**I. Introductions to Income Tax**

**Tax** – A compulsory transfer of money from private individuals or organizations to the government not paid in exchange for a specific good or benefit

* Criteria: 1) Compulsory; 2) Unrequited (not made in exchange for goods and services)
* Examples:
  + **Speeding tickets** are not taxes – Compulsory, but levied to deter certain behaviour, not to raise money for the government
  + Taxes paid on **cigarettes and liquor (**Compulsory if you buy the good – Tax is added onto the true price of the good)
    - Imposed to ensure the price of the good reflects the full cost of consumption (private cost of production + social cost)
* **Lottery tickets** are a form of regressive tax
  + - Government sets price of tickets above the expected value of the prizes – 40% of money paid is not returned to winners
    - The government’s 40% monopoly profit is equivalent to a tax
    - Burden is disproportionately borne by low-income people because they spend a higher % of income on lottery tickets
* **Employment Insurance** and **CPP** are referred to as payroll taxes (taxes on wages and salaries)
* You are purchasing insurance, but it is compulsory; Tax is regressive (cap on how much you can claim)
* The benefit to a taxpayer of having an amount exempted from tax or deducted depends on his/her marginal rate
* In contrast, tax credits have the same value for all taxpayers (value does not depend on the taxpayer’s marginal tax rate)

**Stop – Loss Rules** – Prevent the creation of a loss through deductions

* Examples: 1) Home Office Expenses; 2) CCA for rental/leasing property

**Canada Revenue Agency** (**CRA**)

* Collection arm; Body with whom tax returns are filed; Administer tax system; Wide powers of search and seizure; Issue advanced rulings

**Department of Finance –** Policy arm (Ex. Determine tax deductions and tax credits); Creates legislative draftings that CRA rules on; Drafts budgets

**Tax Avoidance** – Legal; If unsuccessful, generally have to pay tax you attempted to avoid + interest (and maybe penalty) – Risk to trying to avoid

* If it is unclear whether something is legitimate or not, the benefit is given to the taxpayer
* The lower the interest rate the more tax avoidance – Risk of being unsuccessful is lessened; Shifts the level of risk people are willing to take
* Note: GAAR – If you carry out transaction & sole purpose is to avoid tax, transactions can be disregarded and taxes imposed (controversial)

**Tax Evasion** – Illegal; Prohibition encompasses anyone who conspires in as well as participates in tax evasion

**Filing Procedure** Note: CRA can reassess a taxpayer up to three years after tax return filed

* When you file taxes, you get a notice of assessment from the CRA. If you do not agree, you may file a notice of objection
* If CRA denies your notice of objection, case goes to TCC (can use informal procedure if amount owing is $12,000 or less; No evidence rules)
* Appeal is to the Federal Court of Appeal and then the Supreme Court of Canada – Huge incentive to settle to prevent interest accruing

**Taxation Year**

* Individual – Calendar year (December 31st and January 1st are the key dates for determining when income and expenses are included)
* Business/Property Income – Can choose a fiscal period
* Income is included in the calendar year in which the fiscal period ends
* To the extent that you have a fiscal period that ends early in the year, you can defer some income (Best: January 31st)

**Statutory Interpretation**

* Where the taxing statute is not explicit, reasonable uncertainty or factual ambiguity should be resolved in favour of the taxpayer

**A) Tax Base**

* Tax Base – The amount, transaction or property upon which a tax is levied
* Possible Bases

1. Consumption – The amount that an individual spends – Flat rate taxes (Ex. GST, HST, and Excise taxes (Tobacco, alcohol etc.))

* Wealthy spend lower proportion of income on consumption (save more) – Argue for more consumption based taxes

1. Income – The amount that an individual earns – Generates over 50% of government revenues

* **Types:** 1) Employment; 2) Business; 3) Property; 4) Capital Gains (Appreciation of income; Only 50% included in income)
* Gambling gains, windfalls (such as lottery prizes), gifts, inheritances, and personal injury awards are not income

1. Wealth – The amount represented by an individual’s property (wealth) – Property taxes or Property transfer taxes

* Not used in Canada – But, provinces impose tax on real property
* Ex. **Gift Tax**
* Ex. **Estate Tax** – Tax on the value of the estate of a deceased person (Paid by estate holder)
  + Must be combined with a gift tax (otherwise dying would give away estate while living to avoid tax)
* Ex. **Succession or Inheritance Tax** (Paid by successor)

**B) Tax Rates**

* Federal income tax structure is set out in Section 117
* A personal tax credit offsets the tax liability on the first $10,320 (in 2009) – First $10,000 is tax free, then fed tax rates are applied
* Provinces also impose an income tax, which is imposed on the taxpayer’s federal taxable income (Provincial rates vary considerably)
* Federal government collects provincial income taxes and remits them to the provinces (Except in Quebec – Collects own taxes)
* Ontario & PEI have surtaxes – Tax on tax (Ex. In Ontario, if you pay btw $4,006 & $5,127 in tax, you pay an extra 20% on tax paid)
* Quebec’s rates appear high, but there is an abatement to take into account a taxpayer’s previous payment of federal tax
* All taxes in Canada are regressive except the income tax, which is progressive (But, becomes regressive over high-income ranges)
* High income individuals disproportionately earn sources of income that receive favourable tax treatment (such as capital gains)
* Marginal Tax Rate – The tax rate that applies to an additional dollar a taxpayer earns within each bracket – Rate listed in the tax schedule
* Average Tax Rate – Fraction of total taxable income that is paid in taxes – Rate applicable to the taxpayer’s income as a whole
* Proportional Tax – Takes an constant proportion of income as income rises

**C) Calculation of Federal Tax Payable**

1. **Income** – Division B – Section 3

* Compute income (net amount earned) from sources (employment, business, property or capital gains); Make deductions
* **Analysis**
  + What is the source?
  + Is it included in income?
  + When is it included?
  + All things being equal, you would prefer to defer tax payments
  + Is it deductible?
  + When is it deductible?
  + All things being equal, you would prefer to accelerate your deductions

1. **Taxable Income** – Calculate Division C deductions and deduct them from income
2. **Tax Payable** – Division E – Section 117 – Apply federal tax rates to taxable income
3. **Tax Credits** – Apply tax credits to reduce tax payable

* Most tax credits are non-refundable (if tax credits exceed tax that is otherwise owed, the government does not pay taxpayer)
* Ex. Credits for GST, Education, Charitable contributions, and Contributions to registered political parties (75% credit on first $400)
* Important social and political tool for the government – Affect whether individuals donate to charities, political parties, etc.

**D) Functions of a Tax System**

1. Raise revenue to finance government spending

* Ex. To assist constituting the marketplace by funding infrastructure needed to develop and enforce laws regulating markets
* Ex. To stabilize economy (Ex. Through increased gov’t spending on social assistance and loans to small businesses in downturns)

1. Redistribute income and wealth – Ex. Through the use of progressive rates
2. Direct social and economic behaviour through tax expenditures (Tax breaks – Ex. Ded/Ex) – Shortcut to gov’t raising money and spending it
3. Correct market failures – Situations in which individual behaviour will not lead to an efficient allocation of resources

* Types: Public goods; 2) Externalities; 3) Asymmetric information; 4) Cognitive limitations, and 5) Incomplete markets

**E) Evaluative Criteria**

1. Equity – Once a normative theory of a fair tax system has been chosen, it ought to be applied across taxpayers as consistently as possible

* Horizontal Equity: People who are “similarly situated” (in similar circumstances) should pay the same amount of tax
* Vertical Equity: People in different circ’s should be treated “appropriately” differently (Ex. Progressive taxes; Not flat taxes)

1. Neutrality – Taxes should avoid distorting the workings of the market mechanism or personal decisions (Should not impact our choices)

* But, of course they do all the time – Tax expenditures intended to distort choices; People structure affairs to minimize liability

1. Simplicity – System should be comprehensible, easy to comply with and administer, and should be predicable and reasonably certain

* Costs of administering the tax system must outweigh the benefits to be received from levying the taxes
* Note: Tax expenditures (implicit subsidies – Ex. Special tax exemptions, deductions, tax credits) must be evaluated using budgetary criteria:
* Ex. Are the benefits distributed fairly? Is the program target efficient (not unreasonably over or under inclusive)?
* Is the expenditure serving a valid gov’t objective? Does the program avoid any unintended distorting effects?
* Can some other policy instrument better serve the objective? Is the gov’t politically accountable for the program?

**F) Tax Treaties**

* An individual may be liable to taxation in multiple countries on the same income unless relief is provided under a tax treaty
* Common Elements:

1. Foreign tax credit – Canada may give credit against taxes owing with respect to all or part of taxes paid in other jurisdictions
2. Competent authority – If someone is doubly taxed on same amount, but is not eligible for tax credit, he/she can apply to the

Minister of National Revenue for relief – Minister has discretion to grant such relief

1. Tax sparing – Some developing jurisdictions have low tax rates or no taxes in order to stimulate investment

**II. Who Is Subject to Tax?**

**A) The Concept of Residence**

* Residents of Canada are taxed on their worldwide income
  + S. 2(1) – Income tax shall be paid on the taxable income for each year of every person resident in Canada at any time in the year
  + S. 3(a) – Income is to be calculated from sources inside or outside Canada
* A province may tax any individual who resided in that province on the last day of the year (December 31) (***Interpretation Bulletin IT-221R3***)
* An individual is considered to be resident in the province where he or she has significant residential ties (***IB***)
* If an individual is resident in more than one province on December 21, he will considered to be a resident only in the province where he has the most significant residential ties (***IB***)

### 1. Common Law Resident

* Term “**resident**” is highly flexible – Impossible to give it a precise and inclusive definition; Residence is a question of fact (***Schujahn***)
* A person may have multiple residences (***Thomson***, ***Schujahn***)
* **Factors Include**: (***Denis Lee***)
* Residential ties within Canada (In Interpretation Bulletin (below), but no noted distinction in importance)
* Ties elsewhere (Ex. Severance of substantially all ties with former country of residence)
* Past and present habits of life
* Filing a Canadian income tax return as a Canadian resident
* Regularity and length of visits in Canada
* Intention is not relevant to determination of residence (***Denis Lee***)

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| Multiple Residences  Moved “Home” | ***Thomson v. MNR***  (1946 – SCC) | *P was born in Canada. In 1923, he sold his home, declared Bermuda to be his domicile, and obtained a British passport. After one week, he moved to NC, USA. In 1934, he built a house in Canada, and between 1934 and 1942, spent an average of 150 days in Canada. He also spent a month or two in Florida each year.*  >P had at least two and possibly three residences – When he went to Canada, he moved his home  >The mere limitation of time does not qualify that fact  >He moved his wife and child, motor cars and servants  >From each place radiated his living and interests and from each he might make occasional departures  >His living in Canada was substantially as deep rooted and settled as in the US |
| Non-citizen married Canadian | ***Denis Lee v. MNR***  (1990 – TCC) | *P was not a Cdn citizen. He was not allowed to stay in Canada for more than 27 days at time, he could not work in Canada, and he was not in Canada more than 183 days/year. His income was deposited directly in a Cdn bank, in 1981, he married a Cdn citizen residing in Canada and they bought a house, and In 1982, he guaranteed the mtg and swore he was not a non-resident of Canada. He never paid income tax anywhere.*  >The P was a resident in 1982 when he swore to that fact and guaranteed the mtg on the matrimonial home  >Marriage tips scales towards residence (Prof cautions that in many situations marriage may be irrelevant) |

### 2. Deemed Resident

* **S.250(1) –** A person shall be deemed to have been resident in Canada throughout a taxation year (must pay tax for full year) if the person

1. Sojourned anywhere in Canada for a period or periods aggregating 183 days (6 months) or more in a calendar year

* Sojourn – To make a temporary stay in a place; To remain in or reside in for a time (***R & L*** ***Food***)
* Commuting for work and returning every night is not sufficient – Must analyze number of nights in Canada (***R & L Food***)
* Any part of a day is a “day” for the purpose of determining the number of days an individual has sojourned in Canada (***IB***)
* Professional Athletes are only subject to tax where they are a CL resident – Not sojourning (based on tax treaty between Canada and US)
* A child of a deemed resident who is dependent for support generally assumes the Canadian tax status of his/her parent

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| **Keywords** | **Case** | **Facts + Analysis** |
| Commuting for Work | ***R & L Food Distributors v. MNR***  (1977 – TRB) | *P argued company was Canadian controlled to take advantage of a small business deduction. Labe and Rosenthal, SHs and employees, argued they were residents based on s.250(1)(a). Both commuted daily from the US to Ont for work on over 183 workdays. Each returned nightly, except L stayed overnight 6 or 7 times.*  >Neither L nor R qualify as a deemed resident of Canada |

### 3. Part-Time Resident

* **S. 114** – Notwithstanding s. 2(2), part-time residents are taxed…
  + As a resident on their worldwide income only for the portion they were a resident (***Interpretation Bulletin***)
  + As a non-resident for the portion they were not a resident (***Interpretation Bulletin***)
  + Can only be used for people who have not been deemed to be a resident (Ex. A sojourner)
  + The facts must disclose either that the individual commenced to reside or ceased to reside in Canada

**A) Leaving Canada (*IB*)**

* + Note: Interpretation Bulletin is not legally binding, but it sets out the CRA’s position on the issue of residence
  + Generally, unless an individual severs all significant residential ties with Canada upon leaving Canada, the individual will continue to be a factual resident of Canada
* **Primary Residential Ties**
  + Dwelling place (or places), whether owned or leased, available for occupation
    - But, if individual leased to a third party on arm’s length terms and conditions, the CCRA will take into account all circ’s, and may not consider dwelling place to be a significant tie except when taken with other ties)
  + Spouse or common-law partner (partner in conjugal “marriage like” relationship for one year or more), and
  + Dependents
* **Secondary Residential Ties**
* Personal property in Canada (such as furniture, clothing, automobiles and recreational vehicles)
* Social ties with Canada (such as memberships in Canadian recreational and religious organizations)
* Economic ties with Canada (such as employment with a Cdn employer, active involvement in a Canadian business, Cdn

bank accounts, retirement savings plans, credit cards, and securities accounts)

* Landed immigrant status or appropriate work permits in Canada
* Hospitalization and medical insurance coverage from a province or territory of Canada
* A driver’s license from a province or territory of Canada
* A vehicle registered in a province or territory of Canada
* A seasonal dwelling place in Canada or a leased dwelling place
* A Canadian passport, and
* Memberships in Canadian unions or professional organizations
* **Other Residential Ties**
* Canadian mailing address or telephone listings
* Canadian post office box or safety deposit box
* Subscriptions sent to Canadian address (Ex. Newspapers and magazines)
* It is unusual for a single residential tie with Canada to be sufficient by itself to lead to a determination of factual residence
* Where an individual maintains residential ties while abroad, the following factors will be considered to determine significance of those ties:
* Evidence of intention to permanently sever residential ties with Canada
* Ex. If return to Canada was foreseen at time of departure, CCRA will attach more weight to remaining residential ties
* Ex. Presence of a contract for employment in Canada
* Ex. Whether individual complied with provisions of Act dealing with persons ceasing to be residents and non-residents
* Ex. Whether individual informed others that payments to him might be subject to withholding tax
* Ex. Length of stay abroad (Although no length of time is determinative)
* Regularity and length of visits to Canada
* Residential ties outside Canada

