* The purpose of the reserve is to defer taxing the income until the year when it is earned
* **A reserve under s. 20(1)(m) is available only for amounts that are brought into income by s. 12(1)(a); those amounts could have ‘quality of income’ but still not be earned (*Doteasy*)**

***Doteasy* 🡪 is a reserve under s. 20(1)(m) available only for amounts that are brought into income by s. 12(1)(a)? yes.**

* 12(1)(m) applies to amounts ‘described as’
* revenue was included under s. 9 because it had the “quality of income”
	+ Treated as income under realization principle b/c they were non refundable.
* It was also described in para. 12(1)(a) (services not yet rendered)
* **revenue was not yet earned even though it had the quality of income**
* A reserve can be taken for an amount that is not yet earned even if it has the quality of income
	+ Specific rules in s. 12 and 20 over-ride general principles under s. 9
* Tax court- reserve is available for any account in the income that are not yet earned.
* The income is earned when the goods are delivered or the services are performed.

**12(1)(b) *🡪 include property/service related receivables not yet due***

* **Para. 12(1)(b) – include amounts receivable in respect of property sold or services rendered, even if amounts are not due until a later year**
	+ This provision does not apply if the taxpayer uses cash basis accounting
	+ Para. 12(1)(b) basically imposes an accrual accounting requirement for all businesses who are not statutorily permitted to use cash basis accounting
	+ Inc it b/c property is already sold and services are already performed, even though you haven’t gotten the money yet.

**20(1)(n) *🡪 reserve some receivables and include into next yr’s income under s.12(1)(e)***

* **Para. 20(1)(n) permits a reserve for some receivables**
	+ A reserve can be claimed in respect of the sale proceeds of property that are not paid by year-end
		- For property other than real property, the proceeds must be payable more than 2 years in the future
		- For real property, the 2-year rule does not apply
* **A reserve under para. 20(1)(n) is brought back into income the next year under para. 12(1)(e)**
	+ Another reserve can be claimed, and so on

**S. 20 *🡪 allows other deductions and allowances in respect of timing***

* **Para. 20(1)(l) – allowance for doubtful debts**
	+ Debts receivable would normally be included in income by para. 12(1)(b)
	+ “Doubtful” debts may be deducted under para. 20(1)(l)
	+ Any amount deducted under para. 20(1)(l) must be included in income the next year under 12(1)(d)
	+ Another reserve could be taken until the debts are collected or written off
* **Para. 20(1)(p) allows a deduction for “bad” debts**
	+ Debts that are “bad” are debts that are established to have become uncollectable
	+ The business may make a final deduction for bad debts under para. 20(1)(p)
	+ No need to bring those debts back into income the next year
	+ A debt written off as bad is included in income in the future if it is ever collected (para. 12(1)(i))

***Additional Specific inclusion rules:***

* Para. 12(1)(c) – include interest that is received or receivable in the year
* Para. 12(1)(g) – include royalties that are received
* Para. 12(1)(j) & (k) – include dividends that are received
* Para. 12(1)(x) – include inducements, reimbursements, gov’t allowances that are received

**Timing Issues- B&P DEDUCTIONS**

* **The threshold requirement for deductions is that an expense must be incurred**
	+ “Incurred” means that the business must at least have incurred a liability to pay the expense
	+ Accrual accounting suggests that expenses should be deducted in the year in which they were incurred
* Rules about timing of deductions for capital expenditures and CCAs are found in those sections.

**Contingent Liabilities**

* **Para. 18(1)(e) – there is no deduction for contingent liabilities**
	+ **A contingent liability is a liability that does not come into existence until the happening of an event which is itself uncertain to occur**
		- There is no deduction until a liability actually exists; i.e., it is absolute
* **If there is doubt about whether or not amount is payable AND some event must happen before amount is payable, then likely it is contingent and you don’t have to pay which means you can’t deduct it as expense (*JL Guay*- but note inconsistency w/ *McLarty*)**

* ***J.L. Guay* 🡪 deals with when an amount becomes “payable”; contingency amounts can’t be deducted**
	+ Construction holdbacks that were not payable until an architect granted final approval could not be deducted
	+ It was uncertain whether the architect would ever grant approval, or how much would be paid
		- What if the architect never granted approval?
		- What if there were damages to satisfy out of the holdbacks?
	+ is effectively a contingency case
* ***J.L. Guay* is not consistent with 2009 SCC decision in *McLarty***
	+ **SCC held that a liability is not contingent if there is no doubt that a liability to pay exists and the only uncertainty is as to how much will eventually be paid**
	+ The very liability to pay must depend for its existence on the happening of an event which is uncertain to occur
	+ The liability in ***J.L. Guay*** may have been absolute, because the holdback was not necessarily a separate liability from the other amounts paid to the subcontractors

**PREPAID EXPENSES**

* **ss. 18(9) denies a deduction for prepaid expenses**
	+ The deduction must be delayed until the year to which the expenses can reasonably be considered to relate
	+ This is an example of the matching principle
	+ It provides a truer picture of income in each year

**RUNNING EXPENSES**

* **Not recog as category by the Act; a term of art**
* **Running expenses are expenses that are not referable to particular revenue receipts**
	+ More like general operational expenses
	+ It is inappropriate to try to match these expenses to a different time period
	+ **Running expenses are generally deductible in full when incurred (*Oxford Shopping Centres)***
* ***Oxford Shopping Centres*: running expenses are deductible in full during the year, even if they distort the income for that year**
	+ Running expenses are deductible for tax purposes even if the taxpayer treats them differently for financial accounting purposes (***Associated Investors***)
	+ ***Associated Investors****:* running expenses are expenses that cannot be directly allocated to corresponding items of revenue
* ***Canderel* 🡪 tenant inducement payments were running expenses**
	+ (contrast to ***Ikea*** case dealing with TIPs received by taxpayer)

**CAPITAL EXPENDITURES & CAPITAL COST ALLOWANCES**

* **THIS IS ALL IN CONTEXT OF DEDUCTING FROM *BUSINESS* INCOME.**
* **Capital expenditures receive three kinds of recognition under the ITA:**
	+ **Some qualify for capital cost allowance (depreciable property)**
	+ **Some qualify as eligible capital expenditures**
	+ **Some qualify as costs of capital property**
* 🡪 Otherwise, capital expenditures are not recognized for tax purposes (“nothings”)
* **Para. 18(1)(b) prohibits any deduction in respect of any capital outlay or expenditure, including depreciation**
	+ **Except as expressly permitted by Part I**
* **Para. 20(1)(a) allows a deduction in respect of the cost of capital property owned by a taxpayer earning income from business or property**
* **Para. 20(1)(b) allows a deduction in respect of “eligible capital” amounts in respect of a business**

**Capital Expenditures- Characterization**

* **Para. 18(1)(b) prohibits any deduction for an outlay, loss or replacement of capital, a payment on account of capital or an allowance in respect of depreciation, obsolescence or depletion**
	+ **Except as expressly permitted by Part I**
	+ Depreciation, obsolescence and depletion are different kinds of deductions under accounting principles
* **The Act does not define “capital expenditure”**
* **Numerous TESTS: No one test is the main test or applicable in all circumstances (*Johns- Manville, SCC*)**
	+ **Enduring Benefit Test**
	+ **Income-earning structure vs. operation of the business**
	+ **Three pronged test (*Sun Newspapers*)**
		- Advantage sought is for current operations of taxpayer
		- Practice is recurring and expenditures are applied in current operations
		- Means adopted to gain advantage are periodic outlay of its funds
	+ **Acquisition of the means of production vs. the use of those means (*Hallstroms Pty*)**
* **Historically, most important test is “enduring benefit” test: An expenditure is capital where it creates an enduring benefit to the business (**UK decision in ***British Insulated & Helsby Cables v. Atherton)***
	+ **This is the most commonly applied test in Canada**
	+ This test is most applicable when the expenditure creates or acquires a distinct asset
	+ **Factors to consider**
		- Asset created
		- Benefit that endures
		- Structural or operational
* **The benefit of an expenditure “endures” when it extends beyond the accounting period in which the expenditure was made**
	+ It is more accurate to amortize/spread the expenditures over the time periods for which it provides a benefit 🡪 matching principle
	+ In tax, a capital expenditure would not be deductible but it might qualify for CCA/ECE treatment
* **Expense of maintaining capital assets are capital expenses, not deductible. (*BC Power Corp*.)**

