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MONTHLY TAX UPDATE SEMINAR

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GOVERNMENT RELEASES

351(1)

Consider

FINANCE RELEASES (www.fin.gc.ca)

1. September 30, 2010 - **Bill C-47** received First Reading in the House of Commons - It includes the remaining provisions from the **March 4, 2010 Federal Budget** and other technical amendments. The Bill includes provisions such as indexing the working income tax benefit, allowing for a transfer from an RRSP to an RDSP on a tax-deferred basis, implementing Employee Life and Health Trusts, changing the disbursement quota rules for charities, and allowing taxpayers to request online notices from CRA.



"these Releases"

Also, Finance introduced the **explanatory notes** to the legislative proposals on September 30, 2010.

2. September 30, 2010 - Finance Minister Jim Flaherty announced that Ottawa will limit the increase to Employment Insurance

premiums to **5 cents** per \$100 of insurable earnings for employees and **7 cents** for employers in 2011. Mr. Flaherty also announced that premium increases will be **capped at 10 cents** for employees in subsequent years.

CRA RELEASES (www.cra.gc.ca)

1. October 4, 2010 - CRA notes that they have **replaced** the existing Government of Canada **ePASS System** with a new **CRA User ID and Password Service**. Users of these services will need **five security questions** and answers on file to transition to the new Service.
2. October 4, 2010 - CRA notes that there will be a 2011 revision to the **SR&ED Claim Form and Guide** ([Form T661](#), [Guide T4088](#)). The revision includes a table summarizing the cost for all projects and allows claimants to submit project information in Part 2 of the Form for only the **20 largest projects**. The new Form will be effective as of the date of release in April, 2011 and will be mandatory for claims filed **after July 31, 2011**.
3. September 30, 2010 - CRA issued **Guide RC4092, Registered Education Savings Plans (RESPs)** which discusses what is an RESP, Canada Education Savings Grants, Canada Learning Bonds, who can be a subscriber or beneficiary, RESP contributions, payments from an RESP, Educational Assistance Payments, Accumulated Income Payments, and special rules with respect to changing a beneficiary, and transferring RESP property to another RESP.

Commencing in 2007 a **lifetime limit** for contributions is **\$50,000** and there is no limit to the annual contributions. Also, HRSDC pays a basic **CESG of 20%** of annual contributions to a maximum of **\$500** in respect of each beneficiary (\$1,000 in CESG if there is unused grant room from a previous year), and a lifetime limit of \$7,200. **HRSDC** will also pay an **additional** CESG amount for each qualifying beneficiary based on net family income.

4. September 30, 2010 - CRA note that they have received information from the Government of France about HSBC account holders in Switzerland and have begun a series of audits on over **1,000 bank accounts** linked to **Canadian taxpayers**.

It was noted in a CBC news report that **Herv Salciani** obtained a list of some 80,000 accounts when he worked as **head of computer security** at HSBC in Switzerland. More than **1,700** private offshore **bank accounts** belonging to Canadians turned up on the list of secret accounts in Switzerland. To **open** an account you need at least **\$500,000**. French authorities searched Mr. Salciani's mother's house and obtained the

information and noted that there were 8,000 accounts on the list that belonged to French citizens, and only two accounts had been declared for tax purposes.

5. September 23, 2010 - CRA notes that **tax relief measures** are available to taxpayers affected by **Hurricane Igor** in Newfoundland and Labrador.

Any affected individual or business unable to meet their tax obligations because of Hurricane Igor should contact the CRA to apply for taxpayer relief. (**Form RC4288**)

6. September 21, 2010 - **TFSA Returns** and Payment of Taxes - Q&A

Some points mentioned by CRA include:

- (i) **4.8 million** Canadians have opened **TFSA**s.
- (ii) On June 1, 2010 CRA mailed over **72,000 proposed TFSA Returns** to individuals who may have **over-contributed** to their TFSA in 2009 seeking more information about their situation. These are not Notices of Assessments. They are used to calculate the **tax** on over-contributions.

Individuals had until August 3, 2010 to respond by either agreeing to pay or by sending CRA a letter to **request a review** of their file and possible relief. If a taxpayer does not respond, CRA will **reassess** and issue a **TFSA Notice of Assessment**. CRA have noted that they will be **flexible** and treat each circumstance on a case-by-case basis (www.cra-arc.gc.ca/whtsnw/tms/jntstmnt-eng.html)

- (iii) Subsection 207.06(1) requires that a **request for TFSA relief** be initiated by an individual, where it is necessary to demonstrate that errors were **reasonable** and that, if applicable, reasonable steps were promptly taken to **remove any excess** amounts from the TFSA. The **onus** is on the **taxpayer** to **request relief**.
- (iv) If a taxpayer does receive a TFSA Notice of Assessment, they can file a **Notice of Objection** on Form **T400A** or by sending a letter to the Chief of Appeals at their Tax Services Office or Tax Centre **within one year** after the due date of the Return or **90 days** after the date on the Notice of Assessment.
- (v) If the TFSA Notice of Assessment includes a **late-filing penalty** or **arrears interest**, **relief** may be applied for using **Form RC4288**.