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| **Case** | **Facts + Analysis** |
| ***Schujahn v. MNR***  (1962 – Ex. Ct) | *US citizen was transferred to Toronto for a few years then recalled back on Aug 2, 1957. He moved all personal belongings to US, and re-obtained resident membership in his club in the US. His wife and son remained in Toronto to facilitate sale of house. He maintained bank accounts and a car in Toronto for his wife.*  >P divorced himself completely from his residence in Canada on August 2 – Part-time residency established  >Court satisfied that sole reason wife and son stayed in Canada was to sell house – Demonstrated intent not to be a resident  >Use of car and bank accounts was a logical consequence of the necessary means taken by him to sell his house |

### 4. Ordinary Resident

* **S. 250(3)** – A reference to a person resident in Canada includes a person who was at the relevant time ordinarily resident in Canada
* “**Ordinary Residence”** – Place where an individual regularly, normally, or customarily lives in the settled routine of his life (***Thomson***)
* **“Ordinarily Resident”** has a wider scope than **“resident”**
* “Resident” – Focus on taxation yr in question – Courts have sugg physical presence is essential to finding of resid in any one year
* “Ordinarily Resident” – Permits the court to review a taxpayer’s activities over a period of years
  + - Extends beyond physical presence at any given time to a person who has centralized his ordinary mode of living in Canada or has maintained a sufficient nexus or connection, even though physically absent (***Midyette v. The Queen***)
* Where an individual maintains residential ties while abroad, courts generally consider him an ordinary resident (and taxable for full year)
* Exception: Part-time residence – CCRA will consider above factors

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| **Keywords** | **Case** | **Facts + Analysis** |
| Transferred to France For Part of Year | ***The Queen v. K.F. Reeder***  (1975 – FCTD) | *D was born in Canada. In 1972, he took a job with Michelin Canada and was sent for training in France in March. It was anticipated that after training he would return to Canada. He gave up his apt, and put his furniture and car into storage. He rented an apt in France, and bought a car. He used his Cdn license and maintained a bank account in Canada where Michelin deposited his paycheques. He returned on Dec. 1.*  >His ties have all been with Canada, save only those which were necessary to permit him and his family to enjoy an acceptable and expected lifestyle while in France – Resident throughout entire taxation year  >The ties in France were temporarily taken and abandoned on his return to Canada  >If asked where he regularly, normally or customarily lived, Canada must have been the answer |

### 5. Non-Residence

* **S. 2(3)** – Where a person who is not taxable under s. 2(1) for a taxation year

1. Was employed in Canada,

* At least some part of employment must be carried out in Canada; The residence of the employer is irrelevant

1. Carried on a business in Canada, or
2. Disposed of a taxable Canadian property,

* **“Taxable Canadian Property”** defined in s. 248 – Includes real property and certain capital property

income tax shall be paid on the person’s taxable income earned in Canada (Not worldwide income) for the year (Earned from the above)

**A) Carrying on Business**

* + **S. 248(1)** – **“Business**” includes a profession, calling, trade, manufacture, undertaking of any kind whatever, and an adventure or concern in

the nature of trade, but does not include an office or employment

* + “Adventure” must amount to or be part of a “business” (One has an adventure rather than carrying it on) (***Tara – Ex Ct***)
  + Section does not include adventures consisting of isolated purchases & sales carried out through brokers (***Tara – Ex Ct***)
  + To “carry on” something involves continuity of time or operations (in the ordinary sense of a “business”) (***Tara*** – ***Ex Ct***)
  + **S. 253** – Extended meaning of “carrying on business”
  + A non-resident who, in a taxation year,

1. Produces, grows, mines, creates, manufactures, fabricates, improves, packs, preserves or constructs anything in Canada
2. Solicits orders or offers anything for sale in Canada through an agent or servant, whether the contract or transaction is to be completed inside or outside Canada or partly in and partly outside Canada, or
3. Disposes of property situated in Canada (other than capital property)

shall be deemed, in respect of the activity or disposition, to have been carrying on business in Canada in the year

* “**Soliciting orders”** does not include invitations to treat (***Sudden Valley***)
  + Orders must be sought and attempts made to obtain them within the jurisdiction (***Sudden Valley***)
  + **“Offer”** means a binding offer which, if accepted, would create a contract between the offeror and the offeree (***Sudden Valley***)
  + Section was intended to amend former common law to the effect that the contract need not be made within the jurisdiction (***SV***)
  + Common Law Test: Where do the operations take place from which the profits in substance arise? (***Smidth v. Greenwood***)
  + May lead court to consider factors such as place of solicitation, manufacture, delivery, payment, and provision of support services, or whether non-resident maintained a bank account, inventory, branch office, agent, and telephone listing in Canada
  + Substantial weight given to question of where K was formed (Esp. In UK – See ***Grainger***), but location of contract is not decisive
  + Courts will look to substance over form – Look at the reality of the situation (Ex. Intention – Not enough to state an intention)
  + All things being equal, one would probably prefer not to be carrying on business (lower rate of 15%), but cannot take advantage of losses
  + Tax treaties generally require non-residents to be carrying on business through a permanent establishment to be taxable (see ***Tara***)

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| **Keywords** | **Case** | **Facts + Analysis** |
| Solicitation of Orders  Agents for Wine Merchant | ***Grainger & Son***  ***v. Gough***  (1896 – HL) | *P’s act as agents for Louis Roederer, a wine merchant in France. P’s canvass for orders, and receive a commission, but Roederer has discretion as to exercising the orders – He reserved right to refuse any order.*  >No contracts were formed in England – P’s sent orders to R, but until R agreed to comply, there was no K  >Delivery to the purchaser takes place in France; Wine is invoiced to purchaser in R’s name as vendor  >No exercise of trade in England; Irrelevant that P’s receive price of wine for transmission to Roederer  >Distinction between trading *with* a country and carrying on trade *within* a country  >Not sufficient to solicit orders, whether by agent, circulars or advertisements |
| Leasing of Equipment Btw Related Companies  Intention | ***GLS Leasco Inc., McKinlay Transport v. MNR***  (1986 – TCC) | *GLS and McKinlay are both directly controlled by Centra Inc. GLS leased transportation equipment in Canada, primarily to M. GLS argued it carried on business (so they could deduct losses & M would not have to withhold).*  >GLS had no permanent office or staff in Canada, but had use of an office and two employees at McKinley  >All contracts were executed in Canada - Orders were made in Canada and paid for in Canadian dollars  >All equipment was purchased by GLS in Canada, and it was delivered in Canada for use in Canada  >GLS maintained a bank acct in Canada; Accounting was done in US and cheques issued from there  >GLS **intended** to do business in Canada – The substance of doing business in Canada was evident |
| Attempts to Get Cdns to Visit US to Sell Property | ***Sudden Valley Inc v. MNR***  (1976 – Fed CA) | *SV leased office in Van and hired phone operators to contact locals, pitch land in Washington, and invite Cdns to visit Sudden Valley. Advertising did not state there was land for sale, but merely invited Cdns to visit. SV has no license to sell real estate in Canada. No agent in Canada had authority to accept any offer or bind company.*  *SV argued they were carrying on business in Canada (in order to deduct losses).*  >No offer to purchase was obtained in Canada and no attempt was made to obtain any in Canada  >Nothing was offered for sale and no sales were ever made in Canada – No Canadian income from undertaking  >No carrying on of business in Canada – Company was merely extending invitations to treat |
| Isolated Purchase and Sale of Shares | ***Tara Exploration and Development v. MNR***  (1970 – Exch. Ct.) | *Canadian incorporated company had head office and bank account in Toronto, but no person resident in Canada had authority to contract or conduct business on its behalf. All management decisions were made in Ireland. Broker acting for company bought shares in Canada and sold them in Canada for a profit*.  >Purchase and sale of shares was an adventure in the nature of trade in Canada  >The adventure did not in itself constitute “carrying on business” and was not part of a larger activity that falls within those words – It was an isolated transaction and not a part of the business the company was carrying on  >**Caution:** Court stated they had “great doubt as to the correctness of their conclusion” |
| Tax Treaty | ***Tara Exploration***  (SCC) | >Appeal dismissed but on different grounds (But, decision of Exch. Ct. confirmed in subsequent cases)  >Since the profits were not attributable to a permanent establishment in Canada, the taxpayer was not  liable for taxes, based on the *Canada-Ireland Income Tax Agreement* |

**B) Non-Resident Withholding Tax**

* + **S. 212** – Non-residents shall pay an income tax of 25% on certain types of “passive income” paid to them by Canadian residents
  + Ex. Rent, Interest payments, Management fees, Dividends, Pension benefits, Annuity payments, and Estate or trust income
  + The amount of the tax must be withheld by the Canadian resident payor
  + Our tax treaty with the US reduces this to 15%
  + **S. 219** – Imposes a 25% rate on the after-tax profits of a Canadian branch of a non-resident corporation
  + This ensures that non-residents cannot avoid the withholding tax on dividends by carrying on business through a Canadian branch
  + When non-residents sell property in Canada for profit, the purchaser must ensure the vendor pays the capital gains taxes liable
  + The purchaser must get a “clearance notice” from the gov’t before completion (otherwise purchaser is liable for tax)

**B) Taxation of Aboriginal People**

* ***Indian Act* S. 83(1)(a) –** Allows Indian Bands, with the approval of the Minister of Indian and Northern Affairs, to pass by-laws for the

purpose of imposing local taxation on law, or interests in land on the reserve

* “Point of sale” approach in ***NB Indians*** (above) permits reserves to impose their own taxes on reserve sales
* Increasingly, First Nations have also sought power to levy taxes concomitant with their acquisition of powers of self-government

**A) Exemption by Treaty**

* None of the treaties concluded between First Nations and the Crown contain specific reference to taxation
* It was stated that Treaty #8 “did not open the way to the imposition of any tax,” but the Federal Court of Appeal held that the statement (even if incorporated) did not mean that the beneficiaries of Treaty #8 were to be forever exempt from taxation
* First Nations have claimed treaties should be interpreted to imply exemptions from taxes that are linked to benefits the Crown has promised to provide under treaty
* Note: **S. 88** of ***Indian Act*** states that provincial laws will apply to Indians “subject to the terms of any treaty”

**B) Exemption Under Indian Act**

* ***Indian Act* S. 2 –** “**Indian**” means a person who is registered as an Indian or is entitled to be registered (Excludes Metis, Inuit, etc.)
* ***Indian Act* S. 87 (1) –** The following property is exempt from taxation

1. The interest of an Indian or a band in reserve lands or surrendered lands, and
2. The personal property of an Indian situated on a reserve

* Purpose is to preserve the entitlements of Indians to their reserve lands and ensure that the use of their property on reserve lands is not eroded by the ability of gov’ts to tax, or creditors to seize – Purpose is not to confer a general economic benefit upon Indians) (***Williams***)
* Does not apply to corporations (***R v. Kinookimaw Beach Assoc***) – Should advise Aboriginal clients not to incorporate
* Seen as hindering economic development in a way, because extensive advantages come from incorporation (Ex. Lower tax rates)
* Test For Determining Situs of Income:

1. Identify all potentially relevant connecting factors to the reserve, including: (***Williams***)

* Situs of debtor
* Situs of creditor
* Situs where payment is made
* Situe of employment which created the qualifications for the receipt of income
* Situs where payment will be used

1. Determine what weight to give factors in identifying the location of the property, in light of three considerations: (***Williams***)
2. The purpose of the exemption under the ***Indian Act***
3. The type of property in question
4. The nature of the taxation of that property
5. Income must be “integral to the life on the reserve” – Must be intimately connected to life on the reserve (***Recalma***)

* Distinction between income earned from the mainstream and income “integral to the life on the reserve” (***Recalma***)
* Note: ***Recalma*** approach has been criticized
* Sales taxes attach at point of sale – At this point, the property is only located at the place of sale (***New Brunswick Indians v. NB***)
* Items purchased off-reserve, even if used primarily on the reserve are taxable (unless delivered to the reserve)
* Investment Income
* Dominant factors of the CRA is stated to be the location of the income-generated activities of the issuer (bank etc.)
* In light of ***Recalma***, S. 87 is generally not applicable to investment activity (Income is invested in Canadian economy as a whole)
* The investment would have to take place solely on a reserve, but investment is distributed throughout Canada (even money deposited in a bank to earn interest)

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| **Keywords** | **Case** | **Facts + Analysis** |
| EI Benefits On Reserve | ***Williams v. The Queen***  (1992) | *Status Indian located on reserve received unemployment benefits (personal property) in respect of previous employment. Employer was located on reserve, work was done on reserve, and wages were paid on the reserve, but, cheques were mailed from the government (located off-reserve).*  >Unemployment insurance benefits are not taxable  >Nature of taxation: EI payments were replacement of tax-free income (income earned on reserve) |
| Securities Purchased from On-Reserve Bank | ***Recalma v. The Queen***  (1998 – FCA) | *P’s (status Indians resident on reserve) invested over $4 million in securities obtained through BMO branch on reserve and argued return from investment income should be exempt from taxation.*  >Investment income was derived from mainstream economic activity – Invested in economy – Taxable  >Lack of any reserve connections except the dealer’s residence  >Result may be different where funds are used exclusively or mainly for loans to Natives on reserves  >Note: Judge was worried about erosion of the tax base through tax avoidance (partially underpinned decision)  >Prof unhappy with this point – Tax avoidance is legal |

**C) Other Bases For Exemption**

* Aboriginal Rights – The courts have considered whether specific aboriginal rights may create ancillary rights to be exempt from taxation
* Akin to Sovereign Nation – No general exemption of aboriginal persons from taxation has been recognized by the courts or CRA

**III. Income From Office and Employment**

* **S. 5(1)** – Income from employment is the salary, wages and other remuneration, including gratuities, received by the taxpayer in the year
* **S. 6(3)** – An amount received by one person
* While employed, or
* Pursuant to an agreement made before, during, or after employment

Deemed to be remuneration unless it cannot reasonably be considered to be

* Consideration for accepting the job
* Remuneration for services rendered, or
* Consideration in respect of a covenant governing what employee is or is not to do before/after termination (restrictive covenant)
* Cash-Accounting – Revenue included when received; Expenses deducted when paid

**A) Employee vs. Independent Contractor**

* Independent Contractor (Contract *for* service) = Business Income; Employee (Contract *of* service) = Employment Income
* All else being equal, you would generally prefer to be an independent contractor rather than an employee
* Major Differences (Generally prefer to be independent contractor):
* Withholding of Tax
  + - Employee – Employer must withhold and remit taxes monthly; If you overpay, gov’t will not pay interest (unless reass)
    - IC – No withholding; May need to remit taxes quarterly or monthly (Prefer to defer); Payments based on previous year
      * First year of business, generally no income; Can underpay taxes (defer paying); Can underpay $3,000 w/o int
* Basis of Measurement – Timing – Cash accounting vs. Accrual accounting
* Scope of Deductions – We give more deductions to businesses than employees because businesses take more risks
  + - Employee – Deductions restricted to s. 8 (limited); IC – Can deduct any expense incurred to earn the business income