**Additional Cases**

* Routinely cited cases of diff types of examples:
	+ ***B.C. Electric Railway***
		- Railway losing money; switch to bus services; must pay municipalities to do so; it is capital expenditure b/c benefit endures for as long as they operate. Not deductible.
	+ ***Haddon Hall Realty 🡪 rental expenses CE; not deductible!***
		- Corporate landlord spent money replacing bunch of stuff in rental apartments. They are held to be capital expenditures: long life span stuff being replaced. Not deductible.
	+ ***Damon Developments 🡪 hotel expenses NOT CE; deductible!***
		- Similar expenditures as ***Haddon Hall*** but in hotel. Court accepted that b/c of nature of hotel business these kinds of assets have shorter life span and they have to be replaced consistently on an ongoing basis, so for hotel industry they are currently deductible.
	+ ***Algoma Central Railway, SCC***
		- Railways paid geologist to review and survey land in hopes that they would find resources and encourage businesses to go in and extract them which would then generate more business for the railway
		- **Cost of that kind of study was deductible as current expense b/c it didn’t create any enduring benefit**
	+ ***Canada Starch Co. 🡪 about TM***
		- Taxpayer wanted to register TM; someone objected to it; taxpayer paid them $$ to withdraw objection
		- That payment was held to be deductible expense b/c although TM is asset w/ enduring benefit, that benefit resulted from business doing good job and developing quality in the brand, and not by paying someone not to object.
	+ ***Oxford Shopping Centres***
		- Mall paid city money to build traffic improving structures
		- **Payment to city didn’t create benefit to mall, benefit would have been increase in shopping traffic if it would happen so not CE.**
		- At the time it was speculative
		- So not a capital expenditure.
	+ ***Bowater Power Co.***
		- Hydro Co spent money on studies looking at how to increase electricity produced
		- Diff btwn looking at whether you could increase your power generating capacity or actually increasing your power generating capacity
			* **Study is operational expense and not capital expenditure**
	+ ***Pantorama Industries***
		- Jean store hires consulting firm to find new locations for stores and negotiate leases
			* Instinct is to think this is capital expenditure
		- But court held that much like the hotel that is continually replacing on rolling basis its assets, this store has clothing stores closing everywhere in the country and opening in new spots so it’s operational cost.
	+ ***B.C. Power Corp.***
		- They owned subsidiary Co and prov gov expropriated the under stat and compensated them
		- They fought back saying they’re not being paid enough
		- How do you treat costs of fighting expropriation
			* Capital expenditure
			* Incurred to keep shares of the subsidiary which are capital assets
		- This logic is applied now: **expense of maintaining capital assets are capital** expenditures
	+ ***Shabro Investments***
		- **Distinguish btwn improving building (capital expenses) vs repair (current expenses)**
	+ ***Marklib Investments***
		- Similar to ***Shabro***
		- City ordered building to get work done to bring it up to code
		- Cost was current expenditure and not an improvement
		- Generally repairs in sense of restoring condition of asset are deductible, while replacing assets or improving it is capital expenditure
	+ ***BJ Services 🡪 cost of compensating for failed M&E is current expense, deductible!***
		- Mergers and acquisitions
		- Traditionally costs of things like shares of Co are viewed as capital
		- Costs of targeting Co in securities and M&Es
			* They often incur costs for lawyers, accountants, investment bankers
		- BJ was subj of takeover bid; directors approve; agree to pay fee to acquiring Co compensation if it doesn’t go through which they had to pay b/c better bid came along
		- Could they deduct that fee as expense form income?
		- Courts becoming more lenient as treating all costs incurred by co during these transactions as current expenses, even though they relate to ultimately share structures

***Johns-Manville*, SCC 🡪 case surveys tests for def capital expenditure in other cases; NO DEFINITIVE TEST ENDORSED**

* **Facts**: they’re operating open pit asbestos mine; shipping shit to 3rd world; “merchants of death”
	+ The deeper you dig, the steeper the incline so the Co buys more land around the pit every yr to keep the slope manageable and structurally sound.
* **Issue**: is cost of land they incur every yr a capital expense?
* Tests:
	+ **Enduring benefit test**
		- Does benefit of land bought this yr endure to next yr? no, b/c they need to buy more to keep mine from collapsing.
		- It’s confined to that yr’s income.
		- 🡪 not capital expenditure
	+ **Income-earning structure vs. operation of the business**
		- Money spent in structure of the business or operation of the business
			* Eg homer becomes Mr Plow
				+ Cost of plow is a structural thing and it is a capital expense
				+ Cost of diesel is a yr to yr operational cost
		- Acquire the means of production (capital) OR to use the means of production (capital)
	+ **Three pronged test (*Sun Newspapers*)**
		- Advantage sought is for current operations of taxpayer
		- Practice is recurring and expenditures are applied in current operations
		- Means adopted to gain advantage are periodic outlay of its funds
	+ **Acquisition of the means of production vs. the use of those means (*Hallstroms Pty*)**
* Purpose of buying more land each year is not to acquire a new asset to make your mine bigger and better, but to do what is necessary to earn this year’s income
	+ Consistency and recurrence in expenses that are related to operating the business
* The land is not bought so they can have land; it’s dug up and taken away
	+ 🡪 so there is no enduring benefit since the benefit of last yr’s and is gone and they need more land to make it less steep
	+ Land is not permanent and is transitional
* This has happened every yr for 40 yrs and will do so until it shuts down. Operational then again.
* Relevant that land they buy doesn’t contain any ore or mineral, so it doesn’t expand the capacity of the mine.
* Two other sig things
	+ The little bit of land they get, if treated as capital, is not something taxpayer will get any deductions for
		- Taxpayer either gets to deduct cost of land in that yr, or they can never deduct it
		- Strategic outcome of case- no tax recognition
	+ SCC articulated a “default” rule of interpretation: doubt favours the taxpayer
		- When there is ambiguity, the court should default in the taxpayer’s favour
		- When choice here is taxpayer getting all or nothing, taxpayer should get all option.
* **Factors to consider**
	+ **Asset created**
	+ **Benefit that endures**
	+ **Structural or operational**
* SCC surveyed 8 factors that pointed against capitalizing the expense
* The notes to ***Johns-Manville*** identify five categories of cases
	+ Enduring benefit cases
	+ Business structure cases
	+ Intangibles like goodwill, IP, rights
	+ Corporate transaction costs
	+ Repairs vs. upgrades

**Capital Cost Allowance (CCA)**

* **Para. 18(1)(b) prohibits any deduction in respect of any capital outlay or expenditure, including depreciation**
	+ **Except as expressly permitted by Part I**
* **Para. 20(1)(a) allows a deduction in respect of the cost of capital property owned by a taxpayer earning income from business or property**
	+ taxpayer may deduct such part of the capital cost of property as is allowed by regulation
	+ The CCA scheme includes s. 13, para. 20(1)(a), subsection 20(16), Part XI of the Regulations (Regulations 1100-1107), and Schedule II to the Regulations.
		- In annotated ITA regulations are there

**Capital Cost Allowance (CCA) vs Accounting Depreciation**

* **Accounting Depreciation**: as an asset wares out or is consumed, it is used up and eventually it will need to be replaced.
	+ Depreciation would only apply for an asset that has life span of more than one yr, since otherwise you’d claim it in full for that yr
	+ Accounting principle would try to spread that over the time it lasts
* **Conceptually, CCA differs from accounting depreciation in three ways:**
	+ **(1) Calculated on a declining-balance basis**
		- CCA deduction that is allowed is a percentage of the cost of the property, and next year the deduction is percentage of what remains after the deduction of the prev yr
		- Accounting would deduct same bit over the yrs.
	+ **(2) Property is pooled in “classes”**
		- All the diff kinds of property that a business can own and use (land, machinery, IP, etc etc) get grouped into classes (by stat) and value of class as a whole is subj to depreciation cost as a capital cost
		- Accounting- depreciation charge would be done on asset by asset (not class) basis
		- Classes and rate applicable to them is set out in regulations
	+ **(3) CCA is optional**
		- Depreciation in accounting is required. It has to be shown on your in-house statement.

**CCA= % of UCC (undepreciated capital cost)**

**UCC=(AB+C+D+D.1) – (E+E.1+F+G+H+I+J+K)**

* Generally, CCA is calculated by applying a depreciation rate to the capital cost of property
	+ CCA= % of UCC (undepreciated capital cost)
	+ The balance of capital cost remaining to be depreciated is called undepreciated capital cost (UCC)
* Undepreciated capital cost formula:
	+ UCC=(AB+C+D+D.1) – (E+E.1+F+G+H+I+J+K)
	+ We will deal w/ A, B, E, F
* **Accounting depreciation vs. CCA eg**
	+ Assume a property with a 5-year life is acquired for $500
	+ Depreciation would deduct that cost equally over 5 year
	+ CCA will deduct a percentage of that cost each year
	+ SEE CLASS 12 PP, SLIDE 7 table
	+ CCA generally allows more generous deductions early than accounting depreciation
		- But we know that under CCA you’ll never get to 0
		- Whereas w/ accounting you’d get to 0 in the end
		- So later on, accounting becomes more generous

**Meaning of Depreciable Property**

* **CCA is available for property that qualifies as “depreciable property”**

**~~~Is it depreciable property? DEFINITION + CLASSES OF DEPRECIABLE PROPERTY in REGS – restricted property~~~**

**DEFINITION**

* **Depreciable property is defined in ss. 13(21):**
	+ “depreciable property” of a taxpayer as of any time in a taxation year means property acquired by the taxpayer in respect of which the taxpayer has been allowed, or would, if the taxpayer owned the property at the end of the year…be entitled to a deduction under paragraph 20(1)(a) in computing income for that year…”
* **\*\*In short, depreciable property is defined as property that qualifies for CCA (or that would qualify if owned at the end of the year)\*\***
	+ (1) Depreciable property must be **capital property\*\***
		- Under para. 20(1)(a), CCA is computed by reference to the “capital cost” of property
		- The cost of property that is not capital property (inventory) is fully deductible
	+ (2) Depreciable property must be **acquired\*\*** by the taxpayer; i.e. **taxpayer must own the property**
		- **Property is owned when:**
		- The taxpayer holds legal title, or
		- The taxpayer holds the incidents of ownership (not legal ownership)
			* Possession, use and risk; all 3 mean you own the property (***Wardean Drilling***)
	+ (3) “depreciable property” must be **owned at the end of the year\*\***
		- Regulation 1100(1) says to apply the CCA rate to the capital cost of property owned by the taxpayer at the end of the (taxation) year
		- If you sell it on dec 31, you can’t claim it. (individual)

**SCHED II REGS CLASSES**

* **🡪 Determine whether a particular property that is capital property owned by the taxpayer would qualify for CCA by consulting the classes of property in Schedule II to the Regulations**
	+ If the property falls into one of the prescribed classes, it is depreciable property.