- (vi) The **problem** is that **withdrawals** from a TFSA in a given year are **not added back** to the individual's **contribution room** until the **following year**.
 - (vii) As of February, 2010, **financial institutions** were required to **electronically file** with CRA **information** with respect to **TFSA accounts** opened in 2009. This information will be **filed annually**. The information provided will allow CRA to calculate and advise individuals of their unused TFSA contribution room and also to proactively identify individuals potentially subject to the **TFSA excess contribution tax**.
 - (viii) An individual **can contribute** to a TFSA **without** having filed a **tax return**.
 - (ix) CRA recommends that individuals that have over-contributed in 2010 should withdraw the excess as soon as possible to reduce penalties.
7. September 17, 2010 - New **Form T5013** Filing Requirements for **Partnerships** - Starting in 2011, the requirement related to the **number of Partners** in a Partnership will be **replaced** with a new requirement based on **financial activity** and the **types of Partners**.

The new requirements apply to all Partnerships for **fiscal periods ending in 2011 and later**. Currently under certain conditions, CRA has exempted Partnerships with fewer than six Partners from filing the **Form T5013**.

Effective **January 1, 2011**, a Partnership that carries on a business in Canada, or a Canadian Partnership with Canadian or foreign operations or investments, has to file **Form T5013** for each fiscal period of the Partnership if:

- at the **end** of the fiscal period the Partnership has an absolute value of **revenues plus expenses** of more than **\$2 million**, or has more than **\$5 million** in **assets**; or
- at any time during the fiscal period the Partnership is a **tiered Partnership** (has another Partnership as a Partner or is itself a Partner in another Partnership); or has a **Corporation** or a **Trust** as a Partner;
- the Partnership invested in **flow-through shares** of a principal-business corporation that incurred Canadian resource expenses and renounced those expenses to the Partnership; or
- the Minister of National Revenue **requests one in writing**.

For **example**, if a Partnership had revenues of \$1.5 million, cost of goods sold of \$850,000, and other expenses of \$400,000, the absolute value of revenues plus expenses would be \$2,750,000 and the Partnership would have to file. With respect to **assets**, the **cost figure** of all assets, both tangible and intangible, without taking into account the depreciated amount should be used to determine whether a Partnership meets the “**more than \$5 million in assets**” criterion.

Also, the **Form T5013** is being changed for the **2011 tax year**.

For more information see www.cra.gc.ca/partnership.

8. September 17, 2010 - CRA 33-page **Guide T4040** provides information with respect to **RRSPs** and other **registered plans** for retirement and notes that there is now a **rollover** of **RRSP** proceeds to a **Registered Disability Savings Plan** upon the **death**, after March 3, 2010, of the taxpayer.

PERSONAL TAX RETURNS

351(2)

Consider

CHARITABLE DONATIONS



In a September 13, 2010 **External Technical Interpretation** (2010-0377811E5, Boyle, Andrea), CRA notes that it accepts gifts made by a **spouse** or **common-law partner** of the individual as part of the **individual's charitable gifts**. Also, Subsection 118.1(1) (total charitable gifts) permits

"the five-year carryforward"

a **five-year carryforward** for unused donations.

CRA notes that you **have to claim** gifts you have **carried forward** from a previous year **before** you can claim tax credits for gifts you give in the **current year**. If you are **claiming a carryforward**, taxpayers should **attach a note** to the return indicating the **year of the return** with which you submitted the **receipt**, the portion of the **eligible amount** you are claiming this year, and the amount you are **carrying forward**.

Under CRA's administrative policy, it is permissible for a charitable donation that was initially reported on one spouse or common-law partner's return to be **transferred** to the other spouse or common-law partner in a **subsequent year**. Taxpayers should provide all the details regarding the transfer with their submitted returns.

DONATIONS

We understand that CRA has a **new project** for **charitable donations** over \$500. Not only are they asking for copies of the receipts, the taxpayer may have to provide proof of payment. CRA explained that they are getting a lot of fraudulent receipts. Apparently some charities that hand out receipt books for door-to-door collectors are not able to get the books back and CRA is finding that the collectors may be "selling receipts" from these books.

"this CRA initiative"

HOME RENOVATION TAX CREDIT (HRTC)

We have been told by many accountants in our Tax Update Courses that CRA are asking for **support** for **larger HRTC** claims including proof of payment. Also, where the individual has had business or property income on which claims were made with respect to an **office in the home**, CRA has either disallowed the HRTC or requested an explanation as to why the renovation should qualify. If, for example, a part of the renovation was included in the capital cost pool for the office in the home, that amount would not be eligible for the HRTC. However, if none of the renovation related to the office in the home (example, back deck) then the entire amount of the expenditure should qualify for the HRTC. (Paragraph 118.04(1)(h))

"these HRTC issues"

Also, CRA may challenge the HRTC on returns where **moving expenses** are claimed on the basis that the cost relates to a newly acquired home and is not a renovation (118.04(1) - qualifying renovation).

MEDICAL EXPENSES - TRAVEL EXPENSES

In a September 10, 2010 **Tax Court** of Canada case ([Sienema vs. H.M.Q., 2010-572\(IT\)I](#)), the issue was whether the taxpayer, who suffered from **psoriasis and psoriatic arthritis**, was entitled to claim **travel expenses** when he used a hot tub and a UVB phototherapy unit located at his parents' house and whether the taxpayer could deduct transportation and meal costs for both **himself and an attendant** for trips to an arthritis clinic and to a chiropractor.

"claiming travel expenses for medical credits"

Taxpayer Wins!