**B) Who Is An Employee?**

* Traditional Test: Control Test – Employer has right to direct what is to be done and how it is to be done
  + Consider: 1) Power of selection of servant; 2) Payment of wages; 3) Control over method of work; 4) Right to suspend/dismiss
  + However, there is less control in the modern workplace (Encourage independence; Many workers are high-skilled; Unions)
* There is no longer any “one” test – Must examine the whole scheme of operations
* Entrepreneur Test (***Wiebe Door Services Ltd. v. MNR*** (1986 – FCA))
  + Consider: 1) Control; 2) Ownership of the Tools; 3) Chance of Profit; 4) Risk of Loss
  + Commission-like fees are not the same as the risk of profit/loss which an IC has to assume (***Wiebe***)
* Integration Test (***Wiebe***) – Must approach from the persona of the “employee”
  + Employee – Worker is employed as part of the business and his work is done as an integral part of the business
  + IC – Worker’s work, although done for the business, is not integrated into it but is only accessory to it
* Synthesis of Above Tests (***Wiebe***)– Is the worker performing the services doing so as a person in business on his own account?
  + Consider: Entrepreneur Test factors (above), as well as
  + Whether the worker hires his own helpers
  + What degree of responsibility for investment and management the worker has
* “Specific Results” Test**: (*Alexander***)
  + Employee – Contract provides for the disposal of the worker’s personal services to the employer
  + IC – Contract provides for the accomplishment of a specified job or task (perhaps for a limited time)
  + Also consider:
    - Whether payment is made on a regular basis (***Cavanaugh***)
    - Whether a T4 is given by the employer that sets out income as income from employment (***Cavanaugh***)
    - Who has responsibility for away from work expenses (***Cavanaugh***)
    - How name is stated in K – Ex. “Name, consulting” indicative of IC (do not need to incorporate)
  + The intentions of the parties should always be taken into account, but are not necessarily determinative (***Royal Winnipeg Ballet v. MNR***)
  + CRA is likely to inquire into statements of intention more closely in non-arms length dealings

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| **Keywords** | **Case** | **Facts + Analysis** |
| Radiologist  Specific Results | ***Alexander v. MNR***  (1969 – Exch. Ct) | *P was under K to discharge administrative responsibilities and provide professional services, which included securing the services of other radiologists to provide 24-hr emergency services and examinations.*  >Used “specific results” test – P self-employed because K provided for a specified job or task  >P did not have to personally perform the work set out in his K to the hospital and his professional services  were not at the disposal of the hospital |
| University  Tutorial Leader | ***Cavanaugh v. The Queen***  (1997 – TCC) | *P was a tutorial leader and marker for a university (not a lecturer). K was only for length of course (not on-going). He had control over scheduling, # of tutorials, and marking. He had the right to hire someone else to do his work. Course coordinator or prof filled position, not uni. P was not paid on regular basis. P was responsible for all off-campus expenses. P paid for parking at uni. P had opportunity for profit and possibility of loss. T4 given. P supplied own supplies (except course outline and a solution manual)*  >P was ain independent contractor  >Not a sig. amount of control; Significant that P had right to hire someone else to do his work  >A normal employee would not be entitled to the amount of freedom at the P had here |

**C) Benefits**

* **S. 6(1)(a)** – The value of board, lodging, and all other benefits (cash or non-cash) received or enjoyed in respect of, in the course of, or by

virtue of an office or employment must be included in income, except any benefit:

* Derived from contributions to insurance plans or deferred profit sharing plans
* Under a retirement compensation arrangement, employee benefit plan, or employee trust
* Derived from the use of an automobile
* Derived from counselling services
* Rules prevent erosion of the tax base, are horizontally equitable, and overturn rule in ***Tenant v. Smith*** (that only cash included in income)
* **“In Respect Of”** – Words of the widest possible scope – Include “in relation to,” and “in connection with” (***Savage***)
* Benefit does not have to be remuneration for services rendered (***Savage***)
* Benefit must be received in the employee’s capacity as an employee, not as a mere personal gift (***Savage***)
* A sum given in the hope or expectation that the gift will produce good service is taxable (***Laidler***)
* A payment made on the condition that employee continues to work for employer has sufficient connection (***Phillips***)
* If the thing given is required by the employment contract, it is clearly a benefit
* Benefit can be received from a third party, such as a supplier or an advertiser if connected to employment (***Waffle v. MNR***)
* **“Benefit”** – A material acquisition which confers an economic benefit on the taxpayer (***Savage***)
* Benefit must be measurable in monetary terms (***Lowe***) – But economic value does not have to equate to cash
* Value of air conditioning is not included in income – Costs of administration outweigh benefits to be received from tax
* Gym memberships are not taxable
* Services of assistant – Only taxable if taxpayer uses him/her for personal work as well as business work (must be made better off)
* Trips: Must determine whether primarily benefit is for the employee or employer (***Lowe***)
* First, determine if there is a material acquisition – Was the employee made better off? Did he/she get value out of the trip?
* Then, determine if that benefit is a mere incident of what was primarily a business trip
* If benefit is a mere incident of a primarily business trip, it should not be regarded as a taxable benefit (***Lowe***)
* Loyalty Points (Ex. Air Miles)
* CRA’s current position is that loyalty points earned on CC purchases reimbursed by employer are not included in income, if
  + - The points are not converted to cash
    - The plan is not indicative of another form of remuneration, and
    - The plan or arrangement is not for tax avoidance purposes
    - Reflects difficulty of valuing and tracking benefits attributable to points accumulated from employment versus personal use of CC
* Non-Cash Gifts and Awards (including gift cards) from an employer are excluded from income if: (***Interpretation Bulletin IT-470R***)

1. Their cumulative value does not exceed $500 in any one year (anything over $500 will be taxable income), and
2. Gifts were given for a special occasion (such as Christmas, Hanukkah, birthdays, and marriages) or awards were given for employment-related accomplishments and were not performance related)

* Note: Despite bulletin, work Xmas party with dinner, open bar, and hotel stay was taxed in ***Dunlap v. The Queen***
* Professor thinks something was going on in this case – Unclear why they were taxed in the face of the clear bulletin
* To avoid similar liability, businesses should not deduct the cost of a party, and perhaps the party should be toned down

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| **Keywords** | **Case** | **Facts + Analysis** |
| “Lodging”  Long Work Days | ***Sorin v. MNR***  (1964 – TAB) | *P operated hotel. P lived with brother. 4-5 nights/week he was unable to leave hotel until 3:30-4:30am so he stayed at hotel in room used for storage. He also had afternoon naps in the room*.  >Room did not represent “lodging”  >P would have preferred to stay in his own room in his brother’s home  >P was obliged to perform duties under very exhausting conditions |
| Payment for Passing Exams | ***The Queen v. Savage***  (1983 – SCC) | *P received $300 from her employer upon for successful completion of three optional insurance exams. Such payment was available to all employees.*  >Payments were in relation to or in connection with P’s employment – Included in income  >P took course to improve her knowledge and efficiency in company and to  opport for promotion |
| Annual Christmas Gifts to Staff | ***Laidler v. Perry***  (1965 – HL) | *Every year, employer gave each staff member a £10 voucher as a Christmas gift.*  >Vouchers are a taxable benefit  >Vouchers were given to obtain beneficial results for the company in the future by maintaining a  feeling of happiness among the staff and fostering good relations between mgt and staff  >Gift to P was made merely because he was an employee, not out of personal goodwill  >Because gift was made every year, staff must have come to expect it as a regular part of their service |
| Business Trip With Brokers | ***Lowe v. The Queen***  (1996 – FCA) | *P and his wife were sent on business trip to foster important business relationships with brokers. They had to make sure brokers had a good time. They had less than one hour to themselves on whole trip.*  >Principle purpose of trip was business, not pleasure – Any pleasure by P or wife was merely incidental |

**D) Reimbursements**

* Reimbursements are not taxable – They are neither remuneration or benefits (***Ransom***) – Person not taxed on what saves his pocket
* Reimbursement must be a true non-benefit (Just using the word “reimbursement” is not sufficient)
* Losses must be incurred in order to perform employment services and not as a consequence of the receipt of wages (***Gernhart***)
* Moving Expenses
* **CL**: Reimbursements for losses suffered in selling house following a job transfer are not taxable (Merely saves pocket) (***Ransom***)
* Likewise, reimbursements for higher mortgage interest costs following a job transfer are not taxable (***Krull v. Canada***)
* Applies both to increased interest rates and increased mtg principles – No increase in P’s equity in new home
* Limited by both ***Phillips*** and statute
* Payments made to compensate for higher housing costs following a job transfer are taxable (More valuable asset) (***Phillips***)
* **S. 6(19)** – Housing losses paid in the course of or because of employment are deemed to be taxable benefits
* Directly overrules ***Ransom***; Does not apply to eligible housing losses
* **S**. **6(20)** – If housing loss is an eligible housing loss, part of that amount is not a taxable benefit
* Taxable benefit is equal to ½\*(amount paid by employer - $15,000) – First $15,000 is tax free, as is half of the remainder
* **S. 6(22)** – Eligible housing loss means a housing loss in respect of an eligible relocation
* **S.** **248** – **“Eligible Relocation”** – Relocation enables taxpayer to be employed, and distance moved is no less than 40km

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| Reimburs for Clothing | ***The Queen v. Huffman***  (1990 – FCA) | *P was a plainclothes officer. The nature of the work wore out his clothes quickly. Work policy stated that plainclothes officers would be reimbursed for the cost of clothing up to $500/year. P was paid $500.*  >No benefit – P was required to incur clothing expenses and was merely being restored to previous position |
| Portion of Housing Loss | ***Cyril John Ransom v. MNR***  (1967 – Exch Ct) | *P was transferred from Sarnia to Montreal. He sold his house at a loss, and his employer reimbursed him for a portion of that loss.*  >No difference in principle between the reimbursement of an expense or a loss  >Irrelevant that loss or expense covers value of a capital asset; Payment received by P not included in income  >Prof thinks case was wrongly decided – P was better off after payment  >Choice to sell was cause of loss, not employment (did not have to sell – Could have rented house)  >Only reimbursed b/c he was an employee; No one else who lost money on sale in Sarnia was reimbursed |
| Payment for Increased Housing Costs | ***The Queen v. Phillips***  (1994 – FCA) | *P was transferred from NB to Manitoba. His employer gave him $10,000 to compensate him for increased housing costs in Manitoba. No restrictions were placed on the use of the $10,000 payment.* >Payment made on condition that employee remain with employer – Given to P in capacity as employee  >Payment effectively represents a temporary wage increase not available to all employees  >P gained an advantage over fellow employees resident in the community with higher housing costs  >Payment increased P’s net worth by enabling him to acquire a more valuable asset – Taxable benefit |
| Inducement  Income Tax Equalization Policy | ***Gernhart v. The Queen***  (1996 – TCC) | *P, an employee of GM in the US, accepted a posting at GM Canada. GM had a tax equalization policy – GM would pay the difference between the P’s income tax costs in Canada and the US*.  >Payment was made to induce her to serve outside the US – Part of remuneration for services under 5(1)  >Payment may also be viewed as a taxable benefit under 6(1)(a) – Benefit over other residents of Canada  with same income but no tax equalization (Individuals in similar financial circ’s should pay similar taxes)  >If P had paid and been reimbursed, still taxable – Expense was a consequence of the receipt of remuneration |

**E) Valuation**

* **S. 6(1)(a)** – The “value” of a taxable benefit is included in the taxpayer’s income
* The value of a benefit is generally the fair market value of the benefit
* Fair market value is generally the amount a person not obligated to buy would pay to a person not obligated to sell
* The open market value between parties who deal with each other at arm’s length
* In determining the value of a benefit, one may take its cost into consideration (***Youngman***)
* Unused Benefit – Two Positions (must engage facts):
* Irrelevant if benefit is used – Benefit included in income if it was available to the employee (***Richmond***)
* Value of a benefit is to determined based on actual use (***Rachfalowski***)
* Trips – Value based on level of enjoyment (Ex. Number of tours taken, amount of free time) – ***Ferguson v. MNR***; ***Philp v. MNR***

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| **Keywords** | **Case** | **Facts + Analysis** |
| Air Miles Redeemed for Reward Ticket | ***Giffen v. The Queen***  (1995 – TCC) | *P earned air miles on airline tickets paid for by employer, and redeemed them for reward tickets.*  >Value of reward ticket is the price the employee would have been obligated to pay for a revenue ticket  entitling him to travel on the same flight in the same class of service and subject to the same restrictions  as are applicable to reward tickets  >**Economy**: Value is that of the most heavily discounted economy ticket sold for the flight in question  >**Business/FC**: No discounted tickets; Value is equal to that proportion of an unrestricted business/first  class fare which the price of the most heavily discounted economy fare on that flight is of  the price of a full fare economy ticket |
| House Built by Corporation | ***Youngman v. The Queen***  (1990 – FCA) | *P, his wife, and his children owned shares in a corporation. The P had the company build a home for his family. P paid rent of $1,100/month.*  >The benefit was the right to occupy for as long as he wished a house custom built to his specifications  >The fair value is the price the P would have had to pay, in similar circ’s, to get the same benefit from a  company of which he was not a shareholder (the actual value someone else would have to pay)  >Value is more than the free market rental value since the company would have charged a rent sufficient  to produce a decent return on its investment (rate of return of an effectively risk-free investment that year) |
| Parking Spot | ***Richmond v. Queen*** (2009-TCC) | *P was given free parking space by employer. P only used parking spot about 20% of the year*.  >P assessed with a taxable benefit – Parking was available to him even if not used |
| Free Golf Club Membership | ***Rachfalowski v. The Queen***  (2009 – TCC) | *P received free golf club membership from employer. P hated golf and did not golf. He requested cash instead but was denied, and when he tried to refuse membership, he was persuaded not to. He used club occasionally to entertain clients and a couple of times took his wife for dinner.*  >No taxable benefit – Value based on use, and membership primarily used for work, not personal gain |

**F) Allowances**

* **S. 6(1)(b)** – Amounts received by taxpayer as allowances are included in income from an office or employment (Subject to exceptions)
* Allowances are not benefits (you are no further ahead) so are not caught under s**.** 6(1)(a) but CRA wants an accounting of them
* **S. 6(1)(b)(vii)** – Reasonable allowances for travel expenses are not included if:
* Travel is part of the performance of the duties of the employee’s office or employment
* Employee travelled away from:
* The municipality where the employer’s establishment at which the employee ordinarily worked or to which the employee ordinarily reported was located, and
* The metropolitan area, if any, where that establishment was located,
* Allowance is not for the use of a motor vehicle, and
* The employee was not employed in connection with selling property or negotiating contracts for the employer
* “**Allowance”** (***The Queen v. MacDonald*** (1994 – FCA)
* An arbitrary amount – A predetermined sum set without specific reference to any actual expense or cost
* Amount may be set through a process of projected or average expenses and costs
* Usually for a specific purpose
* In the discretion of the recipient – Recipient need not account for the expenditure of funds towards an actual expense or cost
* Allowances are taxed as though they are remuneration because it is possible to use them to conceal increases in remuneration (***Ransom***)

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| **Keywords** | **Case** | **Facts + Analysis** |
| Transporting Hospital Patients | ***Campbell v. MNR***  (1955 – TAB) | *P was a nurse. She used to transport patients in her own car at her own expense. She asked the hospital to buy a car. Instead of doing so, they paid her $50/month if she would use hers. The car was available to any employee to use. She paid for the gas and oil used, and also for any repairs.*  >Monthly payments were an allowance – Included in income  >P could not deduct travel expenses from income – Not part of employment contract |