**RESTRICTIONS**

* **Depreciable property does not include: (i.e. there is no CCA for these things)**
	+ Reg. 1102(1)(a) – property the **cost of which is already deductible**
	+ Reg. 1102(1)(b) – property that is **inventory**
		- Property that a business has can be inventory if it is acquired for resale, or capital property if it is acquired to generate income
		- If capital property is disposed of, there could be a capital gain. Regardless of whether it is depreciable or not.
		- If inventory is disposed of, the receipts are business income.
		- Cost of inventory is usually deductible as a business expense (at time period it is sold usually so there is timing issue).
	+ Reg. 1102(2) – **land**
	+ Reg. 1102(1)(c) – property that was **not acquired for the purpose of gaining or producing income** **(look at purpose of acquiring for each property (*Ben’s Limited*))**
* Most kinds of tangible capital property are depreciable property
	+ Buildings
	+ Automobiles
		- Regular
		- Luxury- cap is $30,000
	+ Computer software and films
	+ IP
	+ Manufacturing equipment
	+ Class 8, residual phrase; prop that doesn’t fit into any other class will fit into class 8 and get claimed
* Some, but not all, kinds of intangible property are depreciable property
	+ Other kinds of intangible property might be eligible capital property

***Ben’s Limited*** 🡪 **the reason for acquiring property must be examined in respect of each property separately when taxpayer seeks to claim CCA on it**

* + **Facts**: Intention to tear down 3 buildings on land and build their own
		- But they couldn’t b/c they didn’t have the zoning and one of the buildings was already leased out so they had to wait out the lease
		- They claimed CCA
		- Crown denied it saying they wanted to tear them down and their purpose wasn’t for earning income
	+ **Issue**: Were buildings acquired for purpose of gaining income as req by regs
	+ Court- purpose of acquiring the buildings must be looked at.
		- It wasn’t to earn income here, just to secure the site so they could expand.
		- The rent they got from lease was tangential; they wanted to get out of the lease.
	+ If taxpayer is claiming CCA in respect of property, one needs to look at the purpose of acquiring that property

**Claiming CCA in respect of depreciable property**

* CCA is claimed at the rates set out in Regulation 1100(1) for each class of property
* When CCA is claimed, the remaining UCC balance of the class is reduced accordingly
	+ CCA claimed is part of “E” in the definition of UCC
* Claiming CCA is optional
	+ Para. 20(1)(a) says “there may be deducted”
	+ If you don’t, you can defer it.
	+ If the taxpayer elects not to claim CCA, unclaimed CCA is not carried forward
		- Instead, the UCC balance remains high and future CCA will be higher.

**Restrictions on claiming CCA for certain kinds of properties**

* Regulation 1100(11) – in respect of a “rental property”, a taxpayer may not deduct more CCA than the income from the property in the year
	+ Income means the “profit” for the year before deducting CCA
	+ A taxpayer cannot create a loss from a rental property using CCA
* Regulation 1100(14) defines a “rental property” as a building used primarily to generate rent
* Regulation 1100(14.1) defines “rent”
	+ Right of person/partnership to use/occupation of all/part of property OR services ancillary to the right of a person/partnership to use/occupation of all/part of property are considered RENT
* Regulation 1100(12) and (14.2) – the rental property restriction does not apply to certain kinds of businesses
	+ Including businesses where the taxpayer is an individual who is personally active throughout the year on a continuous basis
* Regulation 1100(15) to (17) imposes similar restrictions on claiming CCA in respect of “leasing properties”
* Regulation 1100(17) defines “leasing property” as depreciable property used primarily to generate gross revenue that is rent, royalties or leasing property revenues
	+ A “rental property” as defined in Reg. 1100(14) is excluded from “leasing property”
	+ E.g., rental apartments are “rental properties”; rental cars are “leasing properties”
* The leasing property rules have similar exceptions to the rental property rules

**Undepreciated Capital Cost (UCC)**

* **If a taxpayer owns depreciable property, must calculate the undepreciated capital cost (UCC) of each class of property in each year**
	+ UCC is a running balance computed at a particular point in time
* **UCC: Balance of original cost of asset that has yet to be claimed as a CCA deduction**
* **UCC is defined in ss. 13(21)**
	+ **For us, (A + B) – (E + F),**
	+ **or A + B – E – F**
* A is the total of the capital costs of each property of the particular class acquired by the taxpayer
* B is the total amount added to UCC under ss. 13(1) in respect of the class
* E is the total amount of depreciation or CCA previously claimed in respect of that class
* F is the lesser of proceeds of disposition or original capital cost of any property of the class that has been disposed of
	+ B and F are relevant only where property of the class has previously been disposed of
	+ In simplest scenario: UCC= A-E [Original capital cost- CCA you’ve already claimed]

**What is the “capital cost” of a property?, i.e. Item A**

* “Capital cost” and “cost” are not defined in the Act
* **Capital cost usually means the actual, historical cost of property to the taxpayer**
	+ Usually the amount paid or incurred to obtain the property
	+ Capital cost includes associated costs and fees
* **restrictions on what can be added to UCC as capital cost of a depreciable property**
	+ **Reg. 1100(2) – Half-year rule**
		- In the yr in which taxpayer acquires property, only half the cost can be added to the UCC in that yr. so you can get half the reg CCA for the asset.
		- Next yr you can add the full amount.
		- Reason- don’t acquire property on dec 31 and get huge CCA for property they didn’t actually hold all yr to reduce their income.
	+ **s. 13(26) – Available for use rule**
		- nothing can be added to UCC of property until it is available for use in that year
		- theme of provision- until property is ready to be used to earn income, you can’t add it to your UCC and start claiming CCA
		- ss. 13(27) to (32) set out when property is considered to be available for use
		- Generally, property becomes available for use when it is first used to earn income, or is ready to be used
		- There is an outside limit on this deferral – the second taxation year after the year of acquisition
	+ E.g., ss. 13(7) dealing with luxury vehicles
		- Parl has said there is limit on how much you can add as cost of luxury vehicle and get CCA

**Calculating CCA- Dispositions of Depreciable Property**

**CCA= % UCC**

**UCC= A-E-F+B**

**A= capital cost** [original/hist cost of property to taxpayer; half year rule- inc ½ cost in year of acquisition (Reg 1100(2))]

**E= total depreciation/CCA prev claimed**

**F= lesser of proceeds of disposition OR original capital cost of property**

**B= amount recaptured and added to UCC under s.13(1)**

* **What is a disposition?**
	+ Defined in s. 248(1) – any transaction that gives rise to proceeds of disposition
* **What are proceeds of Disposition?**
	+ Proceeds of disposition are defined in ss. 13(21)
		- Includes sale price of property sold, other forms of compensation for property lost, destroyed, expropriated
* **There are four possible scenarios:**
	1. Proceeds of disposition = UCC 🡪 [UCC set to 0; no CAA]
	2. Proceeds of disposition < UCC 🡪 [Excess UCC after F adjustment; Terminal Loss (s.20(16)]
	3. Proceeds of disposition > UCC 🡪 [Recapture (s.13.1))]
	4. Proceeds of disposition > UCC and > capital cost 🡪 [Recapture (s.13.1) + Capital Gain]
* **(1) When the proceeds of disposition are equal to the remaining UCC of the class, the effect of F is that the remaining UCC is reduced to zero**
	+ Because UCC can’t ever be more than capital cost, in these circumstances F will automatically take UCC to zero
	+ No CCA can be claimed in the year
* **(2) Where proceeds of disposition for the property are less than the remaining UCC of the class:**
	+ **When A+D > E-F 🡪 TERMINAL LOSS (s.20(16)) deducted directly from income**
	+ Deduct the excess remaining UCC as a “terminal loss” under s. 20(16)
	+ A terminal loss indicates that CCA has not reflected the full extent of depreciation in the value of the asset
* **(3) When proceeds of disposition for the property exceed the remaining UCC of the class:**
	+ **When UCC becomes (-) 🡪 RECAPTURE in your income (s.13(1)); its own category of business income!**
	+ Subtracting the proceeds from UCC as item “F” leads to a negative amount
	+ s. 13(1) provides that any negative balance of UCC must be included in income from the business or property in that year
	+ Any amount of recapture added to income under s. 13(1) must be added to UCC as item “B”
		- That addition takes UCC back to nil
	+ A negative UCC balance indicates that CCA has exceeded the actual depreciation in value of the asset
* **(4) If the proceeds of disposition for the property exceed both remaining UCC of the class and the original capital cost, there are two tax consequences:**
	+ Recapture of negative UCC under s. 13(1) and
	+ A capital gain to the extent that Proceeds of Disposition exceed Capital Cost
	+ The property has increased in value from its original cost basically and you’re paying the tax conseqs
* **A capital gain could potentially result whenever a capital property is sold, depreciable or not**
* **A capital loss may not result from the sale of depreciable property**
	+ **The definition of “capital loss” in para. 39(1)(b) excludes depreciable property**
* If proceeds < capital cost and the difference has not been deducted to date as CCA, the difference will be deducted as a terminal loss under s. 20(16)
* **ITA does not recognize recapture or a terminal loss until all properties in a class have been disposed of**
	+ Recapture and terminal losses are not calculated for individual depreciable properties
	+ A capital gain may arise for an individual property
		- Capital gains are not computed on a class basis