The Court **permitted these travel expenses** and noted that:

1. The Appellant was obtaining "**medical services**" when he used the hot tub and UVB unit because he was receiving **medical treatment**.
2. A **previous Court case** concluded that similar travel expenses to New York and New Jersey to receive medical treatment were **deductible** ([Mudry vs. H.M.Q., 2008 TCC 160](#)).

EMPLOYMENT INCOME

351(3)

Consider

NON-TAXABLE HOTEL CREDITS

In an August 26, 2010 **Technical Interpretation** ([2010-0368031](#), [Ferguson, Rita, 1-519-645-5261](#)), CRA notes that where the employees' **hotel rooms** are paid by the employer when they are **travelling on**



"a non-taxable hotel credit"

employer business, but stay in **private non-commercial accommodation** instead of a hotel, the "**hotel credit**" that they receive from the employer will generally **not** be a **taxable benefit** on the basis that Subparagraph 6(1)(b)(vii) provides an exception for **reasonable allowances** for travelling in the performance of the duties of an office or employment away from the municipality and the metropolitan area. It is CRA's view that the amounts paid for the "hotel credit" in this Technical Interpretation would constitute a **reasonable non-taxable allowance**.

Editor's Comment

Even though these payments are non-taxable when they are primarily intended to compensate the employee for business expenses associated with staying in non-commercial accommodations, CRA did not indicate that receipts or evidence would have to be provided or, the amount of the hotel credit involved.

In Video Tax News Nos. 349 and 350, we included in the Appendix the **National Joint Council Travel Directives** which provide **government employees** with a **private non-commercial accommodation allowance of \$50**. Presumably this would be non-taxable.

NORTHERN TRAVEL ALLOWANCE

In an August 31, 2010 **Technical Interpretation** ([2010-0373421E5](#), [Vaugh, Phyllis](#)), CRA notes that where an employer **does not pay additional compensation** but simply **re-characterizes** an amount of existing salary or wages as **travel expenses**, the **Northern Residence Travel Deduction** in Subsection 110.7(1) of the Act is **not permitted**.

"not recharacterizing"

HAIRDRESSERS

In a November 25, 2009 **Tax Court** of Canada case ([1546617 Ontario Ltd. vs. M.N.R., 2010 TCC 26](#)), the Court found that the Appellant engaged **nine hairdressers** in **insurable** and **pensionable** employment at the Appellant's hairdressing establishment during 2006.

With respect to Employment Insurance (**EI**), the Court dismissed the taxpayer's appeal on the basis that **Regulation 6(d)** in the **EI Act** is applicable as the nine hairdressers were not the owners or operator of

"EI for hairdressers and barbers"

the establishment.

With respect to the **Canada Pension Plan**, which has no Regulation comparable to 6(d) of the Employment Insurance Regulations, the **status** of the workers as independent contractors or employees was key. The guidelines in the Wiebe Door Services case were applied and the Court found the **hairdressers** were **employees**. There was an extraordinary degree of **control** exercised by the Payer over the workers, there were **rules** that all workers were required to follow, and the **prices** were set by the Payer who controlled the cash.

Even though the hairdressers had the normal tools that they purchased in hairdressing school, the Payer provided all of the chairs, the sinks, and all colouring materials and other hair products. Even though the Payer deducted from the hairdressers pay 10% of the revenue generated toward what is known as **chair renters**, the Court did not place any great weight upon this in view of the **hairdressers' employment intentions** versus the independent contractor status forwarded by the Payer.

The Court could see **no possibility** of any of the workers **profiting** by sound management or increasing their profits.

TAXI DRIVERS

In a June 28, 2010 **Tax Court** of Canada case ([Labrash vs. M.N.R., 2009-3055\(CPP\), 2009-3054\(EI\)](#)), the Court found that the **taxi driver**, who typically drove the cab during the day and hired drivers to drive it during the night, was considered to be an **independent contractor** (not an employee) for **CPP** purposes but, was still subject to **Employment Insurance (EI)**.

"EI for taxi drivers"

The Court noted that:

1. The **lack of control** over the work by the Payer led to **independent contractor** status.
2. The driver had **no guarantee** of having a regular salary.
3. The **driver owned** everything necessary for the overall operation of the business.

However, for the purposes of **EI**, the Court noted that under **Regulation 6(e)** of the EI Act the taxi driver was subject to EI as he was **not** the **owner** or **operator** of the taxi business as a whole or did not own more than **50% of the vehicle**.

This special situation (Employers' Guide - Payroll Deductions, chapter 8, page 36) requires **contributions to EI** even though the taxi driver is otherwise considered **self-employed**. This Regulation was created at the request of the taxi industry to protect drivers who might go through periods of unemployment.

EMPLOYMENT TAX CREDIT (ETC)

In an August 23, 2010 **External Technical Interpretation** (2010-0373051E5, Posadovsky, Tom, 1-613-952-8283), CRA notes that a **retired taxpayer** who receives retirement benefits which are reported as **employment income** is entitled to claim the ETC which, for 2010, is based on **\$1,051**.

"the ETC"

EMPLOYER REIMBURSEMENT OF EMPLOYEE PROFESSIONAL DEVELOPMENT COSTS

In a September 9, 2010 **External Technical Interpretation** (2010-0371431E5, Ferguson, Rita, 1-519-645-5261), CRA reviewed a case where each **teacher** receives a **pre-determined amount** each year for the next three years which must be used for conferences, courses and resource materials. However, **no receipts** will be requested by the employer.