**G) Deductions**

* **S. 8(2)** – Expenditure must be listed in section 8 to be deductible
* Ex**.** Cannot deduct home office expenses incurred in the context of employment
* **S. 8(1)(b)** – Legal expenses incurred to collect or establish a right to salary or wages owed by current or former employer
  + - Taxpayer must be successful in court or otherwise establish that some amount is owed
    - Taxpayer is not precluded from deducting legal expenses if he/she fails to collect an amount established as owed
    - Legal expenses incurred to protect one’s livelihood (rather than collect salaries or wages owing) are not deductible
* **S. 8(1)(h)** – Travel expenses expended by taxpayer travelling in the course of the employment, where the taxpayer
  + - Was “ordinarily required” to carry on duties of office or employment away from the employer’s place of business, and
    - Was required under the contract of employment to pay the travel expenses incurred by the taxpayer in the performance of the duties of the office or employment – Can be implied (***Evans***)
    - Does not apply if taxpayer received an allowance for travel expenses that was excluded from income by s. 6(b)(vii)
* But, administratively, if amount paid exceeds excluded allowance, you can deduct what you are out of pocket
* “Travelling Expenses” is usually used in connection with transportation while on duty (***Martyn***)
* Commuting expenses are generally not deductible because employee not “on duty” (***Martyn***; But see ***Evans***)
* A taxpayer who spends ⅔ of each day travelling satisfies “ordinarily required” condition (***Ondrey v. MNR***)
* By **S. 8(10)**, deduction of these expenses requires a signed certificate by the taxpayer’s employer stating conditions met
* **S. 8(1)(i)(i)** – Annual professional membership dues necessary to maintain a professional status recognized by statute
  + - **“Professional”** – Infers special skills, abilities or qualifications (***Swingle***)
    - Dues must be required to exercise the very right to carry on the taxpayer’s profession or calling (***Swingle***)
    - Professional status must be dependent upon membership in the society (no membership, no status) (***Swingle***)
    - Membership must be “necessary” in order to remain qualified, in the practical or business sense (***Swingle***)
    - Practicing lawyers can deduct dues paid to Law Society (Cannot legally practice without maintaining membership)
    - The cost of professional liability insurance which is essential to practice is not deductible (***Lemieux v. MNR***)
* **S. 8(4)** – Meals must only be included under s. 8(1)(f) or 8(1)(h) if the employee has been away from the work site for at least 12 hours

**S. 8(5)** – Malpractice liability insurance necessary to maintain a professional status recognized by statute–deductible; Other insurance is not

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| **Keywords** | **Case** | **Facts + Analysis** |
| Commuting  Travel Expenses | ***Martyn v. MNR***  (1962 – TAB) | *P, a pilot, attempted to deduct the cost of commuting between his home and the airport. It was necessary for him to travel by car – public transportation was at best very inconvenient and often unavailable.*  >Car expenses were not incurred by taxpayer while carrying on duties of employment away from his  employer’s business, but rather in proceeding from his home to his employer’s place of business and back  >Every employee must accommodate his place of residence to his work (residence is a consumption decision)  >Mode of travel is ordinarily considered part of the personal or living expenses of the taxpayer |
| Commuting  Travel Expenses | ***Evans v. The Queen***  (1999 – TCC) | *P was required to travel from home to a number of schools each day. P was required to transport voluminous amounts of paper and materials to and between the schools, which required her to use her car.*  >It was an implied term of K that she have a car and that she have the materials on hand to carry out her duties  >No other way to have materials on hand but to transport them btw her house and the first/last schools  >Costs of commuting between her house and the first/last schools she visited are deductible |
| Off-Duty Trips to Court | ***Klue v. MNR***  (1976 – TRB) | *P was a detective with the Toronto police. He was obliged to appear in court whenever he was needed. He claimed parking and automobile expenses relating to 84 occasions on which, being off-duty, he had to appear.*  >P was “ordinarily required” to appear in court as part of his duties and this was away from employer’s business  >Trips were not equivalent to commuting – Deduction allowed (for both legs – home to court and back) |
| Member Dues | ***The Queen v. Swingle***  (1977 – FCTD) | *The D is a chemist. To keep up with new developments in chemistry, he joined a number of chemical societies, and claimed the deduction of their annual dues.*  >The D is a “professional” and payments made to the organizations are “annual professional membership dues”  >Was not shown that the professional statuses of a chemist or an analyst are “recognized by statute”  >Acts refer to “analysts” but provide that “any person” may be designated as an analyst – Not professional |

**IV. Income From Business and Property**

**a) Income From Property**

* **S. 248 – “Property”** includes

1. A right of any kind whatever, a share or a chose in action,
2. Money, unless a contrary intention is evident
3. A timber resource property, and
4. The work in progress of a business that is a profession

* Something of value is generally considered to be property for the purposes of the Act
* Property income is the value derived by owner of a property from allowing another person to use the property (derived from ownership)
* Typical Types: Interest, rent, royalties, and dividends (passive income)
* Imputed Income – The economic value derived by the owner from the use of his/her own property; Not taxable
* Requirements: 1) Non-cash income or income in kind; 2) Arises outside the marketplace
* Includes any gain, benefit, or satisfaction from a non-market transaction or event (Ex. Cannot be between landlord and tenant)
* Interest: Compensation for the use of money belonging to another person
* Must be referable to a principal amount and must either accrue daily or be allocable on a day-to-day basis
* **S. 9(3)** – Income from a property does not include any capital gain from the disposition of that property

**B) Property Attribution Rules**

* **S. 56(2)** – A payment or transfer of property made at the direction of a taxpayer to another person is included in the taxpayer’s income
* **S. 74.1(1)** – Transfers and loans to spouse or common-law partner
* Applies to: Transfer or loan, by any means, direct or indirect, to a spouse or common-law partner or someone who has since

become the transferee’s spouse or common-law partner

* Rule: Income or loss from the transferred, loaned, or substituted property is included in the income of the transferor/creditor
* Common Law Partner: Someone the taxpayer has lived in a conjugal (“marriage like”) relationship with for one year or more
* Dependent on co-habitation; Status is ascribed to you – Intention is irrelevant
* **S. 74.1(2)** – Transfers and loans to minors
* Applies to: Transfer or loan to a non-arm’s length minor (under 18) or a minor niece or nephew
* Rule: Income or loss from the transferred, loaned, or substituted property is included in the income of the transferor/creditor
* Non-Arms Length Relationships: Children, grandchildren, etc., parents, grandparents, etc. and siblings
* Avoiding Rules
  + Rules do not apply to adult children
  + Rules do not apply to business income (If you have business, can employ spouse and income-split as long as income “reasonable”)
  + Rules do not apply to transfers for fair market value (S. 74.5(1))
  + Rules do not apply to loans if a “commercial rate” of interest is charged and paid in the year (s. 74.5(1))
  + Prescribed rate is currently 3% - If transferee can earn more than 3% on income from property, parties are better off
  + Rules End When: Taxpayer ceases to be resident in Canada, Transferor dies, or
  + Minor attains age of 18, Spouses get divorced, or live separate and apart because of martial breakdown, or CL co-habitation ends
  + Rules are no longer as important due to demographic shifts (more women working outside home – less incentive) and lower tax brackets

**B) Income from Business**

* + **S. 248(1)** – **“Business**” includes a profession, calling, trade, manufacture, undertaking of any kind whatever, and an adventure or concern in

the nature of trade, but does not include an office or employment

* + Adventure or Concern – Isolated transaction, where the transaction is speculative and intended to yield a profit
* Case Law:  Anything which occupies the time, attention and labour of a man for the purpose of profit (***Smith v. Anderson***)

 An organized activity that is carried on for the purpose of profit

* Organized Activity
  + No tax on a hobby – Mere placing of a bet is not sufficient, even if done regularly by skilled gambler; Must be “organized” (***G***)
  + Irrelevant whether taxpayer has other sources of income or makes a living doing the contested activity
  + Consider whether:
  + Taxpayer sought to minimize risk or had some kind of “system” – Ex. Does the taxpayer practice or take lessons?
  + Taxpayer buy materials and supplies related to the activity
  + Taxpayer advertises his activity
  + Taxpayer has any kind of written business plan as to how the business will unfold (Ex. Figuring out how to make profit)
  + Taxpayer keeps track of the hours spent performing the activity
  + Taxpayer reported income/losses from activity in previous years
    - Profit
      * Mere receipt by finding an object of value, or a mere gift, is not a profit or gain (***Graham***)
      * Winning of a “bet” does not result in a profit or gain, where a bet is an irrational agreement (***Graham***)
      * No relevance between event and acquisition of property; Event does not “produce” income
      * Traditional Test: Taxpayer must have a profit or a reasonable expectation of profit (“REOP” test) – Overruled in ***Stewart***
      * Current Test: (***Stewart***)

1. Does the taxpayer intend to carry on an activity for profit and is there objective evidence to support that intention?

* Distinguishes between commercial and personal activities
* Activity must be carried out in accordance with objective standards of business like behaviour
* If clearly commercial, no need to do any analysis – Such endeavours necessarily involve the pursuit of profit
* If activity has personal elements, consider (non-exhaustive):
  + The taxpayer’s intention – Taxpayer’s predominant intention must be to make a profit
  + The profit and loss experience in past years
  + The taxpayer’s training
  + Any anticipated capital gains (accords with “pursuit of profit”)
  + The capability of the venture to show a profit
  + Whether the activity has been financed externally (if it has, indicative of commercial activity)
  + The amount of time the taxpayer devotes to the activity (***Sipley v. The Queen***)

1. If it is not a personal endeavour, is the source of income a business or property?

* Assessment should not be used to second-guess the business judgement of the taxpayer (***Stewart***)
* No profit need actually be achieved (***Stewart***)
* Note**:** Proposed s. 3.1 (enacted in response to ***Stewart***) would require that the taxpayer reasonably expect to “realize a

cumulative profit” over the course of the business, where profit is determined without reference to capital gains or losses

* This is basically REOP all over again, but it does not specify timespan, and not clear it will be introduced
* But, allowing the ***Stewart*** situation is odd – The only people who can leverage huge properties like this are the very rich
* situation in ***Stewart*** is odd – The only people who can leverage huge properties are very rich
* A bookmaker carries on a business – Calculates odds and quotes them so that on the whole he makes a profit; Organizes an effort (***Gra***)

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| **Keywords** | **Case** | **Facts + Analysis** |
| Betting on Horses | ***Graham v. Green***  (1925) | *P made his living betting on horses on a large and sustained scale.*  >Gambler merely addicted to betting; Money made is not profits or gains |
| Playing Pool against Drunks at Night | ***Luprypa v. The Queen***  (1997 – TCC) | *Taxpayer made money by playing pool.* Held: Pool was taxpayer’s “business”  >Pool was primary source of income  >Taxpayer worked to minimize risk  >Practiced every afternoon; Played M-F every week; Played inebriated opponents after 11:00  >Only drank when not playing, etc. |
| Purchase of Highly Leveraged Properties | ***Stewart v. The Queen***  (2002 – SCC) | *P, an experienced real estate investor, bought 4 condominium units from which he earned rental income. All units were highly leveraged. Projections of rental income and expenses contemplated negative cash flow for 10 yrs – Rents not sufficient to cover high interest costs. Taxpayer claimed losses.*  >No personal element to properties; Clearly commercial activity  >All rented to arms length parties; No evidence he intended to use any of them for his personal benefit  >Rental activities constituted a source of income |

**a) Calculating Profit**

* **S. 9(1)** – A taxpayer’s income from a business or property is the taxpayer’s profit from that business or property for the year
* Profit: Net concept – Difference between total revenues and the costs and expenses incurred in earning such revenues
* Starting Point: Well-accepted principles of business (or accounting) practice (Which is GAAP for the most part, but may differ) (***Canderel***)
* In seeking to ascertain profit, the goal is to obtain an accurate picture of the taxpayer’s profit for the given year (***Canderel***)
* Business principles may offer various acceptable options (***Canderel***)
* Whichever method yields the “truer picture” of profit and which “matches” revenue and expenditure should be chosen
* If not clear which yields “truer picture” taxpayer is free to adopt whichever rule is appropriate and yields accurate picture
* Court cannot insist on application of one principle over another unless one would yield a more accurate picture of profit
* But, principles are subordinate to legal rules (principles are not rules of law) (***Canderel***)
* GAAP – Generally requires accrual accounting (Better matching – Inappropriate to use cash accounting for deducting expenses)
* Revenue included when earned (becomes receivable); Expenses deducted when incurred (become payable)
* Note: Farmers and fisherman are exempt from accrual accounting (due to political pressure(
* Can choose cash or accounting methods –Usually choose cash accounting (better to have loss now!)
* No general matching principle in the Act (although the principle does appear in parts of the Act)

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| **Case** | **Facts + Analysis** |
| ***Canderel v. The Quuen***  (1998 – SCC) | *P made payment to prospective tenant as an inducement to lease space in his premises. Issue arose as to whether expenditure was to be deducted entirely in year made, or amortized over term of lease of tenant?*  >At time of payment, GAAP allowed for three alternative and acceptable methods of accounting for TIP’s  >Difficult to conclude based on evidence that amortization over term of lease would provide a more accurate picture  >No one method emerges as clearly superior – Taxpayer should retain choice – TIP’s deducted in year incurred |

**C) Timing, Prepaid Income, Reserves, and Prepaid Expenses**

**A) Inclusions**

* **S. 12(1)(a)** – Must include prepaid income in income in the year in which it is received, even if it is not earned in that year
* Amounts received in the year on account of services not rendered or goods not delivered before the end of the year
* **S. 12(1)(b)** – Must include in income any amount receivable in respect of property sold or services rendered in course of business in the year
* Taxpayer must have an absolute and unconditional right to receive the revenue either immediately or in the future (***Colford***)
* There must be no condition precedent to acquiring a legal entitlement to the income (***Colford***)
* Rendering of an account (billing) for goods delivered is not a condition precedent (***West***)
* Taxpayer must have a legal right to enforce payment (***Colford***)
* Amount must be ascertainable (***Benaby***)
* **S. 12(1)(b)** – An amount shall be deemed to have become receivable in respect of services rendered on the earlier of

1. The day the service was billed, and
2. The day the service would have been billed had there been no delay in billing

* Cannot deliberately delay billing in order to avoid receivables
* Section **s. 12(1)(b)** applies in cases where profit is not otherwise required to be computer on an accrual basis (affirms accrual method)
* If service has been earned, it has already been included in income under accounting rules – No need to turn to **s.12(1)(b)** (***Maritime***)
* **S. 12(2)** – **ss. 12(1)(a) and 12(1)(b)** shall not be construed as implying that any amount not referred to in those sections is not included in

income for the year, whether it is received or receivable in the year or not

* Nothing clearly included in s. 9 is excluded – The purpose of s. 12(1) is about including income

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| **Keywords** | **Case** | **Facts + Analysis** |
| “Hold Back” Payments in Contracts | ***MNR v. Colford Contracting***  (1960 – Ex Ct) | *P was a plumber. He completed work under three Ks, which provided that a portion of income would be “held back” until an architect or engineer had certified that the project had been completed to satisfaction of the owner*  >P mist have a clearly legal, though not necessarily immediate, right to receive the income  >Sub-contractors are never paid the amount of the holdback until certificates have been issued  >Completion and receipt of the certificate are conditions precedent for inclusion – Both must be fulfilled  >Holdbacks became a receivable on the date the certificate was executed |
| Payment for Expropriation of Land | ***MNR v. Benaby Realties***  (1967 – SCC) | *Crown expropriated two parcels of land from the P in one tax year and paid for the land in the subsequent year.*  >At the moment of expropriation, the taxpayer acquired a right to receive compensation in place of the land  >But, no agreement fixing compensation, thus no amount which could be taken into account as a receivable  >No amount receivable until the amount was fixed either by arbitration or agreement |
| Goods Delivered, Not Billed | ***West Kootenay Power v. The Queen***  (1992 – FCA) | *P billed customers for electricity on a two-month billing cycle. At the end of the relevant years, the P had delivered some electricity for which the customers had not yet been billed.*  >P had a clearly legal, though not necessarily immediate right to receive the income from the goods sold  >Amount outstanding was sufficiently ascertainable to be included (based on estimates of revenue)  >Irrelevant that customers had not been billed and that payments were not due – Estimates included in income |
| Service Delivered, Not Billed | ***Maritime Telegraph v. The Queen***  (1992 – FCA) | *P billed customers for telephone on monthly basis.*  >S. 12(1)(b) has no application  >Appellant earned the revenues before the end of the year – Revenue were receivables  >Records indicated exact times at which services were rendered – Amounts readily quantifiable at year-end |