**Allocation of Depreciable Assets**

* **When you buy assets, some of it will be eligible as depreciable and some won’t.**
	+ **Allocate what counts as depreciable and what doesn’t.**
	+ Buyer wants to claim more CCA so they have incentive to get as much of them categorized as depreciable assets as possible.
* CRA can go in and re allocate the price among a bunch of assets to ensure it reflects fair market value (S. 68)
* When a business is bought and sold, 2 ways to do it
	+ (1) Shareholder can sell shares to new owner but Co remains same legal entity
		- Or
	+ (2) Person could sell the business assets to someone else
		- Eg store; you sell your TM, merch, register etc
	+ When second thing happens we get into allocation

**ELIGIBLE CAPITAL EXPENDITURES (ECE)**

* Not all capital expenditures result in the creation or acquisition of property
* In addition, only depreciable property is eligible for CCA
* **Eligible capital is intended to provide tax recognition for capital expenditures that do not qualify for CCA**
* **Para. 20(1)(b) allows a deduction for eligible capital:** Deduct 7% of the balance of **“cumulative eligible capital”** each year
* **“cumulative eligible capital” defined in s. 14(5)**
	+ Add ¾ of each “**eligible capital expenditure”** to cumulative eligible capital
* **“Eligible capital expenditure” is defined in s. 14(5)**
	+ Includes most capital expenditures made for purpose of gaining or producing income from a business
* **Eligible Capital Expenditures include things like:**
	+ Incorporation and organization costs
	+ Brand names that are not intangible property
	+ Franchises
	+ Goodwill
	+ Customer lists
	+ Licenses
* **ECE does not include:**
	+ any amount deductible under another section
	+ any amount that is not deduction under a provision other than para. 18(1)(b)
	+ Any amount that is the cost of tangible property or intangible property that is depreciable property
	+ i.e., any amount that is the cost of property that can get CCA

**CAPITAL GAINS & LOSSES**

* Any time a capital property is disposed of, there is potential for a capital loss or capital gain.

**Statutory Framework for Capital Gains/Losses**

* **Capital gains are included in income pursuant to para. 3(b)**
* **Include the sum of taxable capital gains + taxable net gain from listed personal property**
* **Subtract allowable capital losses + allowable business investment losses**
	+ Taxable capital gains are the taxable (50%) portion of capital gains
	+ Allowable capital losses are the deductible (50%) portion of capital losses
		- Allowable capital losses may only be subtracted from taxable capital gains within the 3(b) calculation
		- Excess capital losses are carried forward as “net capital losses”
			* Can be deducted in other years to reduce capital gains (s. 111)
			* Back 3 yrs, they can sit indefinitely
		- If you die w/ capital losses sitting there, they can be deducted from capital gains that year but also any other income for that year only that you died. You can’t take them to heaven apparently.
	+ Allowable business investment losses are deducted from income from all sources under para. 3(d)

**Capital Gains/Losses are the subject of subdivision c of Part I – ss. 38-55.**

* **S. 38: sets out the inclusion rates: inclusion rates are given basically**
	+ a “taxable” capital gain is 50% of the capital gain from the disposition of property (s.38(a))
	+ an “allowable” capital loss is 50% of the capital loss from the disposition of a property (s.38(b))
	+ an allowable business investment loss (ABIL) is 50% of the business investment loss (BIL) (s.38(c))
* **S. 39: defines capital gains and losses and business investment losses:**
	+ para. 39(1)(a): **a capital gain is defined as a gain from the disposition of a property, which gain would not be included in income under s. 3**
		- Gains from certain kinds of property listed in para. 39(1)(a) are not included
	+ para. 39(1)(b): **a capital loss is a loss from the disposition of a property, which loss would not be included in income under s. 3**
		- para. 39(1)(b) explicitly excludes depreciable property and eligible capital property from capital losses
		- recall rule 4- proceeds of disposition exceed original capital cost and original cost then they don’t get to claim CCA and have a capital gain
* **s. 40**: rules for computing capital gains and losses
* **s. 41**: rules for listed personal property
	+ taxable net gain from dispositions of listed personal property
* **s. 54**: definitions for subdivision c

**Characterization of Capital Property 🡪 VERY IMPORTANT!!!**

* **There must be a disposition of capital property for capital gain or loss to result**
	+ If no property is disposed of, there cannot be a gain or loss
	+ If property disposed of is not capital property, the gain or loss is not a *capital* gain or loss

**DISPOSITION**

* **“Disposition” is defined in s. 248(1)**
	+ Any transaction or event that entitles a taxpayer to “proceeds of disposition”
* **“Proceeds of disposition” is defined in s. 54**
	+ The definition is inclusive
	+ It includes the sale price of property that is sold, compensation for property taken, destroyed, rendered unusable
	+ “Proceeds” are not confined to monetary forms
		- If someone gives you something in return that is not money.
		- Eg if someone takes on debt you have then you’ve received proceeds in the value of debts you no longer have

***CAPITAL* PROPERTY**

* **KEY: When is property *capital* property, and not inventory?**
* **“Capital property” is defined in s. 54:**
	+ **Depreciable property, or**
	+ **Property the gain or loss from which gives rise to a capital gain or loss**
* 🡪definition of “capital property” is not particularly helpful; look to case law.