"these professional development issues"

CRA notes that if the employee will **not** be required to **account for the payment** or, if the payment will cover professional development or other expenses that are **primarily** for the benefit of the **employee**, then the payment will be **taxable** as employment income. However, if the payment represents a **reimbursement of actual costs** or an **accountable advance** in respect of expenses incurred by the employee for professional development that was undertaken **primarily** for the benefit of the **employer**, then the payment would **not** be **taxable** to the employee. (See Paragraph 18 of [IT470R](#))

SPECIAL WORKSITE

Subsection 6(6) of the Income Tax Act permits an employer to provide a **tax-free allowance** in respect of **board, lodging and transportation** while the employee is at a "**special worksite**" assuming that certain **criteria** are met including that the taxpayer maintains at another location a **self-contained domestic establishment (SCDE)** as the taxpayer's principal place of residence.

"shared accommodations are O.K."

In a September 9, 2010 **External Technical Interpretation** (2010-0367501E5, Cooke, Michael), CRA notes that a **SCDE** is defined in Subsection 248(1) to mean "a dwelling-house, apartment, or other similar place of residence in which a person as a general rule sleeps or eats". [IT91R4](#), Paragraph 7, notes that CRA generally considers a residence to be a **SCDE** for purposes of Subsection 6(6) if it is a **living unit** with **restricted access** that contains a kitchen, bathroom, and sleeping facilities. This would not ordinarily include a bunkhouse, dormitory, hotel room, or a room in a boarding house.

While a question of fact, it is possible that **shared rental accommodations** such as an apartment or a house could reasonably be considered as a **SCDE** even though certain common facilities, such as a kitchen or bathroom, may otherwise be shared with another person.

BUSINESS/PROPERTY INCOME

351(4)

Consider

COMMISSION INCOME ON LIFE INSURANCE POLICIES

In a May 4, 2010 **Technical Interpretation** (2010-0359451C6, [Cooke, Michael](#)), CRA notes that even though Paragraph 27 of **IT470R** notes that **commission income** earned by a **life insurance salesperson**, whether employed or self-employed, would **not** be a **taxable benefit**, presumably because it is similar to an employee product discount, this concession **does not apply** where the **insurance** was obtained for **investment** or **business purposes** or, the amount of commission income is **significant**.

"these insurance commission issues"

REBATE PAID BY A LIFE INSURANCE ADVISOR TO A POLICYHOLDER

In a May 4, 2010 **Technical Interpretation** (2010-0359401C6, [Young, Terry](#)), CRA notes that where a **self-employed life insurance advisor** pays a **rebate** to a client who has purchased a life insurance policy, the life insurance salesperson may **deduct the payment** as an expense incurred to earn business income within the general limitations in the Act. However, the amount may be **taxable** to the **policyholder**.



"these insurance rebate issues"

INTEREST EXPENSE

In an August 10, 2010 **Internal Technical Interpretation** (2010-037671117, [Carruthers, Lori](#), 1-613-260-9630), CRA notes that normally they consider **interest costs** in respect of funds borrowed to purchase **common shares** to be **deductible** on the basis that there is a **reasonable expectation** that the common shareholder will receive **dividends**. These comments are also generally applicable to investments in Mutual Fund Trusts and Mutual Fund Corporations.

"these interest expense issues"

However, CRA provided an exception such as where the corporation is designed to provide a **capital return only**. The corporate policy is that **dividends** will **not be paid**, that corporate earnings will be **reinvested** to increase the value of the shares and that shareholders are required to sell their shares to a third party purchaser in a fixed number of years to realize their value. In this situation, the **interest expense** would **not** be **deductible**.

However, in another **example** CRA noted that where the business plan indicates that its **cash flow** will be required to be **reinvested** for the **foreseeable future** and **dividends** will only be paid when **operational circumstances permit** or when it believes that shareholders can make better use of the cash, the **interest** on money borrowed to acquire these shares would be **deductible**.

EMPLOYEE VS. INDEPENDENT CONTRACTOR

In an August 23, 2010 **Tax Court** of Canada case ([Yetman vs. M.N.R., 2008-3724\(CPP\)](#)), the Court found that **Mr. Yetman** was engaged as an **independent contractor** and, therefore, the Company was **not** required to withhold **Canada Pension Plan** on management fees paid to Mr. Yetman.

"these workers are independent contractors"

The Court noted that:

1. Mr. Yetman entered into a **Written Contract** with the Company as to the **independent contractor status**. Despite the fact that its terms and conditions were not strictly adhered to, the Contract **cannot be disregarded**.
2. The fact that Mr. Yetman **submitted invoices** for his work is another element towards independent contractor status.
3. The application of the five tests (control, ownership of tools, chance of profit, risk of loss, and integration) from the Wiebe Door **case clearly point to an independent contractor status**. There was **no supervision** and control over the execution of the contract; the worker had a chance of **profit** and risk of **loss**; the worker supplied his own **tools and equipment**; the worker had no job security and, he was free to take on **other jobs** or contracts.

This case is the same as another August 23, 2010 **Tax Court** of Canada case ([Bean vs. M.N.R., 2007-3723\(EI\), 2008-3721\(CPP\)](#)).