**B) Reserves**

* **S. 20(1)(m)** – Subject to **s. 20(6)**, where amounts in **s. 12(1)(a)** have been included in income for the year or a previous year, a taxpayer may

deduct a reasonable amount as a reserve in respect of

1. Goods that it is reasonably anticipated will have to be delivered after the end of the year
2. Services that it is reasonably anticipated will have to be rendered after the end of the year

* The administrative practice of the CRA permits a reasonable amount equal to the full amount included in income
* **S. 20(6)** – Can only take a reserve in respect of food/drink and transportation for one year
* Theory is that after one year they are unlikely to be redeemed
* **S. 20(7)(a)** – **S. 20(1)(m)** does not apply to allow a deduction as a reserve in respect of guarantees, indemnities, or warranties
* Payment is too contingent
* **S. 12(1)(e)** – Must include in income any amount deducted under **ss. 20(1)(m)** or **20(1)(n)** in the immediately preceding year
* Result of **ss. 20(1)(m)** and **12(1)(e)** is that income is not included until it is earned (consistent with matching principle)

**C) Expenses**

* **S. 18(9)** – Prepaid expenses must be deducted in the year the services are rendered (not when expenses are paid) – Reinforces GAAP
* General Rule: Expenditures are deductible in the year in which they are incurred (***Guay***)
* Taxpayer must have an absolute, legal and unconditional, though not necessarily immediate, obligation to pay the amount
* Amount of the expense must be quantifiable (***Guay***)

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| **Keywords** | **Case** | **Facts + Analysis** |
| Payment of Withholding Payment | ***J.L. Guay Ltee v. MNR***  (1971 – FCTD) | *P was a contractor. He was entitled to withhold 10% of the amount due under Ks with sub-contractors. Amount became payable 35 days after issuance of certificate by engineer. Issue was when holdbacks could be deducted.*  >Payments were withheld to cover any damages the owner may suffer from sub-contractor’s faulty work  >Far from certain that the amounts so withheld would be paid in full to the sub-contractor  >Until certificate was issued, P was under no obligation to pay the amount and amount to be paid was uncertain  >Withholding payments not deductible until 35 days after the certificate was issued |

**C) Deferred Payments**

* **S. 20(1)(n)** – When real property has been sold and all or part of the sale price is payable to the taxpayer after the end of the year, a

reasonable amount may be deducted as a reserve in respect of the unpaid amounts

* **S. 20(1)(n)** – When property other than real property has been sold and

1. All or part of the sale price is not due until at least two years after the time of sale (Eligibility rule), and
2. All or part of the sale price is not due until after the end of the year,

a reasonable amount may be deducted as a reserve in respect of the unpaid amounts

* Reasonable reserve is the proportion of income not due until after the end of the year that the taxpayer’s profit is to his sale price
* Reserve = x Amount not due until after the end of the year
* Each year, must ask if there is an amount not due until after the end of the year – If yes, take a reserve (unless disallowed by 2 yr rule)
* **S. 20(8)(b)** – **S. 20(1)(n)** does not apply to allow a deduction in computing the income of a taxpayer for a taxation year from a business in

respect of a property sold if the sale occurred more than 36 months before the end of the year

* Ability to take a reserve is limited to three years – Full profit is included over a maximum of 4 years (even if payments outstanding)
* **S. 12(1)(e)** – Must include in income any amount deducted under **ss. 20(1)(m)** or **20(1)(n)** in the immediately preceding year

**C) Deductions – General**

* General Formula:
  1. **S. 9(1)** – Calculate business expenses using well-accepted principles of business and accounting (GAAP)
* If amount is not an expense, no deduction
* If amount is paid out as an expense, go to **S. 18(1)** – Statute overrules GAPP in some instances
  1. **S. 18(1)** – Is the expense prohibited?
     + If no – Deduct expense
     + If yes – Go to **S. 20(1)**
  2. **S. 20(2)** – Is the expense deductible?
     + If no – No deduction
     + If yes – Deduct expense
     + **S. 67** – Deductions are only permitted to the extent that they are reasonable - Applies to all expenses; Reasonableness depends on facts
* **S. 67.6** – No deduction shall be made in respect of a fine or penalty, other than a prescribed fine or penalty (applies to any deduction)
* Does not cover bribes – Bribes may be deducted by the payor
  + - An expenditure properly deductible under accounting principles (GAAP) will be deductible for tax purposes unless prohibited by the Act
    - Note: Taxpayer must pay for an expense to deduct it – Expense cannot be paid by someone else

**D) Deductions – S. 18**

### 1. S. 18(1)(a) and S. 18(1)(h)

* **S. 18(1)(a)** – Expenses are only deductible to the extent they were made or incurred for purpose of gaining or producing income from B or P
* **S. 18(1)(h)** – Personal or living expenses, other than travel expenses incurred by the taxpayer while away from home in the course of

carrying on the taxpayer’s business, are not deductible

* To be deductible, expenses must be expended as part of the operations, transactions or services by which taxpayer earned the income (***IO***)
* Expenses must be expended as part of the process of earning the income; Must be incidental and connected to the business (***IO***)
* Expenses must relate to activities carried on in the normal course of the taxpayer’s income earning operations (***Leduc***)
* Expenses which are incurred to make the taxpayer available to the business or able to work are not considered business expenses
* Cannot use “but-for” test to analyze expenses – Would open floodgates
* Purpose of the expense must be to gain or produce income from the business in which the taxpayer is engaged (***Royal***)
* **Factors to Consider in Determining Purpose of Expenditure** (***Leduc***)
* Whether a deduction is ordinarily allowed as a business expense by accountants
* Whether the expenses is normally incurred by others involved in the taxpayer’s business
* Whether a particular expense would have been incurred if the taxpayer was not engaged in the pursuit of business income
* Business Need Test: Would the need exist apart from the business?
* Not necessary that expenditure actually produce income – May be deductible if not productive of any income or results in a loss (***IO***)

**A) Legal Expenses**

* The fact that a legal liability is being satisfied is by itself irrelevant – Must look behind the payment to its relationship to the business (***IO***)
* Cannot “type-cast” expenses – Expenses of any kind may be deductible (depends on their connection to the business)
* Deductibility determined by the activity that resulted in the charges and its connection to the business (***Leduc***)
  + Where a business carries out activities in the normal course of its operations and the cost of those activities is deductible, any expense incurred to defend those activities is a direct result of the activities themselves and hence is deductible (***Leduc***)
  + Can deduct all moneys paid to discharge liabilities normally incurred in the ordinary operations of the business (***IO***)

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| Damages From Employee Negligence | ***Imperial Oil Ltd v. MNR***  (1947 – Ex Ct) | *P sought to deduct cost of a damage settlement arising out of collision at sea. P’s business was the manufacturing and marketing of petroleum products. As part of this business, it transported those products*.  >Costs are deductible  >Transportation of products by sea was part of the business from which the P earned his income  >Risk of collision between vessels is a normal and ordinary hazard of marine operations  >Negligence on part of P’s employees was an ordinary risk of the P’s marine operations and incidental to it |
| Social Club Member-Ships | ***Royal Trust Co v. MNR***  (1957 – Ex Ct) | *P developed policy of requiring some of its employees to join social clubs and other organizations. It sought to deduct the cost of the admission fees and annual membership dues*.  >Costs are deductible Note: The expenses at issue in this case would now be prohibited by s. 18(1)(l)  >Opinion of accountant/officers that the deduction was proper (amount was paid as a business expense)  >Business contacts were made at club, business was discussed, competitors followed same practice  >P’s purpose in incurring costs was to increase business by making contacts (and so gain or produce income)  >Clubs were to be used as extensions of its office facilities |
| Housekeeper Wages Paid by Farmer | ***Benton v. MNR***  (1952 – TAB) | *P was a 62-yr old single farmer with poor health. He was subject to dizzy spells and must not be alone. He hired housekeeper to do household chores while he did farm work. He tried to deduct wages paid of $780.*  >Deduction only allowed for $325 – Her portion of the farm work done that helped earn P’s income  >Housekeeper mainly did domestic tasks; Remaining $455 was a personal or living expense  >Irrelevant that but-for her services, he could not have earned his income  >Note: If he had hired farm labourer and done housework himself, expense would have been deductible |
| Legal Fees Paid by Lawyer to Defend Against Criminal Charges | ***Leduc v. The Queen***  (2005 – TCC) | *P, a lawyer, claimed a deduction of $140,000 for legal expenses paid to criminal lawyers to defend him on eight criminal charges. P had received a letter from the Law Society that stated if he was convicted, the matter would be brought before a Committee to determine if an investigation should be started. He stated the expenses are deductible because if convicted he would lose his license to practice law*.  >P’s legal expenses were personal expenditures  >Not normally incurred by others involved in the P’s profession; P would have incurred costs anyway  >Possibility that P would lose his job was too remote (only hypothetical)  >No investigation had been commenced by LS; Disciplinary action does not necessarily entail disbarment  >Criminal charges have nothing to do with the P’s legal practice (did not arise out of law practice)  >P’s business thrived during period of lawsuit (cannot argue he defended himself to restore fallen business) |

**B) Child Care Expenses**

* **S. 63** – Allows limited deduction for child care expenses; Deduction must be taken by low-income earner
* Can deduct up to $7,000 for a child under 7 years of age (0-6), and $4,000 for a child aged seven or older
* Child care expenses do not fall under **s. 18(1)(a)**
* If Symes had been successful, men would also be able to claim child care expenses – Would open floodgates
* Benefits also would not flow to women – High income spouses (typically men) would take the deductions (bigger subsidy)
* Employer day care – Taxable benefit for employees
* Expenses associated with day care operation are only deductible if employer runs it as a separate business (to make money)
* Not deductible if employer runs day care simply for its employees

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| ***Symes v. The Queen***  (1994 – SCC) | *P was a lawyer. She hired a full-time nanny and deducted the amount as a business expense*.  >P would not have incurred expenses except for her business  >But, the need which is met by child care expenses exists regardless of the P’s business activity  >Expenses were incurred to make her available for work rather than for any purpose associated with business itself  >No evidence to suggest child care expenses are considered business expenses by accountants  >Given s. 63, child care cannot be considered deductible under principles applicable to business deductions |

**C) Food and Entertainment Expenses**

* **S. 67.1** – Can deduct 50% of the lessor of the actual cost of the food/entertainment and an amount that would be reasonable in the circ’s
* Remaining cost is not deductible – “Personal or living” expense (**s. 18(1)(h)**)
* Ex. Human need for food and water exists apart from the business – It is not a need that is intrinsic to the business
* Primary purpose of the expense must be expense (but no need to allocate costs between business and personal aspects)
* But, Can deduct the full cost of the extra food and water a taxpayer must consume over the average person’s intake in order to perform

his/her job, if there is a corresponding deduction allowed for fuel in the form of gasoline for the same type of business (***Scott***)

* Extra food consumed must be necessary for work “fuel” – Cannot be a personal preference to eat more (***Scott***)

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| **Keywords** | **Case** | **Facts + Analysis** |
| Food for Foot/Transit Courier | ***Scott v. MNR***  (1998 – FCA) | *P was a foot and public transit courier. The work required him to consume an extra meal per day over and above what the average individual would consume. He sought to deduct the costs associated with that extra meal.*  >Couriers who drive automobiles are allowed to deduct their fuel  >Thus, foot/transit couriers can deduct the “fuel” needed in order to perform their job |

**D) Commuting Expenses**

* Travelling expenses are deductible where taxpayer travels between his/her office and another work locale
* General Rule: Expenses incurred to travel between home and work are generally considered to be “personal or living” expenses
* Exception: Expenses deductible where taxpayer travels between home office that represents “base of practice” and another work locale (***C***)
* Maintenance of home office must be necessary for the successful carrying on of the business (***Cumming***)
* Personal preference for a distant location may have an effect on the amount able to be deducted (***Cumming***)
* Fearing work-related “personal safety” concerns while commuting not sufficient to convert expenses into ded expenses (***Hogg v The Queen***)
* Automobile expenses must be apportioned between use of car for business and personal expenses (***Cumming***)

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| **Keywords** | **Case** | **Facts + Analysis** |
| Commuting Between Home Office and Hospital | ***Cumming v. MNR***  (1967 – Ex Ct) | *P was a physician anaesthetist. He renders all of his services to his patients at the hospital, but is paid directly by patients, and does all of his billing and administrative work at home. He had no office at hospital and returned home when not at hospital. P also received emergency calls at home. P used car to travel between his home and the hospital, and sought to deduct costs of maintaining and operating the automobile.*  >Evidence that other anaesthetists in the area also used automobiles to travel to and from the hospital  >Expenses regarded as properly deductible from the perspective of commercial accounting principles  >P had no “base of practice” at the hospital – His base of practice was his home  >P allowed to deduct 25% of operating expenses and 50% of capital cost based on mileage estimates provided |

**E) Home Office Expenses**

* **S. 18(12)(a)** – No deduction is permitted in respect of a home office, except to the extent that the work space is either:

1. The taxpayer’s principal place of business, or

* Irrelevant if taxpayer is employed someone else

1. Used exclusively for the purpose of earning income from business and used on a regular and continuous basis for meeting clients, customers or patients of the individual in respect of the business

* Exclusive: Ex. Keep the kids out; Make it an office, not a pleasure room; Make it look like an office
* **S. 18(12)(b)** – Deductible amount must not exceed the taxpayer’s income from the business for the year – Cannot create losses (stop-loss rule)
* But, losses not taken can be carried forward indefinitely to apply against future income from the business (**S. 8(12)(c)**)
* Calculation Method:

1. Calculate profit from business: Deduct all business expenses except home office expenses from business revenues

* Ex. If taxpayer has dedicated utility lines for home office, deductible at this stage as business expenses
  + If expense cannot be separated from main house, it is a home office expense, not regular business expense

1. Deduct home office loss carry over from last year

* Can deduct as many losses as possible that would not exceed taxpayer’s income

1. Deduct home office expenses

* Ex. Can deduct: Rent, property taxes, maintenance fee, utilities, insurance etc.
* Deduction should be based on a reasonable allocation of costs attributable to the home office
  + Most common method is to determine the amount of space occupied by the office compared to the total usable area of the home and then deduct a proportionate amount of the expenses of the home

1. If any loss is created, carry loss forward

* Losses can only be carried forward for one year, but deduction taken of carry forward amount first

**E) Education Expenses**

* General Rule: Non-deductible – Personal Expense (**s. 18(1)(h)**)
* But, amounts paid for professional refresher courses may be deductible
* Note: **S. 118.5** – Tax credit for tuition fees paid for obtaining post-secondary education