**Real Estate**

* **The most common distinction is capital gain vs. adventure in the nature of trade**
	+ **Intention at the time property is bought is important**
		- If intention is to flip it at some point, it’s prob business
		- If intention is to keep it, it’s prob capital
* **If present at the time of acquisition of a property, an intention to resell at a profit nearly always indicates an adventure in the nature of trade, i.e. business income 🡪 NOT CAPITAL GAIN/LOSS**
* **A secondary intention to resell also turns an investment transaction (capital) into an adventure in the nature of trade (business income) (*Regal Heights*)**
	+ Secondary intention means that the prospect of reselling at a profit was an **“operating motivation”** at the time the property was acquired- more than tacit understanding that if price is right later you’d sell
* **An “adventure in the nature of trade” is included in a ‘business’ under ss. 248(1), NOT CAPITAL GAIN**
	+ Most often an isolated maybe speculative transaction, undertaken for profit (although it doesn’t have to be undertaken for profit) (***Taylor***)
* **Principles (for adventure in nature of trade) from *Taylor***
	+ **“Adventure” implies a single, isolated transaction**
	+ ***Positive indicators:***
		- A transaction carried out in the same manner as a dealer in the property would indicate an adventure in the nature of trade
		- Some kinds of subject matter are unlikely to be investments or personal property, probably an adventure in the nature of trade
			* Eg toilet paper, no one needs that much so if you stockpile you want to resell.
		- Property can only be disposed of through trade
	+ ***Negative indicators:***
		- An adventure in the nature of trade is not necessarily organized in the way a business would be
			* Often it is isolated and a one-off transaction
		- It is not *necessary* to have an intention to resell property at a profit (MT- Problematic)
		- Intention to make a profit may be an indicator, but its absence is not determinative
* **Relevant factors in determining whether real estate is capital property:**
	+ Length of time the property is held
	+ Reasons for sale
	+ Method of financing, expectation of profit
	+ Other activities of the taxpayer
	+ Use while the property was owned
* **It is fairly frequent for taxpayer to change plans and to change the use of the property**
	+ It is possible for property to change its character from capital property to inventory, or vice versa
	+ This change will change the nature of any gain or loss
	+ **There will not be a change in use from a change of intention alone (*Peachy*)**
		- **You must change the actual use of the property**
		- **A taxpayer must take a “clear and unequivocal positive act” to implement the changed intention**
	+ **Identify intention and *when* it is relevant (*Bodine*;** [citrus farm sold to Costco]; clear unequivocal act to change intention found**)**
	+ vacant land was purchased for development of residential lots, but not developed and eventually sold in bulk and intention remained unchanged b/c taxpayer changed his mind but didn’t act on that change of mind (***Peluso***)
* ***Regal Heights* 🡪 importance of a secondary intention to the adventure in the nature of trade**
	+ Secondary intention that, if my plan doesn’t work and I can sell it, then it’s still adventure in nature of trade. Speculative
	+ Secondary intention test is still w/ us: when taxpayer buys property w/ intention to use it as capital property, but had secondary intention to use it otherwise, they can still be characterized as engaging in adventure in nature of trade and have property fit under business income
	+ Land, purchase and sale was an adventure in nature of trade and it was not capital and it was a business, and not a capital gain. So the income is business income and it is taxable.
* Cases after ***Regal Heights***suggest the secondary intention must be a “motivating intention”
	+ Needs to be motivating factor b/c everyone who buys a property as a capital property would always sell it one day if she got the right price. And that doesn’t mean your property suddenly becomes inventory for the purpose of an adventure in the nature of trade.
		- Prospect of selling it must be one of the reasons you bought it
* ***Peachy***:
	+ **Facts**: taxpayer bought some farm land to make it residential and sell but their application for zoning failed and they couldn’t develop the land and they just let the farmland sit. One day they got an offer and they sold it and made a gain.
	+ **Issue**: is gain income or capital?
		- Taxpayer obv wants it to be capital, so they argued that although when they bought it they intended to have as inventory for housing business, we changed our plan and sat on land and so it became capital property.
	+ There will not be a change in use from a change of intention alone
		- You must change the actual use of the property
	+ A taxpayer must take a “clear and unequivocal positive act” to implement the changed intention
	+ The property remained inventory because nothing was done to use it as capital property
	+ Property that was purchased as inventory remained inventory even though the taxpayer did not carry through its plans to build and sell homes and the property sat vacant for 10 years
	+ Still good law
* ***Bodine***:
	+ **Facts**: taxpayer transferred farmland to a partnership which entered into another partnership to develop the land, but the land was never developed and continued to be farmed until it was sold
		- B is farmer and he had a lot of land and grew citrus and was successful.
		- Tipping point where land is more valuable for development than farming so he paired up with developer and started selling off the 500 acres bit by bit.
		- He formed partnership w/ wife and they became owner of parcel 6 (land at issue). And now partnership owns this land. Immediately after (like days) the partnership joined into new partnership w/ the developer.
		- Partnership 1 agreement said purpose was to improve and develop land of parcel 6 and sell it at appropriate time, but it also said it would enter partnership 2.
		- Partnership 2 agreement said purpose was to develop and sell this land for as much as possible.
		- P1 was supposed to transfer land to P2 so they could sell it but they never did the land transfer for 6 yrs.
		- He was growing his citrus on it that whole time
			* He argued the partnership was just for admin reasons so he doesn’t have to get his ex wife’s sig every time
		- Then he got offer to sell the land to Costso and they did and as 80% owner of partnership he gained 3.2 million.
	+ **Issue**: is that gain capital gain or gain from adventure in the nature of trade (i.e. business income)?
	+ The partnership was significant
		- You transferred ownership of land to P1- that is meaningful event.
	+ The transfer to the partnership marked a change of intention
		- B argued that I still was farming that land and despite the change of intention the use was still the same thing. So the use is still to make income so it’s capital.
		- Crown argued those acts are the clear and unequivocal acts req to show change
	+ The transfer to the partnership, and the subsequent partnership, was a clear and unequivocal act dedicated to carrying out the new intention
	+ The property switched from capital property to inventory, the gain was business income
	+ It’s MT’s case; woot woot.
	+ **You need to identify the intention, but also when the intention is relevant. b/c property was placed in partnership, that intention was relevant; not the intention when he acquired land 40 yrs ago originally that it be farm land.**
* ***Peluso* 🡪 vacant land was purchased for development of residential lots, but not developed and eventually sold in bulk and intention remained unchanged b/c taxpayer changed his mind, not didn’t act on that change of mind.**
	+ **Facts**: clearly the land was inventory when they acquired it. And they had clear plan for development.
		- But changes ensued and they decided not to develop the land, and sold it bulk.
	+ **Issue**: is the gain capital gain or gain from adventure in the nature of trade?
	+ The land was always inventory
	+ Did not become capital property just because the taxpayer decided not to develop it
	+ The taxpayer just changed its plan, did not implement any steps to use the property as capital property
		- They decided *not to do* something. They didn’t *do* anything.

**Personal Property**

* Personal means it’s not real property
	+ Real is land, personal is things
* MT- doesn’t think it’s that diff
* ***Canadian Kodak Sales* 🡪 Sales of business inventory are always business income even if sold in bulk or as part of the sale of a business**
	+ a leasing company merged with a sales company and eventually sold its leasing inventory
	+ The proceeds were proceeds of an integrated sales business
	+ The income was business income.

**Corporate shares**

* **Shares are not treated much differently from other kinds of property.**
* **s. 39(4)** – “Canadian security” election
	+ A taxpayer may elect to deem a Canadian security to be capital property for all purposes
* Traditionally, shares were viewed as inherently capital property
	+ There is no principled reason to treat them differently from other property though
* ***Irrigation Industries*, SCC 🡪 suggests that an intention to resell shares does not make them inventory; shares are inherently capital**
	+ **Facts**: Taxpayer’s purpose was to build a mill but they didn’t for yrs
	+ In short span they bought shares in a mining company and it went big and they sold it and gained
	+ **Issue**: is gain business income or capital trade?
	+ **Analysis:**
		- TJ:
			* Shares are speculative
			* They wanted to sell them
			* It is basically income
	+ SCC surprisingly overturned.
		- Intention alone doesn’t make the property inventory b/c anyone who buys any property is always prepared to sell it if they get a good offer.
		- You need a clearer indication of trade.
		- These guys aren’t carrying on trade in a securities dealt sense
		- Shares are a form of investment in a company, and an investment is capital, so shares are inherently capital.
	+ Why surprising? b/c this is a departure from accepted principles of determining an adventure in the nature of trade.
	+ High point for concept that corporate shares are always a capital property.
* **Cases since *Irrigation Industries* have backtracked**
	+ Shares are not treated much differently from other kinds of property

**Computation of Gains and Losses, s. 40**

**POD – (ACB + Outlays) = Capital Gain/Loss** [computation governed by s.40]

**POD- proceeds of disposition**

**ACB- adjusted cost base (price they paid to acquire it -Plus/minus statutory adjustments)**

**Outlays- anything you spent for the purpose of disposing of property (eg realtor fees)**

* If proceeds exceed (ACB + outlays), then there is a capital gain under para. 40(1)(a)
* If proceeds are less than (ACB + outlays), then there is a capital loss under para. 40(1)(b)
* **“Proceeds of disposition” def in s. 54**
	+ The definition is inclusive
	+ It includes the sale price of property that is sold, compensation for property taken, destroyed, rendered unusable
	+ “Proceeds” are not confined to monetary forms
* **Adjusted cost base is defined in s. 54**
	+ ACB = the historic cost of a property plus or minus adjustments under s. 53
		- Adjustments under s. 53 are highly technical
	+ Historic cost in lay terms is really the cost of the thing to the taxpayer
	+ **EXAM**: If you encounter taxpayer acquiring property and incurring cost for it, it won’t necessarily say the ACB is x. what it cost them to acquire that is the ACB obv after adjustments.
* **subpara. 40(1)(a)(iii): Where proceeds of disposition are payable wholly or partly in a future year, you’re allowed a reserve:**
	+ taxpayer may defer up to 1/5 of the gain per year for 5 years

**Special Rules for Capital Gains and Losses**

**Four special rules:**

* Personal-use property
* Listed personal property
* Principal residence exemption
* Lifetime capital gains exemption/deduction

**Personal-use property 🡪 Capital Gain allowed [min. $1000 (s.46)]; Capital Loss deemed 0 (s.40(2)(g)(iii)**

* **s. 54 defines “personal-use property” as property used primarily for the personal use and enjoyment of the taxpayer or individuals related to the taxpayer**
* **A taxpayer may realize a capital gain on personal-use property**
* **Subpara. 40(2)(g)(iii) deems any loss on personal use property to be nil**
* **Subsection 46(1) imposes a $1,000 value threshold for personal-use property**
	+ Gains or losses on personal-use property worth less than $1,000 are not recognized
	+ 46(1) disregards any personal property under $1000 by deeming the stat adjustment in the formula to be $1000 or whatever the value is.