In both cases, Mr. Yetman and Mr. Bean were the only two workers in the Company. Previously they had been employed with Canada Post but were terminated in 2006. Mr. Yetman is the father of the 50% shareholder in the company, Jennifer Yetman and, Mr. Bean is the spouse of the other 50% shareholder, Amber Bean. Both Mr. Yetman and Mr. Bean are **directors** of the Company. They both had **registered** personally for **GST** even though they were the **President** and **Vice President** respectively of the Company.

The Company was established because clients prefer to deal with a Company rather than with individuals. The shareholding of the Company was set up to give an appearance of **neutrality**. The family shareholders invested only \$50 each in the share capital of the Company and, were not involved in the day-to-day operations of the business.

REPAIR VS. CAPITAL

In an August 23, 2010 **Tax Court** of Canada case ([Martinello vs. H.M.Q., 2008-3653\(IT\)I](#)), the taxpayer's **rental property** was damaged by a **hurricane-strength storm**. The taxpayer incurred **significant expenses** to put the property back into a rental position. In fact, the expenses were such that the taxpayer successfully received the **GST New Housing Rebate** on the basis that the rental property was **substantially**

"these significant repairs are deductible"

renovated.

Taxpayer Wins!

The Court found that even though the GST New Housing Rebate was received, although it perhaps should not have been, the expenses were incurred to put the property **back into its original condition**. This constitutes a **repair** and is **deductible**.

LONG-TERM DISABILITY BENEFITS - NO CPP

In a January 28, 2010 **Federal Court of Appeal** decision ([Toronto Transit Commission vs. M.N.R., 2000 Dossier; Docket: A-203-09](#)), the Federal Court **overturned** the previous Tax Court decision and concluded that the **long-term disability benefits** paid to employees of the Toronto Transit Commission under an **employer-funded program** were **not** subject to employer's contributions under the **Canada Pension Plan**.

"no CPP here"

CLASS 52

In a July 27, 2010 **External Technical Interpretation** ([2009-0347471E5, Dagenais, Anne](#)), CRA notes that a Personal Digital Assistant (**PDA**) Device may generally be included in **Class 52** (100% CCA) as it appears to meet the definition of "general purpose electronic data-processing equipment" (**GPEDPE**).

CRA notes that this PDA is **used by truckers** for deliveries and pickups and works with wave cells and is connected to a central dispatch. In addition, the PDA can be used as a phone, GPS, send and receive emails, and browse the Internet. It can also be used to take pictures in case of property damage during delivery or pickup.

"all the criteria in Class 52 and Regulation 1104(2) - GPEDPE"

Also, the PDA replaces the paper usually used by truckers. It includes a touch screen, a pen detachable to allow customers to sign on the screen, calendar appointments, and a record of the journey of the day. These devices are equipped with a reader barcode. (Regulation 1104(2))

Also, in a September 7, 2010 **External Technical Interpretation** ([2009-0340861E5, Dagenais, Anne](#)), CRA notes that one of the requirements of Class 52 in Regulation 1104(2) for GPEDPE is that the electronic equipment requires an internally stored computer program that can be **altered by the user** of the equipment. CRA was asked whether pulsar MIT (Multiple Impulse Therapy) used by a chiropractor would qualify. CRA could not conclude because the information provided did not indicate whether this alteration test could be met.

Editor's Comment

To qualify as **Class 52**, the **GPEDPE** must be acquired after **January 27, 2009** and before **February 2011**. It is important to apply the **specific criteria** in Class 52 and Regulation 1104(2) to determine if an asset qualifies for Class 52 treatment.

REPLACEMENT PROPERTY RULES

In a September 1, 2010 **External Technical Interpretation** (2010-0374241E5, Atkinson, James, 1-519-457-4832), CRA noted that a **building** which is **owned by Mr. A** and **leased to his operating corporation** would likely be considered a **“former business property”** for purposes of deferring the tax on a disposition of the building and a purchase of a **replacement property**.

“this building rented to a related person qualifies”

CRA notes that Subsection 44(1) permits a taxpayer to **elect to defer** the capital gains where a **“former business property”** is voluntarily disposed of, and a **“replacement property”** is acquired. A **former business property** is defined in Subsection 248(1) of the Act as real property used **primarily** for the purpose of earning income from a **business** and **excludes a rental property**.

However, **rental property** is defined for the purposes of the definition of **former business property** as meaning real property used **principally** for the purpose of earning rental revenue unless the property is **leased** by the taxpayer to a **related person** and is used by that **related person principally** for any purpose other than **earning rent**.

In this case, it **is not included** in the definition of **rental property**.

CRA notes that a taxpayer must **elect** to have the provisions of Subsections 44(1) and 13(4) apply. Where the **replacement** takes place in the **same year**, the **calculation** will be considered to **constitute an election**.

MANAGEMENT FEES

351(5)

Consider



When addressing tax planning for owner-managers, we typically refer to the **“salary/dividend mix”** in planning for distributions of cash to the owner. Some practitioners, and some clients, prefer to structure payments deductible to the corporation as **self-employment income**, rather than employment income, to the **owner-manager**.

Often, the motivation for such classification is a desire to avoid the need to remit source deductions and file **T4 slips**. In some cases we have seen in practice, an amount originally planned to be employment income is reflected as **business income** instead because the client has not remitted the required source deductions. Commonly, these payments are referred to as **“management fees”** to the **owner-manager**.