### 2. Other Deductions

* **S. 18(1)(b)** – Capital expenditures and allowances in respect of depreciation, obsolescence, or depletion are not deductible
* **S. 18(1)(l)(i)** – Outlays or expenses incurred for use or maintenance of yacht, camp, lodge, golf course, or facility are not deductible, unless

made or incurred in the ordinary course of the taxpayer’s business of providing the property for hire or reward

* **S. 18(1)(l)(ii)** – Outlays or expenses incurred as membership fees or dues (whether initiation fees or otherwise) in any club the main

purpose of which is to provide dining, recreational, or sporting facilities for its members are not deductible

### 3. Capital Expenditures

* **S. 18(1)(b)** – No deduction shall be made in respect of an outlay, loss or replacement of capital or an allowance in respect of depreciation

**Capital Expenditure vs. Current Expenditure**

* Test: When an expenditure is made

1. Once and for all (non-recurring, one-time payment), and
2. With a view to bringing into existence an asset or advantage for the enduring benefit of a trade, expenditure attributable to capital

* “Asset” ought not to be confined to confined to “something material” (***Dominion***)
* “Advantage” paid for need not be “of a positive character” (***Dominion***)
* May consist in the getting rid of an item of fixed capital that is of an onerous character (***Dominion***)
* May consist of “preliminary expenses” with a view to construction of a capital asset (***Dominion***)
* If no new property created or acquired, cannot be any “cost” of “property" within the meaning of **s. 20(1)(a)** (***Denison***)
* Note: ***Dominion*** equated concept of “procuring asset” with “protecting” or “maintaining” asset
* If a business man does nothing but carry on his ordinary current operations but so plans those operations, without increasing the costs of those operations, that he has an asset of an enduring nature at the end of a period of operation, costs are current expenses (***Denison***)
* General Test:
* Capital
  + - * If you are bringing an asset into existence, more likely to be capital (***Denison***)
      * But, in ***Dominion*** and ***Inskip***, expenses to maintain existing assets/rights held to be current expenses
      * If expenditure is voluntary, it is more likely to be capital (***Kellogg***)
      * If a right defended is an exclusive right, it is more likely to be capital (***Kellogg***)
* Current Expenditure:
  + - * If expenditure is involuntary, it is more likely to be current (***Kellogg, Gold Bar***)
      * If you are just maintaining something, more likely to be current (***Kellogg***)
      * If a right defended is a right in common with others, more likely to be current (***Kellogg***)
      * If you can relate expense to an ongoing stream of income, more likely to be current (***Inskip v. MNR***)
      * Expenses incurred to defend a right related to a stream of income are current (***Farmers Mutual v. MNR***)
* If the costs of the expenditures are small relative to the cost of operations, more likely to be current (***Johns-Manville***)
  + - * Goodwill (IP Rights, reputation, customer/client lists etc.);
      * Once goodwill is in existence, it can be bought, and money paid for it would be ordinarily be a capital expense (***Starch***)
      * Money paid to acquire goodwill as a by-product of the process of operating a business is a current expense (***Starch***)
      * The money that is paid is paid for the operation of the business – Goodwill is merely a by-product
      * Ex. A TM acquires its necessary distinctiveness as a result of the ordinary current operations of a business (***Starch***)
      * Registration merely facilitates enforcement of rights – It does not create a trade-mark (***Starch***)
      * Legal Fees are not included in Regulation Schedule – If capital expenses, no CCA therefore no deduction

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| **Keywords** | **Case** | **Facts + Analysis** |
| Pension Fund Contribution | ***British Insulated and Helsby Cables v. IRC***  (1926 – HL) | *P created a pension fund for its employees and made the first contribution.*  >Object & effect of the payment was to establish the fund and so offer all employees a sure provision for old age, and secure for company substantial and lasting benefit of being able to secure/retain contented & efficient staff  >Payment was made not as a gift or bonus, but to “form a nucleus” of the pension fund  >Without the payment, the fund might not have come into existence at all  >Payment was a capital expenditure |
| Mine Operation  Creation of Throughways | ***Denison Mines Ltd. v. MNR***  (1972 – FCA) | *P owned and operated a mine. P expended large sum to build “throughways,” which provided the means of removing ore from the mine.*  >Even if P was correct that throughways are a capital asset, there was no acquisition or creation of property  >P already owned property – It simply removed ore to expose rock bed that it previously owned  >Even if expense brought new asset into existence, expense was a current expense (Operating cost of the mine)  >No more was spent on extracting ore for throughways than would have been spent to extract ore for sale  >P arranged operations to have throughways of enduring benefit, but cost incurred to earn profit by selling ore  >Expense was incurred to create their inventory; Cannot be counted twice as current and capital |
| Purchase of Land at Edge of Mine  Current Asset | ***Johns-Manville v. The Queen***  (1985 – SCC) | *Cost at issue was for the purchase of land at the periphery of an open pit mine. Operations required P to progressively acquire land so as to maintain the walls of the conically-shaped mining pit at a sale angle. Soil was stripped away and wall of pit was pushed outwards. All that remained of land was a part of a sloped wall, well below original surface.*  >Purpose of expenditure was removal of a current obstacle in operation of mine, not acquisition of a capital asset  >Not “once and for all” – Expenses incurred year in and year out for almost 40 years  >Expenditures were an integral part of day-to-day operations of the business (Directly related to cost of operation)  >No evidence to indicate that mining operations could continue in the future without this annual expenditure  >Benefit was transitional – No enduring value  >Land not acquired for any intrinsic value  >Land “consumed” in mining process – At end of day, no asset is produced and no asset remains  >Asset did not add to ore body, not did it increase the productive capacity of the mind  >Expenditure did not increase value (mine was not worth any more), only maintained value  >Expenditures relative to the cost of operating the mine were small  >No CCA for land – If not current, no tax credit for annually occurring expense completed connected to daily business |
| Legal Expenses to Defend Right to Earn Income | ***MNR v. The Dominion Natural Gas***  (1941 – SCC) | *United brought an action to restrain Dominion from supplying gas in certain areas. Dominion successfully defended the action, and claimed the litigation costs as a deduction.*  >Expenditure is a capital expenditure  >Expense incurred once and for all and for the purpose of procuring the advantage of an enduring benefit  >Expenditure procured an advantage for the company of an enduring benefit (exclusive franchise)  >Could potentially argue case was wrongly decided:  >Used the term “procure” in the sense of protecting or maintaining something  >Expense was to protect/maintain existing right to their exclusive franchise; Nothing new was created  >Franchise right was exclusive, but expense related more to stream of income than capital asset  >Expense was involuntary |
| Defending Use of Unregistered TM  Current Expense | ***Kellogg Company v. MNR***  (1942 – Ex Ct) | *P marketed a product under the name “shredded wheat.” A competitor alleged TM rights in the name. Kellogg incurred a substantial expense for legal fees in its successful defence and attempted to deduct the amount of the fees*.  >No material or positive benefit – Only achieved judicial affirmation of advantage already in existence & enjoyed  >P never disbursed money to acquire something – Did not procure an asset of enduring benefit  >Used the term “procure” in the sense of acquiring something new, or bringing a new asset into existence  >Expense was involuntary – Not incurred one and for all, or for the benefit of a trade  >Right was held in common with the general public – TM had not been registered, so others could use it as well  >Kellogg simply encountered a business difficulty which it had to get rid of |
| Sum Paid to Withdraw TM Opposition | ***Canada Starch v. MNR***  (1942 – Ex Ct) | *Taxpayer developed name “Viva” for new product. Registrar of TM considered “Viva” to be confusing with TM registered by Power Super Markets. P paid Power $15,000 for its agreement to withdraw its opposition.*  >TM can only arise out of current operations of business  >Registration is an empty right if it is not based on a TM that has become distinctive through current operations  >TM was not “acquired” by the $15,000 – TM was acquired by operations of business  >Once a TM is established, it is a capital asset |

**Repair of Tangible assets**

* Repairs – Current expenditures
* Outlays for the purpose of repairing the physical effects of use of capital assets in a business (***Steamship***)
* Damage caused by accident or vandalism can call for “repairs” (***Shabro***)
* Repair to an integral part of an overall asset or operation (***Steamship***)
* Generally speaking, replacements of worn or damaged parts are repairs even if substantial (***Shabro***)
* Do not become capital outlays merely because repairs required are extensive or their cost is substantial (***Steamship***)
* Repairs may use technology unknown when the original structure was built (***Shabro***)
* Repairs may take conditions into account (Ex. Dampness) that were not considered when original structure was built (***Shabro***)
* The lower the proportion of the cost in terms of the total cost of the asset, the more likely it is to be a repair
* Major Replacements, Upgrades, Additions, and Improvements – Capital expenditures
* “Repairs” that have become so substantial as to constitute replacements of assets are not deductible (***GB***)
* Substantial cost alone does not necessarily make an expenditure a capital expense (***Steamship***)
* An “upgrade” is something different in kind from what the capital asset originally was (***Steamship***)
* If cost of replacement is high relative to cost of ordinary repairs, more likely to be capital expenditure (***MNR v. Vancouver Tugboat***)
* In other words, it replaced item could have been repaired for less, more likely to be a capital expenditure
* Debate cannot be solved by looking at the effect of the expenditure – It is expected that repairs to a capital asset should improve it (***Gold Bar***)
* Must look at intention of taxpayer – What was the purpose of the outlay? (***Gold Bar***)
* Was the intention to improve capital asset, to make it different, to make it better? (***Gold Bar***)
* Capital expenditures involve a very important elective component not present in the genuine repair crisis (***Gold Bar***)
* Intention is not determinative
* See ***Shabro*** – Construction done in face of crisis, but substantial improvement, therefore capital expenditure
* Part of an expenditure might constitute a capital asset and part might constitute a current expense

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| **Keywords** | **Case** | **Facts + Analysis** |
| Replacement of Floors, Walls, and Boilers in a Ship | ***Canada Steamship v. MNR***  (1966 – Ex Ct) | *Expenses were of two types: 1) Those incurred to replace floors and walls, made necessary by wear and tear;*  *2) Those incurred to replace the boilers in one of the ships*  >Expenses of first type are clearly deductible – Repair, and not so different in kind to constitute an upgrade  >Replacing boilers – Capital outlay – Judge felt bound by earlier decision; Reached result with “great hesitation”  >Would have thought it arguable that since the function of the ship involves movement, the equipment or  machinery required to effect such movement is an integral part of the ship as a capital asset  >In that case, the cost of replacing the machinery would be a current expense, even though the machine  could be installed in a factory as a distinct and separate capital asset |
| Replacement of Floor Built on Landfill | ***The Queen v. Shabro***  (1979 – FCA) | *Cost at issue related to replacement of a substantial part of the floor of a rental property. Building was built on a site created by fill. Bottom floor was made of concrete slabs reinforced by “wire mesh.” Fill compacted, causing floor to break. Floor could not be replaced as it was – Necessary to have steel piles inserted into fill for support.*  Supporting Piles:  >Installation of piles was necessary to give the building the character of a long-term usable asset  >Piles were a permanent addition to the structure and were not a repair  Floors:  >Prior to the change, the building had a floor which made the building unusable  >To improve the building, it was necessary to replace to the floor  >Improvement operation was whole replacement work, not merely sinking of the steel piles (w/ *some hesitation)*  >Removal of old floor, sinking of piles, and replacing concrete slabs part of single improvement operation  >Improvement was made to the building that was essentially different in kind from a repair as it originally was |
| Repairs to Damaged Brick Wall | ***Gold Bar Developments v. The Queen***  (1987 – FCTD) | *Taxpayer owned an apartment building. Bricks began to fall from exterior. Inspection revealed entire wall was unsound. Taxpayer made repairs, using metal cladding instead of brick veneer.*  >P had decision forced upon him – Expenditure not voluntary or for purpose of creating improvement  >Decision to spend the money was a decision to repair to meet a crisis  >Sum in issue represented less than 3% of the value of asset  >Appearance of the building was not any better than it would have been had the original brick been replaced  >P was entitled to use advancements in building technology and techniques  >Nothing in the repair project attempted to change the structure of the building |

**E) Deductions – s. 20**

### 1. Capital Cost Allowance

* **S. 20(1)(a)** – In computing income, there may be deducted such part of the capital cost to the taxpayer of property as is allowed by regulation
* Property must be depreciable – Act permits deduction of CCA to reflect “depreciation”
* **Regulation 1102(2)** – Property is not depreciable unless it is used to gain or produce income (not inventory)
* Cannot be too literal with definition – Does not matter if property actually depreciates (may actually appreciate)
* “Capital Cost” is generally the amount expended by a taxpayer to acquire property (not defined in Act)
* Cost is the actual, factual, or historic cost
* Includes all amounts paid, and debts incurred, to the vendor at the time of acquisition
* Ex. Includes legal fees spent to acquire property (but not legal fees spent to determine entitlement to property)
* Ex. Includes funds borrowed to acquire the property (Ex. Mortgages), accounting fee, engineering fees etc.
* For a debt to be included, it must be a real debt – Cannot be a contingent liability
* Payment must be paid by the taxpayer, not a third party
* Includes all capital expenditures to improve property after acquisition
* Does not include taxpayer’s own labour in improving the asset
* **Regulation 1102(1)** – Restrictions – Cannot take CCA on property:

1. The cost of which would be deductible in computing the taxpayer’s income

* Cannot take CCA on current expenses (Capital and current expenditures are mutually exclusive)

1. That is included in the taxpayer’s inventory

* Property is either inventory or personal property (Mutually exclusive)
* Inventory is part of the income stream – Goods for sale
* Capital property is assets that are part of the business – Income generated by their use, not by their sale

1. That was not acquired by the taxpayer for the purpose of gaining or producing income

* Cannot take CCA on personal property
* Significantly different from s. 18(1)(a)
* Instead of looking at business as a whole (as in s. 18(1)(a)), must look at the property itself that was acquired
* **Regulations – Schedule II** – Lists the property in each class
* Class 8 – “Catchall” – Includes all tangible assets not included in any other class
* Some exceptions – Ex. Land (Does not depreciate), Animals, Trees, and Mines
* Certain items are not mentioned in Schedule II and therefore no CCA is permitted
* **Regulation 1100(1)** – Gives the percentages for each class for the purposes of calculating CCA (which is a percentage of UCC)
* Act requires all assets in respect of a particular business that are within a particular class to be pooled; CCA is claimed on entire class
* Assets have been assigned to classes generally based on an estimate of their useful lives
* Current Expenses – Fully deductible in the year incurred (s. 18)
* Capital Expenses – Must ask whether they are subject to CCA rules; If not, no deduction is permitted
* All things being equal, you would prefer expense to be current – Would prefer to take the deduction now
* Taxpayer may choose not to claim CCA in a given year but rather defer its deduction to a subsequent year
* Timing of the deduction for CCA is fixed at the end of the taxation year