**Listed personal property 🡪 Inc in income: ½ Net Gain (All LLP Gain- All LLP Loss) (s.41(1)-(2)) [min. $1000 (s.46)]**

* **s. 54 defines listed personal property as personal-use property that is art, jewellery, rare books, stamps or coins**
* **“taxable net gain” from listed personal property is included in income under para. 3(b)**
	+ Losses from LPP can only offset gains from LPP
* **s. 41(1) – The “taxable net gain” from listed personal property is ½ the net gain from dispositions of LPP**
* **s. 41(2) – The “net gain” from dispositions of LPP is all LPP gains in the year minus all LPP losses in the year**
	+ 🡪 self contained!
* When the taxpayer’s LPP losses for the year exceed the LPP gains, the taxpayer has a “listed personal property” loss under s. 41(3)
	+ LPP losses may be applied against LPP gains in other years – back 3 yrs, forward 7 yrs
* **Because LPP is a kind of personal-use property, it is subject to the $1,000 value minimum in s. 46(1)**

**Principal Residence 🡪 Capital gain from disposition is non-taxable! (s.40(2))**

* **Under ss. 40(2), an individual’s gain from a principal residence can be tax-exempt**
	+ **exemption is based on the number of years that the individual “ordinarily inhabited” the property out of the number of years that the individual owned the property**
	+ If the individual ordinarily inhabited the property for the entire time that he/she owned the property, the entire gain will be exempt
* This is a clear violation of tax neutrality and policy was put in place to encourage ppl to buy their own homes
* **s. 54 defines “principal residence”**
	+ It must be a “housing unit”
	+ It must be owned by the taxpayer – solely or jointly
	+ It must be ordinarily inhabited in the year by the taxpayer, the spouse/common-law partner, or by a child under 18
		- Ordinarily inhabited is not defined term. We don’t need to get into it.
	+ The taxpayer must designate the residence in the income tax return
		- No other residence may be designated by the taxpayer, spouse, or unmarried child under 18 in the same year
	+ AND it has to be capital property! If you’re a house flipper, that’s adventure in the nature of trade and it’ll count as business income .
* **Under s. 54, a principal residence is deemed to include land**
	+ includes:
		- land “subjacent” to the housing unit
		- land “immediately contiguous” to the subjacent land to the extent that the land may reasonably be considered to contribute to the use and enjoyment of the residence
	+ Limit: **For land in excess of ½ hectare, the taxpayer must demonstrate that the excess land is necessary for the use and enjoyment of the residence (*Yates*)**
		- The possibility of subdivision is extremely important in satisfying the “necessary to the use and enjoyment” test (***Yates***)
* ***Yates*****🡪 ‘necessary to use and enjoyment’ test for getting principal residence exemption on capital gains on sale of land; importance of possibility of subdivision**
	+ the taxpayer was required to own at least 10 acres, could not subdivide; therefore, all 10 acres were “necessary” to the use and enjoyment of the residence.
	+ They didn’t want 10 but 1, but they weren’t allowed to. So they eventually sold 9 of it back to city.
	+ They got to claim full exemption for all that land
	+ Potential to legally split land and hive off that 1 hectare is important
		- When taxpayer can show he cannot legally split the land and keep what they want, they’re generally successful in convincing court they need the whole thing.

**Lifetime capital gains exemption/deduction**

* **Every individual is permitted a lifetime total of $375,000 of taxable capital gains in respect of:**
	+ Qualified small business corporation shares
	+ Qualified farm property
	+ Qualified fishing property
	+ Shares of qualified farming or fishing corporations
* **This exemption shelters a lifetime total of $750,000 of capital gains**
* **The exemption operates as a deduction from taxable income under s. 110.6**
* You should know then that certain kinds of small businesses, farm and fishing properties, there is generous break where they can get tax free capital gains 🡪 Know it exists!

**Recognition & Non-recognition Rules**

* **Recognition rules require taxpayers to recognize capital gains or losses even when property is not actually disposed of**
* **Non-recognition rules permit taxpayers not to recognize, and to defer, capital gains or losses even when property is actually disposed of**
* **Recognition rules usually deem a taxpayer:**
	+ to dispose of property for proceeds equal to the fair market value of the property at that time, and
	+ to immediately reacquire the property at a cost equal to the same fair market value
* Recognition rules deem a disposition that has not taken place in fact
* Any accrued capital gains and losses are realized.
* **Non-recognition rules generally deem:**
	+ the disposing taxpayer to dispose of property for proceeds equal to ACB instead of the actual proceeds in fact, and
	+ the acquiring taxpayer to acquire the property at a cost equal to the disposing taxpayer’s ACB instead of amount actually paid
* The result of a non-recognition rule is that the disposing taxpayer usually has no gain
* The gain is deferred and will be realized by the acquiring taxpayer when they dispose of the property
* **Significant recognition rules include:**
	+ Change of use from income-earning to personal and vice versa – s. 13(7) for depreciable property, s.45(1) for capital property
	+ Becoming a resident or ceasing to be resident – s. 128.1
	+ Death of an individual – s. 70(5)
* **Significant non-recognition rules include:**
	+ Exchange of property for a replacement property – s. 44
	+ Transfer to a spouse or to a trust for the benefit of a spouse – s. 70(6) and s. 73(1)
	+ Transfer of farm or fishing property to a child – ss. 73(3) and 70(9)
* Some recognition and non-recognition rules are **automatic**:
	+ Change of use rules, residency rules, death
	+ Transfer to spouse or spouse trust by will
* Other recognition and non-recognition rules are **elective:**
	+ Replacement property election
	+ Transfer to spouse or spouse trust while alive
	+ Transfer to corporation in exchange for shares (s. 85)

**Allowable Business Investment Losses (ABILs)**

* **Under para. 38(c), an ABIL is ½ of a BIL**
* **Under para. 39(1)(c), a BIL is:**
	+ A capital loss
	+ From the disposition of
		- A share of a small business corporation (defined in s. 248(1)), or
		- A debt owed by a CCPC that is an SBC, a bankrupt SBC, or an insolvent SBC
* **POLICY**: To give favourable tax incentives to invest in small businesses

**Recognition and Non-Recognition Rules**

* **To qualify as a BIL, the share of debt must be disposed of:**
	+ **under s. 50(1), OR**
	+ **to an arm’s length person**
* **s. 50(1) allows a taxpayer to elect to dispose of a debt or a share for proceeds equal to nil when:**
	+ The debt is a **bad debt**, or
	+ The **corporation** to which the share relates is **bankrupt**, winding-up or insolvent and **not reasonably expected to carry on** business again
* Under s. 50(1):
	+ taxpayer is deemed to dispose of the share or debt for proceeds = nil, triggering a loss equal to ACB
	+ THEN taxpayer is also deemed to immediately reacquire the debt or share at ACB = $0
	+ Could be a gain if the debt or share is actually disposed of in the future
* **subpara. 40(2)(g)(ii): important restriction on ABILs**
	+ **the loss from a debt is deemed to be nil *unless* the debt was acquired:**
		- for the purpose of earning income from a business or property, OR
		- as consideration for the transfer of capital property to an arm’s length person
* The purpose of the ABIL rules is to encourage investments in small businesses through debt or equity

**Identical Properties Rule, s.47**

* **S.47 rule says, when taxpayer acquires property identical to property already owned, the cost of the property will each be the average of all.**
	+ You buy a property
		- Eg share of TD bank for $40. They climb to $50 next week. You buy second one.
	+ These 2 shares are interchangeable- if you sell one in week 3, which one did you sell? They’re identical and interchangeable.
	+ So each of those TD shares cost you $45 each
	+ Your ACB would be based on this new deemed cost.

**NON-ARM’S LENGTH RELATIONSHIPS**

* Non-arm’s length relationships can be problematic (pursuant to pesky things like ethics and morals and human feelings)
	+ Relationships, connections and influence distort economic outcomes and transactions
* Arm’s length transactions are presumed to occur on market terms (fair market value)
* **A non-arm’s length transaction is likely not to occur on market terms**
	+ Non-arm’s length parties would have to prove that the terms of their transactions are market terms
		- They can prove this by kissing the ring on Adam Smith’s invisible hand

**When are two persons NOT dealing at arm’s length?**

* **ss. 251(1) sets out three circumstances:**
	+ (a**) related persons** are deemed not to deal at arm’s length
		- regardless of the actual terms of a transaction
	+ (b) **a taxpayer and a trust in which the taxpayer or a non-arm’s length person is beneficially interested** are deemed not to deal at arm’s length
	+ (c) otherwise, it is a **question of fact** whether persons are dealing at arm’s length
* Note- person inc corporations.
* ITA does not say when a non-arm’s length relationship exists in fact
* **Bargaining between parties acting in their own economic self-interest is the essence of arm’s length dealings**
* **The case law establishes three tests for a non-arm’s length relationship in fact:**
	+ A common mind directs both parties to a bargain
	+ Two parties act in concert without regard to their separate interests
		- One or more party don’t display that they’re pursuing their own self interests
	+ One party has sufficient influence over the other to have *de facto* control

**When are persons related?**

* **There are three kinds of relationships:**
	+ Individuals related to individuals
	+ Individuals related to corporations
	+ Corporations related to corporations
* **ss. 251(2) sets out rules for each kind of relationship**