While such a classification can sometimes be supported (see **VTN 351(3)** – Employee vs Independent Contractor), there are a **number of issues** to consider in remunerating the owner-manager using business, rather than employment, income, including the following:

- **simply calling** a payment business, rather than employment, income **does not make it so**. We understand CRA has challenged the classification in some situations, requiring a T4 slip to be prepared and applying late filing penalties. This was discussed in VTN 320(15). The usual criteria for determining whether a relationship is one of employment would apply. As the owner-manager commonly is a Director, he is already an officer of the company (an employment position), which means a **separate business arrangement** must be argued. The **services** provided as **employee** and as **independent contractor** then need to be **segregated** in some manner.
- an **expense cannot** be deducted if it is “**unreasonable**” in amount. Most practitioners are aware of CRA’s longstanding administrative position to accept that all employment remuneration paid to owner-managers active in the business as “reasonable”. The CRA does **not extend** this practice to amounts paid to **non-employees**, potentially requiring the client to support the reasonableness of the fees paid based on services provided. In **VTN 350(5)** we reviewed two recent cases where such support was required in respect of **intercorporate management fees**. The same issues would apply to fees paid to individuals.
- **Management fees** are a commercial activity, so the recipient may be required to collect and remit **GST/HST** on these amounts. Even if the amounts are under \$30,000, the individual **may** not meet the “**small supplier**” exemption, as he/she may be **associated** with one or more corporations or other entities which are Registrants, such as a wholly owned corporation. Where the fees are paid from a business which is Registered for GST/HST, this creates an administrative and cash flow issue. Where the business is exempt, the GST/HST would not be recoverable, and could become an additional cost to this approach.
- Although **source deductions** are avoided, the benefits of this are limited, as the individual will be required to **remit instalments** if this approach is maintained over time.
- It is common to deduct an **accrued bonus** from corporate income, with the individual reporting the income at a later date when the bonus is paid, as employment income is reported on the cash basis. If the fees are **business income**, then they must be accounted for on the **accrual basis** – the “bonus forward” option is eliminated.

“can we support the existence of a separate non-employment relationship?”

“does support exist for the reasonableness of fees paid?”

“the potential costs related to GST/HST”

“remitting instalments instead of source deductions”

“you can’t “management fee forward”

- Although this is only sporadically enforced, it is likely that such management fees are required to be reported on a **T4A slip**. If CRA chooses to enforce this requirement, the penalties for failure to file are the same as for **T4 slips**.
- The owner-manager **still pays CPP**, being subject to both the employer and employee portions on his/her business income. This may be mitigated if CPP has been withheld on other sources of employment income.
- As this is not employment income, it is **not** eligible for the **Canada Employment Tax Credit** unless he/she has employment income from other sources. The maximum credit is reached at \$1,051 of employment income for 2010.

"issuing T4A slips"

"this possible loss (\$157.65 of personal taxes)"

The benefits of **self-employment**, rather than employment, income for the **owner-manager** may not be worth the costs and risks resulting from the **above issues**.

"whether the benefits outweigh the drawbacks"

Thanks to **Hugh Neilson**, B.Comm, C.A., TEP, an independent contractor to **Ernst & Young LLP**.

GROUP SICKNESS AND ACCIDENT INSURANCE PLAN - OFFSHORE

351(6)

Consider

In an August 6, 2010 **Tax Court** of Canada case (2006-3533(IT)G and 2007-2611(IT)G (Marcantonio Constructors Inc. (MCI) vs. H.M.Q.), the **appeals** by the taxpayers were **dismissed**.



"this offshore plan loses"

Taxpayer Loses

CRA successfully **denied deductions** for **accrued liabilities** to offshore Trusts for contributions to Employee Sickness and Accident Insurance Plans.

CRA argued that the contributions were **not deductible** on a number of bases including that the Trusts and the Plans were **shams**, the contributions were **not laid out to earn** income, the contributions were payments on **account of capital** and the contributions to the Trust were **unreasonable**. The Trusts were in either the **Cayman Islands** or **Bermuda**.

The Appellants are among 75 clients of an Ottawa Solicitor.

The other problem

Also, CRA was successful in reassessing **statute-barred years** arguing that the **taxpayer** knew of the debatable issues. The alleged **concealment** of the deductions in the financial statements constituted more **than negligence or carelessness**. It is **willful default** and entitles the CRA to reassess **beyond the normal time** for doing so. The alleged failure **to disclose** that more than \$500,000 in 1999 and \$700,000 in 2000 was being deducted from income on account of accrued liabilities to these Trusts was considered as a deliberate misrepresentation.

"these years were not statute-barred"

The taxpayer took the position that the income tax returns were prepared by **qualified and experienced accountants**, and that **he simply relied** on their advice in **signing them**. However, the Court found that the **officer** signing the income tax returns **cannot avoid** his obligation in this way. He must demonstrate a **reasonable effort** to understand the component elements of the return.

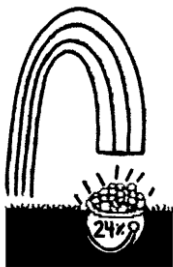
Editor's Comment

This case **has been appealed** to the Federal Court of Appeal.