**Capital Cost Allowance Calculation**

* CCA – May deduct the appropriate percentage of UCC of each class allowed by **regulation 1100(1)**
* **S. 13(21)** – “**Undepreciated Capital Cost**” (UCC) = (A + B) – (E + F)
* **A** = The capital cost of all acquisitions of property in the class
* **B** = Recapture
* **E** = All CCA previously claimed in respect of the class, including any terminal loss
* **F** = The lesser of the original capital cost of the asset and the proceeds of disposition of the asset that has been disposed of
* Prevents the recapture of the amount by which the proceeds of disposition exceed the original cost of the property
* This excess is taxed as a capital gain
* Simplified Method**:**
  + - Take the UCC of the class at the end of the previous year, deduct CCA claimed for the previous year, add the cost of new purchases in that year, and subtract proceeds of disposition (up to cost) of property disposed of in that year
* Half Year Rule – **Regulation 1100(2)** deems assets in the year of acquisition to be used for six months
* The purpose is to restrict the CCA on new assets in the class to one-half of the amount that would normally be deductible
* Arbitrary way to deal with problem that assets are not always purchased on Jan 1st and should not get full yr depreciation
* When purchases in the year exceed proceeds of sale (up to cost) in the year, CCA is calculated using the Notational UCC
* Notational UCC: Year-end UCC otherwise determined (before CCA deducted) – ½ (Acquisitions – Dispositions)
* CCA is calculated using Notational UCC but then deducted from the original UCC balance
* When the actual life of an asset differs from the estimated useful life in the Act, there may be an over-allowance or under-allowance of CCA
* **S. 20(16)** – Permits a deduction for a “terminal loss”
* Deals with the situation where an asset actually depreciates at a rate faster than the relevant CCA rate
* Will only occur if there are no assets in the class at the end of the year and the UCC has a positive balance
* Positive CCA balances are fully deductible
* Cannot take a capital loss with respect to depreciable property! (Full amount is included in terminal loss) (**s. 39(1)(b**))
* **S. 13(1)** – Requires the taxpayer to include “recapture” in income
* Deals with the situation where an asset does not, in reality, depreciate as quickly as it is written off for tax purposes
* May occur even if there are assets left in the class
* Can be deferred if class is suitably “replenished” before end of the year – Taxpayer can buy additional assets in same class
* If disposal of assets was involuntary (Ex. Fire), taxpayer is given a year to replenish class before facing recapture
* Rental and Leasing Property
* **Regulation 1100** creates a “stop-loss” rule – Amount of CCA is limited to the taxpayer’s net income from all such properties
* Taxpayer cannot use CCA to create or increase a rental property loss – CCA can only be used to reduce income to zero

**Allocations**

* Cannot take CCA with respect to land (not depreciable) – Must allocate the cost of the property between the land and any buildings (***Ben’s***)
* Both land and buildings must be acquired for the purpose of gaining or producing income (***Ben’s***; ***IT Bulletin 218A***)
* Taxpayer must make the buildings income-producing (Ex. Rent them out for a bit) to become eligible to take CCA
* If the building is demolished without ever having earned income, it cannot be used as depreciable income (**Bulletin**)
* If building is only used for a short time before being torn down, the taxpayer must establish that a primary intention on acquiring it was to gain or produce income (**Bulletin**)
* If parties are dealing at arms length, the vendor and the purchaser have very different interests with respect to cost
* Vendor does not want to face recapture – Wants allocation to building to be up to amount of UCC balance, but no more
* Prefers to allocate as much as possible to the land
* Recapture (amount by which UCC is exceeded) is a full inclusion, but gains on land are C.G’s – Half inclusion
* Purchaser can take CCA on the building – Prefers to allocate as much as possible to the building
* Where property is used partly for the purpose of gaining and producing income and partly for some other purpose, the taxpayer’s capital cost is apportioned according to the percentage of its income-earning use (**S. 13(7)(c)**)
* **S. 68 –** Apportionments must be reasonable
* If vendor and purchaser are dealing at arm’s length, there is a presumption that the allocation is reasonable (***The Queen v. Golden***)
* If you are not dealing at arm’s length with other parties must be very careful with allocation – Should get independent valuations

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| **Keywords** | **Case** | **Facts + Analysis** |
| Allocation between Land and Buildings | ***Ben’s Ltd v. MNR***  (1955 – Ex Ct) | *P bought three properties, with three houses, with the intention of removing the houses and using the land to expand his business. He paid $42,832.65, sold the houses for $1,200, divided the remaining $41,632.85 between the land and the building, and took CCA on the amount allocated to the buildings*.  >P was not allowed to take CCA  >Entire amount had been expended for the purpose of acquiring the land (and thus no portion was expended  for the purpose of acquiring depreciable assets) – Sole intention wrt the houses was to have them torn down  >There was never any intention to acquire the houses for gaining or producing income (violated Reg 1102(1)(c)) |

**Gifts & Non-Arms Length Transactions**

* CRA wants to ensure that people do not avoid taxes by gifting capital property (with built in capital gains) to family members
* **S. 69** – Also applicable to employment income

1. Where a taxpayer has acquired anything at an amount in excess of fair market value from a person with whom the taxpayer was not dealing at arm’s length, the taxpayer shall be deemed to have acquired it at that fair market value

* Proceeds to the vendor remain the selling price

1. Where a taxpayer has disposed of anything (capital property or inventory)
2. to a person with whom the taxpayer was not dealing at arm’s length for no proceeds or for proceeds less than the fair market value thereof at the time the taxpayer so disposed of it, or

* Applies to both gifts and sales

1. to any person by way of gift *inter vivos*

the taxpayer shall be deemed to have received proceeds of disposition therefor equal to that fair market value

* The capital cost of a taxpayer who acquires property in non-arms length sale for less than FMV is what that taxpayer paid
* The capital cost to the giftor will be what he/she paid for it
* Both will have a low capital cost, which will result in large capital gains (Meant to dissuade this activity)
* The difference between what is paid for the assets and FMV will be taxed twice (by giftor and giftee)

1. Where a taxpayer acquires a property by way of gift, bequest or inheritance or because of a disposition that does not result in a change in the beneficial ownership of the property, the taxpayer is deemed to acquire the property at its fair market value

* **S. 251(1)** – Related persons shall be deemed not to deal with each other at arm’s length
* **S. 251(2)(a)** – “Related persons” are individuals connected by blood relationship, marriage, or common law partnership or adoption
* Blood: Includes parents, grandparents etc. (up the line), children, grandchildren etc. (down the line), siblings, and in-laws
* Marriage: Includes spouse, spouses of the siblings of his her spouse, and siblings of spouses of his or her siblings
* Generally does not include aunts, uncles, nieces and nephews, but subject to **s. 251(1)(c)**
* **S. 251(1)(c)** – It is a question of fact whether persons not related to each other are at a particular time dealing with each other at arm’s length
* Even if parties are not related, they may not be dealing at arm’s length
* CRA considers the following criteria:

1. The existence of a common mind that directs the bargaining for both parties to the transaction

* If taxpayer and the receiver of the property have a strong common interest so that they would both benefit from the transaction (Ex. Friends) they are likely to be caught by the rules

1. Parties acting in concert without separate interests
2. *De facto* control, in the sense of excessive or constant advantage, authority or influence by one party over the other, and
3. Prices different from fair market value

**Change In Use**

* Personal/Capital Account to Business:
* **S. 45(1)(a)** – Where a taxpayer, having acquired property for some other purpose, has commenced at a later time to use it for the

purpose of gaining or producing income, the taxpayer shall be deemed to have

1. Disposed of it at that later time for proceeds equal to its fair market value at that later time, and
2. Immediately thereafter reacquired it at a cost equal to that fair market value

* For the purposes of any future capital gains/losses, the proceeds of disposition and adjusted cost base are equal to FMV
* **S. 13(7)** – Subject to any regulations made for the purpose of s. 20(1)(a) (CCA),

1. Where a taxpayer, having acquired property for some other purpose, has begun at a later time to use it for the purpose of gaining or producing income, the taxpayer shall be deemed to have acquired it at that later time at a capital cost to the taxpayer equal to the lesser of fair market value and its original cost + any taxable capital gain

* When moving from personal 🡪 business, ACB and capital cost are not always the same
* To the extent that the property has not appreciated in value (Ex. Property depreciated), both will always be FMV
* If property has appreciated in value (FMV > Cost), capital cost limited to original cost + taxable C.G (Less than FMV & ACB)
* Note: It is better to have a high capital cost because there is a full deduction on capital cost
* Business to Personal/Capital Account:
* **S. 45(1)(a)** – Where a taxpayer, having acquired property for the purpose of gaining or producing income, has commenced at a later

time to use it for some other purpose, the taxpayer shall be deemed to have

1. Disposed of it at that later time for proceeds equal to its fair market value at that later time, and
2. Immediately thereafter reacquired it at a cost equal to that fair market value

* For the purposes of any future capital gains/losses, the proceeds of disposition and adjusted cost base are equal to FMV
* **S. 13(7)(a)** – Asset deemed to be disposed of at FMV and reacquired at a capital cost of FMV
* Moving from business 🡪 personal, there is never a difference between ACB and capital cost
* Note: Change in use triggers half year rule if capital costs of acquisitions exceed proceeds of disposition

**Sample CCA Calculation**

UCC (With Half Year Rule)

* Starting Position: UCC Balance from Previous Year
* Add: **A** = The capital cost of all acquisitions of property in the class
* Subtract: **F** = The lesser of the original capital cost of the asset and the proceeds of disposition of the asset that has been disposed of
* UCC Before CCA = X
* Notational UCC = UCC Before CCA – ½ (Acquisitions – Dispositions) = Y
* CCA = Class % x Y = Z
* UCC Balance = UCC Before CCA – Z = Final Result

**F) Loss Carryovers**

* **S. 3(d)** – Losses from one source can be applied towards income from other sources (but cannot be applied towards spouse’s income)
* Business losses can be carried forward 7 years, and back 3 years

**V. Capital Gains & Losses**

* Why do we tax capital gains?

1. Vertical Equity – Wealthier people are more likely to have capital gains – Should assume a more appropriate burden of taxation
2. Horizontal Equity – A dollar is a dollar, no matter how it is earned
3. Neutrality – Reduces incentive for taxpayers to structure their txns to look like capital txns rather than income-producing txns

* Capital Property
* Used Personally
* No CCA
* On Disposition – Capital Gain or Capital Loss (if allowed)
* Used to Earn Business/Property Income
* Take CCA
* On Disposition – Recapture? Terminal Loss? AND Capital Gain?

**a) Definitions**

* Capital Property – **S. 54(b)** – Means

1. Any depreciable property of the taxpayer, and
2. Any property (other than depreciable property), any gain or loss from the disposition of which would, if the property were disposed of, be a capital gain or a capital loss, as the case may be, of the taxpayer

* Depreciable Property – **S. 13(21)(b)** – Property acquired by the taxpayer in respect of which the taxpayer has been allowed, or would be

entitled to, a deduction under s. 20(1)(a) in computing income for the given taxation year

* Adjusted Cost Base – **S. 54** – Means,

1. Where the property is depreciable property of the taxpayer, the capital cost the taxpayer of the property as of that time (above)

* Will be equivalent to actual cost in every case except where there has been a change in use
* Actual cost includes the full cost of acquiring a property
* Disposition – **S. 248** – Includes any transaction or event entitling a taxpayer to proceeds of disposition of the property
* CRA: Any event or transaction where possession, control and all other aspects of property ownership are relinquished
* Common Law – Cessation, divestiture, alienation or transfer of incidents of ownership
* Deemed Dispositions:
* Change in use (from income-earning to non-income-earning and vice versa) (**s. 45**)
* Death – Deemed to dispose of all capital property on death (**s. 70(5)**)
* Departure from Canada (Giving up Canadian residence) (**s. 128.1(4)**)
* Other Examples: Sale, gift, expropriation, barter, destruction, theft
* In principle, any right that is convertible into cash is likely to result in a disposition when it is converted
* A share is disposed of if the rights attached to it are altered so fundamentally as to change the nature or identity of the property
* Proceeds of Disposition – **S. 54** – Includes:

1. The sale price of property that has been sold

* Sale price includes the value of any non-cash consideration such as property or services
* When the purchaser assumes any liability or encumbrance, it forms part of the vendor’s proceeds of disposition

1. Compensation for property unlawfully taken
2. Compensation for property destroyed, and any amount payable under a policy of insurance in respect of loss or destruction
3. Compensation for property taken under statutory authority
4. Compensation for property damaged, and any amount payable under a policy of insurance in respect of damage to the property

* Inventory – **S. 248(1)** – Property, the cost or value of which is relevant in computing a taxpayer’s income from a business for a taxation year
* Capital Gain – **S. 39** – A gain is a capital gain if it is not a gain that would be business income (not very helpful)
* Taxable Capital Gain – **S. 38(a)** – ½ of the taxpayer’s capital gain for the year from the disposition of the property (**s. 38(a)**)
* Allowable Capital Gain – **S. 38(b)** – ½ of the taxpayer’s capital loss for the year from the disposition of the property (**s. 38(b)**)

**a) General Rules**

* **S. 3(b)** – Include in income the amount, if any, by which

1. The total of
2. All of the taxpayer’s taxable capital gains for the yr from dispositions of property other than listed personal property, and
3. The taxpayer’s taxable net gain for the year from dispositions of listed personal property (Calculation done separately)

Exceeds

1. The amount, if any, by which the taxpayer’s allowable capital losses for the year from dispositions of property other than listed personal property exceed the taxpayer’s allowable business investment losses for the year

**Gains**

* **S. 40(1)(a)** – A taxpayer’s gain for a taxation year is the amount by which the taxpayer’s proceeds of disposition exceed the total of the

adjusted cost base to the taxpayer of the property immediately before the disposition and any outlays or expenses to the extent

that they were made or incurred by the taxpayer for the purpose of making the disposition

* Starting point is to determine the “cost of property,” which, for the purposes of capital gain or loss is the Adjusted Cost Base
* Recall: Generally the same as capital cost, except when there has been a change in use of appreciating property (above)

**Losses**

* Capital losses can only offset capital gains – Can not be used to reduce other sources of income
* Can only be used to reduce capital gains income to zero
* Unused losses can be carried forward indefinitely (to be applied against future C.G’s) or carried back for up to three years (“Loss Carry Overs”)
* Restrictions on right to carry losses back to previous years:
* An earlier year’s loss must be deducted before a later year’s loss
* Each item of loss can be deducted only once
* Cannot take capital loss on depreciable property or personal use property (**S. 39(1)(b)**)

**a) Distinction Between Ordinary Income and Capital Accounts**

* Types of Assets:

1. Business Assets – Property used in a business to generate income by its sale (Inventory)
2. Capital Assets – Property used in a business to generate income by its use (Equipment) and Personal property

* Most cases hinge on whether the transaction is a “adventure or concern in the nature of trade” under the definition of business
* Recall: Income earned by the use of a capital asset is business income
* Tree = Capital; Fruit = Income; The tree is the capital that produces the fruit (income); Tree produces income upon sale

### Considerations

**a) Interpretation Bulletin IT-459**

1. Frequency of Transaction

* Generally, when a person habitually does a thing that is capable of producing profit, he is carrying on a business

1. Taxpayer’s Conduct/Experience

* Did the taxpayer deal with the property acquired by him in the same way as a dealer in such property ordinarily would deal with it?
* If the transaction is of the same kind and carried on in the same way as a transaction of an ordinary dealer in property of the same kind, it may fairly be called an adventure in the nature of trade (***Taylor***)
* Must compare what dealers in the same kind of property ordinarily do with what the taxpayer did
* Evidence that efforts were soon made to find or attract purchasers or that a sale took place within a short period of time after the acquisition points to a trading intention
* Significant whether steps were taken with the intended result of improving the property’s marketability
* But, a transaction may be an adventure in the nature of trade every though nothing was done to the subject matter of the transaction to make it saleable (***Taylor***)
* Significant if taxpayer has a commercial background in similar areas or has had previous experience of a similar commercial nature
* If property at issue is a commodity, very difficult to argue gain/loss is not ordinary income unless you are in the trade of that commodity