***Individual—Individual***

* connected 🡪 related 🡪 deemed non-arm’s length
* **para. 251(2)(a): individuals are related when they are connected by blood relationship, marriage or adoption**
* **ss. 251(6) outlines when individuals are connected**
	+ para. 251(6)(a):connected by **blood relationship** extends to parents and children, other descendants, and siblings
		- Note extended meanings of child, parent, brother, sister, grandparent, aunt, uncle, great-aunt, great-uncle, niece and nephew in s. 252
	+ para. 251(6)(b): individuals are connected by **marriage** to:
		- the person to whom they are married (their spouse), and
		- persons who are connected to the spouse by blood relationship (parents, children, siblings)
	+ para. 251(6)(b.1): individuals can be connected by **common-law partnership** in the same way as by marriage
	+ para. 251(6)(c): individuals connected by **adoption**:
		- an adoptive parent is connected to the adoptive child by adoption (legally or in fact)
		- an adoptive child is connected to:
			* The adoptive parents, and
			* Persons who are connected to the adoptive parents by blood relationship
				+ For this purpose, blood relationship includes only parents of the adoptive parents, and other children/descendants of the adoptive parents

***Individual—Corporation* 🡪 NOT ON EXAM**

***Corporation—Corporation***

* para. 251(2)(c): two corporations are related when they are controlled by the same person
	+ There are various other cross-ownership or cross-control rules
	+ Also some deeming rules in ss. 251(3) and (5)

**Tax Consequences of non-arm’s length dealings**

* **There are numerous tax consequences specifically for non-arm’s length relationships:**
	+ For example: s. 69, s. 160, ss. 74.1-74.5, s. 78

**Deemed Proceeds & Cost- s. 69**

* **In a non-arm’s length transfer of property, s. 69 applies to deem the tax attributes of the property for the parties**
	+ tax attributes are things like the cost of property, the proceeds of disposition
	+ **s. 69 can override the actual terms of a transaction for tax purposes**

**para. 69(1)(a) – deemed cost rule**

* When a taxpayer acquires anything from a non-arm’s length person for a price greater than FMV, para. 69(1)(a) deems it to be acquired at FMV
	+ para. 69(1)(a) prevents an artificial increase in cost
	+ para. 69(1)(a) does not deem the transferor of the property to receive proceeds equal to fair market value. Proceeds will be actual amount received.
		- There could be a punitive result
* Why pay more? The more you pay for something, the higher your cost, the higher your ACB, so
	+ If you sell it, the higher the cost, the lower your taxable capital gain
	+ If the property is depreciable property, the more you pay for it, the higher your capital cost, the higher your UCC, the higher your CCA.
	+ If you’re buying/selling inventory, any gain is 100% taxable since it’s business income.

**subpara. 69(1)(b)(i) – deemed proceeds rule**

* When a taxpayer disposes of anything to a non-arm’s length person for no proceeds, or for proceeds less than FMV, para. 69(1)(b) deems the proceeds to be FMV
	+ subpara. 69(1)(b)(i) prevents an artificial reduction of a gain
	+ subpara. 69(1)(b)(i) does not deem the transferee to acquire the property at a cost equal to FMV
		- Potential for double taxation and a punitive result

**subpara. 69(1)(b)(ii) – disposition by gift *inter vivos***

* Where a person disposes of anything by way of gift *inter vivos,* he is deemed to receive proceeds equal to FMV
	+ subpara. 69(1)(b)(ii) can trigger a gain or a loss on the gift of a property- capital gain/loss
		- money has constant value so it cannot happen for money.
	+ creates a tax disincentive to gift property *inter vivos* because of the liquidity problem

**para. 69(1)(c) – Deemed cost of acquisition for recipients of gifts**

* Where a person acquires anything by way of gift *inter vivos,* he is deemed to acquire the property at a cost equal to FMV
	+ para. 69(1)(c) creates a cost for property that is acquired by the gift recipient at no cost
* they will take the property and if the value changes over time, they will have a gain or a loss.
	+ So it creates a deemed cost from which to figure that out.
* Unlike para. 69(1)(a) and subpara. 69(1)(b)(i), the gift rules in 69(1)(b)(ii) and 69(1)(c) do not create the potential for punitive double taxation
* **The gift rules in 69(1)(b)(ii) and 69(1)(c) apply to all gifts *inter vivos* – not just non-arm’s length gifts**
* **The deemed cost and proceeds rules in s. 69(1) apply to *any property***
	+ Eg ***Marcantonio* 🡪 applied to inventory**
	+ do not apply just to dispositions of capital property
	+ These rules apply to the disposition and acquisition of “anything”
		- Could include inventory

***Marcantonio* 🡪 example of applying ss. 69(1) to the acquisition of inventory**

* Taxpayer was carrying on business. Acquired inventory from related party and paid too much- more than FMV.
* It was then deducting too high a cost and getting too low a business income (lower profit).
* So court went in and adjusted.
	+ Lower cost, higher profit.
* The deemed values have the same effect on the gain or loss as they would if the property is capital property
* The gain or loss is business income instead

**Third Party Liability- s. 160**

* **A person who receives property from a non-arm’s length person may become liable for the transferor’s tax debt under s. 160**
	+ Very broad: transfer can be direct or indirect by means of a trust or by any other means whatever
	+ applies when a taxpayer transfers property to his spouse (or future spouse), to a child under 18, or to any non-arm’s length person
* **If the transferor of property owes a tax debt for the taxation year in which the transfer occurred or for a prior year, then:**
	+ The transferor and the transferee become jointly and severally liable for the transferor’s tax debt
* The transferee’s liability will be reduced by the FMV of any consideration given for the property
* **The transferee’s liability is limited to the lesser of:**
	+ (FMV property) – (FMV consideration), and
	+ The transferor’s total tax debt for the taxation year and all prior years
		- Tax debt under the Act- anything, not just the transfer
	+ Liability of transferor for the year- doesn’t apply retroactively for future tax debt
* **The transferee’s liability under s. 160 cannot exceed:**
	+ The difference between the FMV of the property and the FMV of any consideration given, and
	+ The transferor’s tax debt
* **To exchange consideration that reduces liability under s. 160 , there must be an exchange of valuable consideration (*Livingston*)**
	+ There must be a binding contractual relationship
	+ The exchange must leave the tax debtor with something of value that could be collected to satisfy the tax debt
* **Deposits of money to another person’s bank account are a transfer of property (*Livingston*)**
* **purpose of s. 160 is to stop a taxpayer from preventing collection of their tax debt by placing property in friendly hands**
* s. 160 may apply even if there is no tax liability at the time of the transfer
	+ It will apply if there is any tax liability for the year in which the transfer occurred or a prior year
* s. 160 applies regardless of the purpose of the transfer of property
	+ eg Father can give money to children for school and they could become liable for their father’s debt
* There is no time limit on a s. 160 assessment
	+ Under s. 160(2), the Minister may assess the transferee “at any time”
* **EXCEPTION**: s. 160 does not apply to transfers between spouses under a court order or written separation agreement (basically spousal and child support stuff)

***Livingston* 🡪 s. 160 application + principles**

* **Facts**: Mrs D ran construction Cos which all went bankrupt; she owed income tax; also liable for GST and source deductions; all in all about $750,000 liability.
	+ Debtors can move stuff around and make it harder for creditors.
	+ Whenever CRA found a bank account, it was already empty.
	+ Mrs D had gone to friend, L; agreed to open bank account in L’s name and D put in her money; D got ATM card from L and L also gave her blank cheques signed so she could pay ppl.
		- No body could seize it then to get at D.
	+ D deposited ~38,000 into this account.
	+ CRA couldn’t take L’s account.
	+ CRA got $233 from D when D went bankrupt, and D didn’t declare L account.
* **Issue**: was D’s transferring of money into L’s account a transfer of property?
	+ Crown- argues yes; they are not at arm’s length and this is transfer of property.
	+ L- money wasn’t transferred to her; deposited in her account in name only; basically like trust.
		- In alternative, to extent she was transferred money, she gave consideration by giving it back so there is no net transfer to her.
* **Held**: L is liable.
* **Deposits of money to another person’s bank account are a transfer of property**
	+ Transfer of the right to that money; legal right is property.
	+ It does not matter whether the owner of the bank account benefitted from the money.
* **To exchange consideration that reduces liability under s. 160 , there must be an exchange of valuable consideration.**
	+ There must be a binding contractual relationship
	+ The exchange must leave the tax debtor with something of value that could be collected to satisfy the tax debt
* D and L are conspiring to get out of tax consequences and s.160 is designed exactly not to let them do that.