CORPORATE REORGANIZATION

351(f)

Consider



In an August 25, 2010 **External Technical Interpretation** ([2010-0374231E5](#), *Labarre, Sylvie*), CRA notes that "**safe income on hand**" attributable to the **old common shares** should be **allocated to new preferred shares** and to **new common shares** received on a **Section 51 reorganization** of capital on a **pro-rata basis** based on the relative amounts of the gain inherent in the preferred shares and in the new common shares at the time of the exchange.

"this safe income allocation"

CRA notes that because the new preferred shares and common shares were issued in exchange for the old common shares, the new preferred shares and common shares take on the "**safe income on hand**".

RELATIONSHIP BREAKDOWN

351(8)

Consider

LIVING IN THE SAME RESIDENCE

In a July 27, 2010 **External Technical Interpretation** (2010-0364841E5, Meunier, Pierre-Luc), CRA notes that it is **possible** that both spouses **can live apart** because of a breakdown of their marriage **even if** they still **live under the same roof** if the following circumstances are present:

- they occupy **separate bedrooms**;
- there is a **lack of sexual relations**;
- there is little or **no communication**;
- there are **no domestic services** to each other;
- the spouses receive their **mail separately**; and
- the spouses have **no common social activities**.



"living in the same residence can still be living separate and apart"

CRA notes that if these tests are met, the existence of a **joint account** and the management of **joint expenses** shall **not preclude** the fact that the taxpayers are **living separate and apart**. Therefore, either of the spouses may claim the wholly dependent person tax credit (**WDPTC**) for a dependant. The **WDPTC** is only available with respect to one domestic establishment. The person claiming the WDPTC may also claim the **child credit** under Paragraph 118(1)(b.1).

CRA

351(9)

Consider

COLLECTIONS

Under Subsection 225.1(2), CRA may **not take any collection** actions where a taxpayer has served a **Notice of Objection** to an assessment until **90 days after** CRA has confirmed or varied the assessment. However, this does **not apply** to **GST/HST assessments** under the Excise Tax Act or **source deductions** under the Income Tax Act as they are considered to be **Trust Funds**. (Sections 225 and 225.1 of the Income Tax Act)

"this GST/HST and source deduction collection issue"

Also, since April, 2007 CRA can **withhold** income tax, GST/HST or **other refunds** as a **set-off** against amounts that are under **Objection or Appeal**. Therefore, a taxpayer who has an **Appeal** before the Courts (for example, a **tax shelter**) may not receive a refund on other tax or GST/HST amounts. However, CRA notes that this will only be applied when **recovery** is considered to be **in jeopardy**. Also, these collection

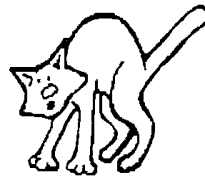
"this set-off"

restrictions do not apply to source deductions or to GST. (Subsection 225.1(6)) Taxpayers may also stop a CRA collection action if they issue a Notice of Intention to file a Proposal under the Bankruptcy and Insolvency Act. (See Information Circular [98-1R3](#))

In a September 3, 2010 **Federal Court** case ([Brent Robarts vs. M.N.R., Docket: T-510-10](#)), the taxpayer was successful in **setting aside a CRA Jeopardy Order** that was issued under Subsection 225.2(2) in respect of a tax debt of \$1,265,953 relating to the 2005, 2006 and 2008 taxation years. The taxpayer was successful in arguing that the Minister had not fulfilled their obligation to take full and frank disclosure and to show that there were reasonable grounds to believe that the collection of any part of the tax debt would be jeopardized by a delay.

Editor's Comment

Clients should **be warned** that CRA Collection Officers may **still contact** them even though they have **filed a notice of objection**. It may be best for the **accountant** to talk to the Collection Officer.



REQUEST THE ADJUSTMENTS

In an August 16, 2010 **Technical Interpretation** ([2010-0354811I7](#), Frank, Lindsay), CRA notes that under Information Circular [IC75-7R3](#) it will **not reassess** a particular statute-barred taxation year to **generate a refund** based solely on a **successful** Appeal by another taxpayer.

"no adjustments here"

DUE DILIGENCE DEFENCE - SECTION 163 PENALTIES

Under **Subsection 163(1)**, a taxpayer who **failed to report** an amount required to be included in income, and who had previously failed to report an amount in any of the **three preceding taxation years**, will be liable to a 10% federal penalty in respect of the repeated failure (and also in most cases a 10% provincial penalty).

"Form [T1135](#)"

CRA notes that a taxpayer will **not** be penalized under Subsection 163(1) if a degree of **due diligence** can be demonstrated. To that end, the **taxpayer** must **establish** that he/she took reasonable precautions to avoid the event leading the imposition of the penalty. In other words, a taxpayer who, for a given year, fails to declare an amount as part of income will need to display **greater vigilance** to avoid a repetition in the three years following the first omission.

In this case, it is clear that the taxpayer had demonstrated due diligence in respect of the first assessment as it was the taxpayer who recognized that he omitted to report a taxable dividend on the return and initiated steps to **rectify** the omission through a **T1 adjustment**.

FORM T1135 PENALTIES

Form T1135 is required to be filed when the **total cost amount** of all

specified foreign property owned by a taxpayer at **any time in a year** is more than **\$100,000**. (Subsection 233.3(3) of the ITA)

In a September 10, 2010 **Federal Court** case ([Canwest Communications Corporations vs. A.G.C., T-1613-09](#)), an application for **taxpayer relief** against the \$2,500 penalties was made on behalf of **seven** related companies where the **T1135** Form was not filed. The Application was made on the basis that they **misunderstood** that the Form is still required to be filed even though the **foreign assets** are held through a **money manager** and **all the income** is reported.