1. Nature of the Property

* Did the nature and quantity of the property exclude the possibility that its sale was the realization of an investment or was otherwise of a capital nature, or that it could have been disposed of other than in a transaction of a trading nature? (***Tay***)
* Presumption that purchase and sale were an adventure or concern in the nature of trade if:

1. Property was of such a nature/quantity that it could not produce income or personal enjoyment to its owner by virtue of its ownership and the only purpose of the acquisition was a subsequent sale

* Ex. Purchase of a large quantity of one kind of good
* Ex. Property cannot be hung up for enjoyment

1. Property is capable of producing income only if the taxpayer is in a position to operate of lease it to produce income, and the taxpayer is not in such a position and could make use of the property only by selling it

* Capital Account
* Gains on investments
* Businesses and securities are prima facie of an investment nature
* Proceeds of life insurance policies
* Amounts forgiven if indebtedness of a business nature is forgiven

1. Taxpayer’s Intention

* Was the taxpayer’s intention consistent with other evidence pointing to a trading motivation?
* Intention to sell at a profit is not sufficient, by itself, to establish taxpayer was involved in a business adventure
* A transaction may be an adventure in the nature of trade although the person entering upon it did so without any intention to sell its subject matter at a profit (***Taylor***)
* But, intention to sell at a profit may be an important factor (***Taylor***)
* Will be viewed as corroborative evidence if another test clearly suggests a business adventure and it is established/inferred that taxpayer intended to sell at first suitable opportunity
* Was the taxpayer’s intention to use the property to make money through its use or sale?
* Secondary Intention / Change in Use
* If the primary intention is to hold the property as an investment, any secondary intention to sell the property if the primary intention could not be fulfilled is evidence towards profit being on income account (***Regal***)
* Ex. Lack of evidence of intention to develop land regardless of any complications evidence of income account
* If taxpayer’s plans were thwarted in a manner that was beyond their control and they could not have expected what happened, this is evidence that there was no secondary intention to sell – Evidence of profit being on capital account (***Riz***)
* Must demonstrate that it was through no lack of action on the taxpayer’s part that investment plans fell through
* But, if the asset is, in and of itself income-producing, a change in intention (change in use) requires an allocation of profits between income and capital accounts (***Hughes***)
* Ex. If property acquired to hold as an investment and converted to a trading nature,
* Gain from purchase to the moment of change will be on capital account
* Gain from moment of change to the time of sale will be on income account
* See above change in use rules for ACB
* Intentions are not limited to the purposes for acquiring the property but extend to the time at which the disposition was made

1. Isolated Transactions

* Following factors are not sufficient to prevent a finding that a transaction was an adventure or concern in the nature of trade:

1. The transaction was a single or isolated one

* The singleness or isolation of a transaction is not determinative (***Taylor***)
* But, the isolation or singleness of a transaction can be a very important, relevant factor (***Taylor***)
* Trading generally implies more than one transaction

1. The taxpayer did not create/set up any organization to carry out the transaction (***Taylor***)
2. The transaction is totally different from any of the other activities of the taxpayer and he never entered into such a transaction either before or since (***Taylor***)

**B) Other Considerations**

1. Is transaction “speculative”?

* “Speculative” is often used in connection with adventures in the nature of business or trade
* Not often clear as investments are also speculative (Ex. Purchase of shares, as discussed in ***Irrigation***)

1. Does taxpayer possess special knowledge of the commodity at issue?

* A different bulletin holds this to be equivalent to trading in securities – Transaction treated on income account

### Securities

* *Prima facie* of an investment nature – Normally used to produce income through their operation or mere possession (**Bulletin**)
* Acquisition of shares is a well recognized method of investing capital in a business enterprise (***Irrigation***)
* Money invested will be used in the business to earn income through use (***Irrigation***)
* Typically earn dividends (income from use) – Must consider the history of the security’s dividends (***Irrigation***)
* But, not detrimental to characterization as capital if there is no immediate likelihood of dividends being paid (***Irrigation***)
* Shares are not, in themselves, articles of commerce (***Irrigation***)
* Very likely that shares will be on capital account (***Irrigation***), unless you a trader (Buying and selling frequently – Ex. A Broker)
* **S. 39(4)** – A taxpayer may elect to characterize gains and losses from the disposition of Canadian securities as capital gains/losses
* Once determination is made, it cannot be changed – Any gain/loss in the future will be deemed a capital gain/loss
* **S. 39(5)** – Traders/dealers in securities and certain others (Ex. Financial institutions) are prohibited from making the election
* Fairly pointless to make election since shares are likely capital unless you are a trader (and then you cannot make election anyway)

|  |  |  |
| --- | --- | --- |
| **Keywords** | **Case** | **Facts + Analysis** |
| Purchase of 1,500 Tonnes of Lead to Sell to Business | ***MNR v. James Taylor***  (1956 – Ex Ct) | *Taxpayer was the president and general manager of a company engaged in fabricating various products from lead. The company was permitted to have only a 30-day supply of raw metals, which resulted in shortages from time to time. Taylor purchased 1,500 tons of lead himself to sell to the company. He made a profit of $83,712.24.*  >Nature and quantity of the subject matter excluded any possibility that it was of an investment nature or was  otherwise of a capital nature  >He could not do anything with the lead except sell it, and he bought it solely for the purpose of selling it to company  >No considerations of a capital nature in mind – All his reasons were business reasons of a trading nature  >Anticipated better supply terms from suppliers and increase in salary, not profit from selling lead  >He dealt with it in exactly the same manner as any other dealer in imported lead would have done  >Adventure was speculative  >Purchase and sale of lead was an adventure in the nature of trade |
| Isolated Purchase and Sale of Shares | ***Irrigation Industries v. MNR***  (1962 – SCC) | *Company purchased 4,000 shares of a mining corporation. Shares were sold a month later for profit.*  >Isolated transaction in securities – Capital – Purchase of shares constitutes an investment  >Purchase and sale took place through brokers  >Not the sort of trading that would ordinarily be carried on by those in the business of trading in securities  >Not determinative that taxpayer intended to sell as soon as he reasonably could and not hold shares indefinitely |
| Shopping Mall Frustrated by Other Shopping Mall | ***Regal Heights Ltd v. MNR***  (1960 – SCC) | *Taxpayer bought land to build shopping centre. Another company announced plans to build a shopping centre only 2 miles away. Taxpayer determined that, under the circ’s, it was impractical to build the centre, & sold land at a profit.*  >Profit was on income account based on secondary intention  >The establishment of a shopping centre was dependent on the negotiation of a lease with a major dept. store  >No evidence that the store made strong efforts to find a tenant – Efforts were all of a promotional character  >No evidence of any intention to build regardless of the outcomes of the negotiations  >Purchase was an undertaking in the nature of trade – A speculation in vacant land |
| Shopping Mall Frustrated by Land Owner | ***Riznek Construction v. The Queen***  (1979 – FCTD) | *Taxpayer assembled land with the intention of building a shopping centre. The municipality approved the project, but the centre could not be completed b/c the owner of a small parcel of land changed his mind at the last moment. Taxpayer sold part of the land for profit.*  >Profit was on capital account – No evidence of any secondary intention to resell if development was frustrated  >They could not have known that this would happen when they purchased the undeveloped land |
| Apartment Building Converted To Condos | ***Hughes v. The Queen***  (1984 – FCTD) | *Taxpayer purchased an apartment building for rental income. It became apparent that the venture was unlikely to produce income, and she successfully applied to have the apartment converted to strata title in order to sell the units individually for profit.*  >Taxpayer’s only intention at the time of purchase was to hold the apartment as an investment  >When the investment was frustrated, there was a change of intention to one of selling for profit  >Court apportioned gain between income and capital accounts  >Gain from purchase to the moment there was a change in use was on capital account  >Gain from the moment of the change in use to the time of sale was on income account  >Court will only apportion profit for assets that are in and of themselves income producing |

**a) Reserves**

* If the terms of sale of a capital property provide for the seller to receive the selling price in a series of instalments, the taxpayer may claim a reserve for future proceeds (**s. 40(1)(a)**) – Taxpayer can reduce amount of gain in the year of disposition and defer the balance to future years
* Taxpayer must report the reserve claimed in the following taxation year
* Reserve can be taken for a maximum of four years (so that entire gain is included over five years)
* Formula for a reasonable reserve =

**a) Personal Use Property**

* **S. 54** – Includes:

1. Property owned by the taxpayer that is used primarily for the personal use or enjoyment of the taxpayer or for the personal use or enjoyment of one or more individuals, each of whom is
2. A person related to the taxpayer

* Examples: Clothing, cars, boars, furniture, listed personal property, family home, summer cottage, or other recreational property
* Two Restrictions:

1. Cannot take a capital loss on personal use property
2. The cost (ACB) and proceeds of disposition will never be less than $1000 (Eases enforcement and administration)

### Listed Personal Property

* **S. 54** – The taxpayer’s personal-use property that is all or any portion of, or any interest in or right to, any

1. Print, etching, drawing, painting, sculpture, or other similar work of art
2. Jewellery
3. Rare folio, rare-manuscript or rare book
4. Stamp, or
5. Coin

* Only includes listed property
* All PUP rules apply to this category with one exception
* Can take a capital loss on LPP, but only against gains on LPP (only to offset gains from LPP)
* Calculation: Deduct any negative balance of (Taxable Gains – Allowable Losses) or
* Different from other PUP because, as “collectibles,” their value does not inevitably decline through use
* If its value falls, it may be for essentially the same reasons that cause any capital loss, such as changing market conditions

### Principal Residence Exemption

* **S. 54** – Principal residence means a particular property that is a housing unit, or leasehold interest in a housing unit, that is owned, whether

jointly with another person or otherwise, in the year by the taxpayer if the unit was ordinarily inhabited in the year by the taxpayer,

spouse, former spouse, or child

* “Housing Unit” – May include a house, condo, townhouse, mobile home, camper, trailer, cottage, or houseboat
* “Ordinarily Inhabited” – Requires that the housing unit must be in most cases, usually or commonly occupied as an abode
* Includes seasonal or recreational occupation

**a) Designation (S. 54(c))**

* The exemption applies to only one dwelling for each taxation year for each family
* A taxpayer who owns more than one principle residence must, when the first property is disposed of, designate one of the properties as the principal residence for each year in which both were owned
* The taxpayer should determine which of the properties has enjoyed the greatest increase in value and should designate that property as the principle residence
* Only one property may be claimed by a family, comprising of two spouses and unmarried children under 18
* Spouses living together are therefore limited to one principal residence, but those who are legally separated and living apart may each claim a principal residence

**B) Conversion to Rental Property**

* A homeowner who vacates the principal residence and rents it out may continue to claim the dwelling as a principal residence for a maximum period of absence of four years as long as the owner elects to treat the dwelling as personal-use property while renting it out (**S. 45(2)**)
* Cannot take CCA on the property if you make this election and vice versa – If you rent property, likely want to take CCA
* If rental continues beyond 4 years, in the 5th year there will be change in use and a deemed disposition
* Four year rule is incremental – Can rent it out for 4 years, live in it for 1, and then rent it out for 4 years ago
* A homeowner who vacates the dwelling in order to move at least 40 km close to a new place of employment may continue to claim the principal residence exemption for the property for the duration of the relocated job plus one year

**C) Calculation**

1. Property sold at a loss – No deduction (PUP – **S. 40(2)**)
2. Property qualified/designated as a principal residence for the entire period of ownership – Entire gain is tax free
3. Property qualified/designated as a principal residence for only a portion of the period of ownership

* Formula:
* Deduction is based on the # of years of ownership that the taxpayer occupied the property as his/her principal residence
* Extra year allows taxpayer to reduce his/her liability to compensate for the fact that when he/she sells a property at any time in a given year, the designation for that entire year will be used up – Despite the fact that he/she will probably buy another property immediately, he/she will not have a designation for it (Can only have one designation per year)

**a) Intra-Family Transfers**

* **S. 69** applies to gifts and non-arm’s length transactions
* But**, s. 73** takes precedence over **s. 69** when the transfer is between spouses
* **S. 73** – Spousal Rollover – Where a capital property has been transferred to a spouse or common law partner, the property is deemed

1. To have been disposed of at that time by the individual for proceeds equal to the ACB of the transferor, and
2. To have been acquired at that time by the transferee for an amount equal to those proceeds

* PD and Acquirer Capital Cost = ACB
* Capital gain is deferred until the spouse (acquirer) disposes of the property
* Rule applies because spouses are considered to be a single economic and social unit
* Encourages distribution of property within a relationship
* Rule applies automatically unless parties opts out of its application (Elects otherwise)
* Property attribution rules
* Recall: If taxpayer transfers income-producing property to spouse, any income generated is attributed back to transferor (**S. 74.1)**
* In addition**: S. 74.2** – Capital gains of transferred property are attributed back to transferor
* Entire capital gain is attributed back – Not just the capital gain at the time of transfer
* Recall: Rules do not apply to sales at FMV (Can be self-defeating if plan was to move property to low-income spouse)
* If you sell property to spouse at FMV, must elect out of the roll-over rule

**VI. General Provisions**

* **S. 69** – Gift/Transfer
* **S**. **67** – Reasonableness of Deductions
* **S**. **67.1** – Reasonableness of Food/Entertainment Expenses
* **S. 73** – Transfers to Spouse
* **S**. **74.1** – Attribution Rules
* **S**. **248** – Definitions
* **S**. **251** – Definition of “arms-length”

**VII. Business Income vs. Property Income**

* General Rule: If income is derived principally from ownership of property – Property; If it involves a significant amount of activity – Business
* Consider: (***Lois Hollinger v. MNR***)
  + Whether the income was the result of efforts made or time and labour devoted by the taxpayer
  + Whether there was a trading character to the income
  + Whether the income can be fairly described as income from a business within the meaning of that term as used in the Act, and
  + The nature and extent of services rendered or activities performed
  + Property income has no active and extensive business-like intervention
  + The number of properties owned – The larger the number of properties/buildings owned, the more likely it is to be a business
* Interest to financial institution – Business; Interest from savings account or private loan – Property
* Dividends – Property, although may constitute business income to an investment dealer in some circumstances
* Rental Income – Generally dependant on level of services provided by landlord (***Walsh and Micay v. MNR***)
* Services such as provision of heat, electric stoves, and refrigerators, janitorial services to common hallways, snow removal, carpeting in some rooms of the suites and drapes for the windows are those which tenants expect and landlords normally provide
* Services such as the provisions of breakfast, maid, linen, laundry etc. might characterize rental income as income from business

**VIII. Bringing it all Together**

* **S. 2** – Tax payable by Canadian residents

1. Tax payable is a percentage of taxable income
2. Taxable income for the taxation year is the taxpayer’s income less loss carryovers (income less Division C deductions)

* Loss Carryover: To the extent that current year losses cannot be used in the year that they arise, they may be carried over
* S. 3 does not permit a negative balance that would entitle a taxpayer to a refund of tax
* **S**. **3** – Income for taxation year

1. Include all source incomes (Gross profit – Deductions, if positive); If deductions exceed profits, deduct under s. 3(d)
2. Include taxable capital gains less allowable capital losses (net amount)
3. Deduct Division E deductions (Ex. Child Care)
4. Deduct all source losses (Any amount by which deductions exceeded losses)

* Ex. If you have 3 businesses (A, B, and C), if A and C makes a profit, include them under 3(a); If C makes a loss, deduct it under 3(d)