**Attribution Rules – ss. 74.1-74.5**

* **The attribution rules intend to prevent income-splitting among persons who are not dealing at arm’s length** **by deeming split income to be income of the transferor**
	+ Income-splitting is achieved by transferring income-earning property from one party to another party who pays a lower rate of tax
* Attribution rules in the Act apply only to individuals
	+ Other rules like s. 69 and s. 160 apply to “taxpayers” and “persons” (i.e., also corporations)
* The main attribution rules are ss. 74.1(1) and (2), and 74.2(1)

**s. 74.1(1) *– Attribution of income from a spouse***

**🡪 when an individual transfers property to a spouse and the spouse earns income from that property**

* This section applies when:
	+ An individual transfers or loans property
		- Directly or indirectly, by means of a trust or by any other means whatever
	+ To the spouse or future spouse
* Any income or loss earned from the property by the spouse is deemed to be the income or loss of the transferring individual as long as the spouse remains the spouse and is a resident of Canada
* Any income or loss from any property “substituted” for the transferred property is also attributed to the transferor

**ss. 74.1(2) – *Attribution of income from a minor***

**🡪 when an individual transfers property to a non-arm’s length minor/niece/nephew and the minor earns income from that property**

* This section applies when:
	+ An individual transfers or loans property
		- Directly or indirectly, by means of a trust or by any other means whatever
	+ To a non-arm’s length minor or to a niece or nephew
		- Niece or nephew isn’t related so they are not deemed to be non-arms length minor so that’s why they are inc.
* The minor’s income or loss from the property is deemed to be the income or loss of the transferring individual
	+ Attribution continues as long as the minor remains a minor and a resident of Canada
	+ Also applies to income or loss from “substituted” property
* **ss. 74.1(1) and (2) both…**
	+ use the same broad language re: a transfer as s. 160
		- Directly or indirectly, by means of a trust or by any other means whatever
	+ apply to income from property transferred or loaned
	+ apply to income and loss from the property transferred

**s. 74.2(1) – *Attribution of capital gains***

**🡪 when an individual transfers property to a spouse and the spouse earns capital gains from the property**

* This section applies when:
	+ An individual transfers property
	+ To a person who is, or who becomes, their spouse
* Any net taxable capital gains or allowable capital losses from disposing of the property are deemed to be the gains and losses of the transferor
	+ There is a separate rule for gains and losses from the disposition of listed personal property
* Any attributed gain or loss is deemed not to be the income of the transferee

**There is no equivalent of s. 74.2(1) that attributes capital gains from property transferred to a minor.**

***🡪 Two additional attribution rules:***

* + s. 74.3 applies when an individual transfers property to a trust in which the individual’s spouse, or a non-arm’s length minor, niece or nephew has a beneficial interest
		- The transferee’s income from the trust will be attributed to the transferor of the property
	+ s. 74.4 applies when the individual transfers property to a corporation in which the spouse or non-arm’s length minor owns 10% of the shares (“specified shareholder”)
		- The transferor is deemed to receive interest income
		- s. 74.4 applies only when it is reasonable to conclude that a main reason for the transfer to the corporation is to benefit the other person

**Exceptions to attribution – ss. 74.5**

* ss. 74.5(1) provides that the attribution rules in ss. 74.1(1)-(2) & 74.2 do not apply in respect of income from property that was transferred:
	+ The transferee has given full consideration for the property, or
	+ Interest is payable on the loan that gave rise to attribution
		- Interest must be payable at least at a “prescribed de”
		- Interest must actually be paid within 30 days of the end of the year
	+ if the transfer is to a spouse, there is a further requirement in s. 74.5(1)(c) that the spouses must elect not to have the non-recognition rollover in s. 73(1) apply to the transfer in order for the attribution rules not to apply (i.e., the transferring spouse must not defer any capital gain in respect of the transfer).
* s. 74.5(2) provides that the attribution rules in s. 74.1(1) & (2) and s. 74.2 do not apply in respect of income from property that was loaned if the loan bears interest and interest is actually paid within 30 days after the end of the year.
* ss. 74.5(1)(c) – the attribution rules do not apply if the transferor elected not to have the rollover in s.73 apply.
* ss. 74.5(11) – the attribution rules do not apply if one of the main purposes of transferring the property is to reduce the tax that would be payable in respect of income from that property.
* s. 74.5(3) –attribution rules do not apply to any income or capital gains from property transferred to a spouse or common-law partner who lives separate and apart from the transferring spouse because of a breakdown of the marriage or common-law partnership.
	+ i.e. if the spouses separate, attribution of income stops even while the separated spouses remain legally married.

**TAX AVOIDANCE**

**What is tax avoidance?**

**Evasion----------abusive tax avoidance-----------legal mitigation**

* **Tax avoidance is doing something legal in order to reduce tax liability**
	+ Illegal activity = tax evasion
	+ Legal activity = tax avoidance
* Tax avoidance may be okay (tax mitigation) or unacceptable from a policy viewpoint (abusive tax avoidance)
	+ Tax mitigation = Parliament expects/anticipates that taxpayers will take opportunities to reduce taxes
	+ Abusive tax avoidance = Parliament did not expect/anticipate the taxpayer to receive a tax reduction
* Parliament does not usually expect people to take action solely for the purpose of reducing tax
	+ Tax consequences are intended to apply to transactions undertaken for other purposes (business, investment, personal reasons)
* **Abusive tax avoidance often features artificial, unnatural isolated transactions**
	+ Usually the tax purpose is apparent
	+ Eg ***Singleton***

**Judicial Responses to Tax Avoidance**

* Historically, tax avoidance was addressed through the courts
	+ Parliament relied on the judiciary to disallow tax results that were abusive/wrong
* **The Canadian legal tradition was strongly influenced by the UK tradition**
	+ UK tradition focused on strictly interpreting tax statutes
	+ Differed from a more activist US tradition
* US tradition commenced w/ ***Gregory v. Helvering* 🡪 addressed tax avoidance through statutory interpretation**
	+ Mrs G is rich; owns shares of UM, UM owns M. UM and M are both Cos.
	+ She wants to sell the shares.
		- She created new Co, UM transferred shares to New Co and then to her
		- Law at the time was that shares gotten b/c of corporate re=org are not taxable.
		- She then sold them.
		- She argued that is corporate re-org and she isn’t taxed.
	+ A tax-motivated corporate reorganization was not given favourable tax treatment accorded to “a plan of reorganization”
	+ The Court did not view the transactions as the kind of reorganization that the statute intended to benefit
	+ The court read “reorganization” as “reorganization in the course of corporate business”, not reorganization for tax purposes
* ***Gregory***displays three judicial responses to tax avoidance which have continued:
	+ Business purpose test
	+ Sham doctrine
	+ Substance vs. form
* US has codified the business purpose test and substance vs. form in a statutory test for tax avoidance
* UK tradition- ***Duke of Westminster*****🡪 interprets “substance vs. form” as being legal substance vs. legal form**
	+ Employees were paid a weekly “annuity” equal to their employment earnings instead of wages
	+ The Duke could deduct annuity payments, but not wages paid to servants
	+ Employees signed a side “agreement” that they would not claim their regular wages
		- They paid weekly payments that just so happened to be equal to the wages
		- Employees said they basically said I understand I won’t claim my wages.
	+ Duke argued- I am transforming wages into annuity payments through legal doc
		- He won in HL.
	+ **The House of Lords endorsed “legal substance”**
		- Rejected suggestion that they would look at the economics.
	+ The true legal rights are determinative of the tax consequences
* Lord Tomlin:
	+ Every man is entitled if he can to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioners of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax.
* ***Duke of Westminster* tradition interprets “substance vs. form” as being legal substance vs. legal form**
	+ The true legal relationships matter, not what the parties label the relationship
	+ Economic substance or reality does not matter
* **Focus on legal substance leads to two judicial “doctrines” in response to tax avoidance**
	+ **Sham (wow!)**
	+ **Ineffective transactions**
* A **sham** exists when a taxpayer outwardly appears to create particular legal relationships but actually creates different relationships
	+ A sham involves an element of misrepresentation or deception
	+ A sham will be disregarded
	+ The taxpayer will be taxed on the basis of the true legal relationships
* An **ineffective transaction** is one that is not legally effective
	+ There is a defect or a failure to perform a required step
	+ The transaction does not have legal effect
	+ The taxpayer will be taxed on the basis of the actual existing legal relationships
	+ Intention is not important – this doctrine focuses on mechanics

***Antle* 🡪 eg of sham and also ineffective trust instrument to evade tax (failed)**

* **Facts**: Canadian resident was going to sell shares to third party
* Transferred shares to trust for his wife and trust sold those shares to the wife and then she sold them to the third party
* Trust generated the capital gains in its hands (b/c wife sold at the same price) and he doesn’t have a gain
* So he argues the trust is in Barbados and Canada can't tax that and top tax % in Barbados is 2.5%
* **Holding:** The taxpayer was taxed on the basis that the trust did not exist or the shares were not property of the trust.
* A trust was not properly settled because the common law requirements for forming a trust were not met
* In addition, the transfer of shares to the trust was not properly implemented for technical reasons
* The taxpayer and the trustee signed a document that they knew misstated their true intentions – this was also a sham
	+ Even if the trust was valid, it would be ignored and the taxpayer would be taxed as if no trust was formed
* So the shares are not the trusts’ but his so the gain is his.

***Stubart Investments, SCC 🡪* Canadian tradition displayed; Duke of Westminster principle restated; modern stat interpretation is enough**

* **Facts**: A company with losses purchased the business of a profitable company, signed an agreement retaining the profitable company to operate the business as an “agent”
* The profitable company paid over its profits to the loss company in accordance with the agreement, the loss company reduced the profits with prior losses
* **Holding**: SCC declined to endorse a business purpose test which would have denied the effect of the business transfer.
* Modern rule of stat interpretation: ordinary meaning + context, scheme etc is enough!
	+ Did not think any special rule is needed to stop tax avoidance
* restated the ***Duke of Westminster***principle
	+ Wilson J. described it as “entrenched” in Canadian law
* explicitly declined to follow US and UK interpretive approaches
	+ UK courts have moved beyond ***Duke of Westminster***