"a Voluntary Disclosure"

The **Court dismissed** the taxpayer's Application for judicial review.

Editor's Comment

A **Voluntary Disclosure** should be considered in these situations. There is generally a requirement that the Voluntary Disclosure be made only **after one year** has passed unless there are other older years to which the Voluntary Disclosure also applies. (See Information Circular 00-IR2 and [RC199](#))

WEB TIPS

351(10)

Consider

www.tax-services.ca

This website contains **basic tax information and calculators** for both Canadian taxpayers and preparers.



"these legal fee issues"

From the main page, individuals are able to click on one of the following subjects in the top information bar:

- Canadian Tax Calculator
- CPP EI Maximum
- Tax Strategies Canada
- RESP Rules Canada
- CESSG
- Corporate Tax Rate
- Personal Income Tax Calculator
- Income Tax Rates
- GST PST HST
- Tax Deadlines
- RRSP Tax Savings Calculator
- RRSP Contribution & Deduction Limit

On the right hand side of the page, one can skip directly to the most commonly used tools on the website. Such tools include items such as:

- Canadian Income Tax Calculator 2010

- Canadian Income Tax Calculator 2009
- CPP EI Maximum 2011
- Income Tax Rates Canada 2010

Of Particular use is the basic **Canadian Income Tax Calculator**. Very simplistic in that only the **province and income level are used**, this calculator can give you a quick estimate of what one's taxes would be. To see **how much tax would be paid based on a different province or income level**, the user simply **changes the relevant field** and hits the **calculate** button again. The results displayed include the **tax payable**, the **After Tax Income**, the **Average Tax Rate**, and the **Marginal Tax Rate**.

Please note that the tools and calculators on this page are fairly basic and use a number of assumptions. It should not be relied upon for specific consultation but rather for viewing basic concepts and trends.

"to suggest a web tip of your own, please send it to joe@videotax.com"

DID YOU KNOW...

351(11)

Consider

ONTARIO CHILDREN'S ACTIVITY TAX CREDIT



Ontario is proposing a **tax credit** that parents may claim of up to \$500 of eligible expenses per child under age 16. They would receive a **refundable** tax credit worth up to \$50 per child, or up to \$100 for a child under 18 with a disability. The credit would apply to **any eligible expenses** incurred on or after January 1, 2010.

"this Ontario children activity tax credit"

Activities that are **eligible** for the **Federal Children's Fitness Tax Credit** would automatically be **eligible** for the **Ontario Children's Tax Credit**. Also, eligible **non-physical extracurricular activities** qualify if they are supervised but not part of a school's curriculum. This was discussed in Ontario News Release **NW2010/09/06**.

This could include activities in sports, arts and culture such as music, drama, dance, visual arts, language, intellectual and interpersonal skill and academic activities.

NATIONAL JOINT COUNCIL

See [Appendix A](#) for the **October 1, 2010** kilometric rates.

TAX UPDATE COURSES

Please call our office at (1-877-438-2057) for details on the two-day **14-hour Tax Update Course** to be held across Canada from September to December, 2010 or see www.videotax.com.

"this Tax Update Course"

Also, the two-day **Tax Update Course** will be held in **Cancun, Mexico** on December 6 and 7, 2010.

The preceding information is for educational purposes only. As it is impossible to include all situations, circumstances and exceptions in a seminar such as this, a further review should be done by a qualified professional.

Although every reasonable effort has been made to ensure the accuracy of the information contained in this seminar, no individual or organization involved in either the preparation or distribution of this letter accepts any contractual, tortious, or any other form of liability for its contents or for any consequences arising from its use.



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APPENDIX A



National Joint Council Appendix B - Kilometric Rates - Modules 1, 2 and 3

Effective October 1, 2010

The rates payable in cents per kilometre for the use of privately owned vehicles driven on authorized government business travel are shown below:

Versions:
Current – October 1, 2010 ↕

Province/Territory	Cents/km (taxes included)
Alberta	51.5
British Columbia	52.0
Manitoba	47.5
New Brunswick	49.5
Newfoundland and Labrador	53.0
Northwest Territories	58.0
Nova Scotia	51.0
Nunavut	58.0
Ontario	55.0
Prince Edward Island	50.0
Quebec	56.5
Saskatchewan	46.0
Yukon	60.5

Note:

- The kilometric rate payable when a Canadian registered vehicle is driven on government business travel in more than one province or in the USA shall be the rate applicable to the province or territory of registration of the vehicle.

For convenience, the Department of Foreign Affairs and International Trade (DFAIT) kilometric rates:

[Module 3: DFAIT - United States of America Mileage/Kilometre Rates \(http://www.njc-cnm.gc.ca/doc.php?did=4968&lang=eng\)](http://www.njc-cnm.gc.ca/doc.php?did=4968&lang=eng)

[Module 4: DFAIT - International Trade Kilometre Rates at Locations Abroad \(http://www.njc-cnm.gc.ca/doc.php?did=4958&lang=eng\)](http://www.njc-cnm.gc.ca/doc.php?did=4958&lang=eng)

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<http://www.njc-cnm.gc.ca/directive/index.php?lang=eng&avid=97-12>