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2013 TAX PLANNING TIPS THIRD QUARTER

AUTO ALLOWANCES: Fixed Payments for Small Trips Can be Costly!

In a March 28, 2013 Technical Interpretation, the Canada Revenue Agency (CRA) notes that:

1. An *allowance* received for the use of *a motor vehicle* is deemed *not* to be *reasonable* (and therefore taxable to the employee) unless based solely on the *number of kilometres* travelled.

2. In this case, the employee was provided $4.60 *per trip* of less than 10 kilometres. CRA concluded that this payment would be *taxable to the employee*, however, certain expenses may be deductible by the employee.

Because it is a taxable allowance, the *employer* will *not be entitled* to the GST/HST *Input Tax Credit*. However, the *employee*, in addition to deducting employment expenses, may be *entitled to a GST/HST rebate*.

DISASTER RELIEF PAYMENTS: What Is the Tax Impact?

In a June 27, 2013 Technical Interpretation, CRA indicated that there would be *no immediate tax* consequences for payments respecting *personal losses* received as a result of Alberta *flood relief* assistance.

In a July 12, 2013 Technical Interpretation, CRA commented on an employer's *emergency assistance plan*, under which the *employer would match* voluntary employee contributions to create a relief fund directed to assist employees in their recovery efforts. All *payments* would be *based exclusively on need* and the extent of damage to the employee`s property.

CRA indicated that disaster relief payments received in the individual's capacity *as an employee* would be *taxable*. However, payments received *as an individual* would *not* be subject to taxation. CRA would generally consider the payments to be received on an individual, non-taxable basis provided all of the following criteria are met:

- the recipient was *affected by a disaster* (CRA refers the reader to http://www.publicsafety.gc.ca/prg/em/cdd/index-eng.aspx in this regard);
- the *payment is philanthropic* and intended to compensate for personal losses or damage suffered during a disaster;
- the payment is made in *a reasonable period of time* following the disaster;
- the payment is *voluntary, reasonable* and *bona fide*;
- the recipient deals *at arm's length with the employer*, and not to a shareholder, connected person or person of influence such as executives with the power to control company decisions (CRA notes that payments to such persons may still be received in capacity as an individual, where the *facts demonstrate* the receipt was on the *same basis as* payments to other *individuals who deal at arm's length* with the employer);

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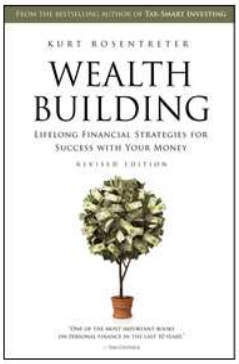
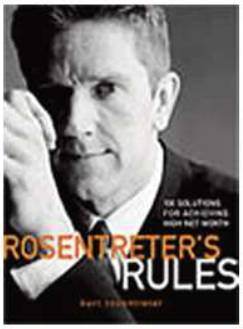
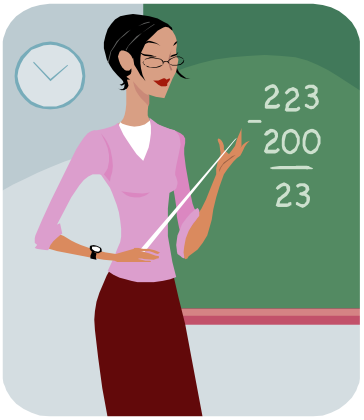




- the payment *is not based on employment factors* such as performance, position or years of service;
- the payment is *not made* in exchange *for past or future employment services* or to compensate for *loss of income*;
- the payment *is not in respect of regular salary* for a period in which the individual is unable to report to work due to a disaster; and
- the *employer does not claim* a business *deduction* in respect of the payment (CRA notes it would not be a charitable contribution as it is not paid to a registered charity).

EMPLOYMENT INSURANCE: Which Working Hours Count?

The number of hours or weeks one needs to qualify for EI are based on where the person lives and the unemployment rate in that economic region at the time the claim is filed. In an April 12, 2013 Tax Court of Canada case, at issue was how many of a teacher's hours worked were *insurable hours* under the *Employment Insurance Act* (EIA).



Taxpayer wins

The government originally did not include hours spent *attending meetings* assigned by a principal, *preparation and planning* of courses, *marking* student work, and *recording student achievements* in determining eligible employment hours.

The Court noted that:
The EIA defines hours of insurable employment and notes that where a person's earnings are *not paid* on an *hourly* basis but the employer provides evidence of the *number of hours* that the person actually *worked* in the period of employment and for which the person was *remunerated*, the person is *deemed* to have worked that number of hours in *insurable employment*.

The Court increased the number of hours from 509 (as conceded by CRA) to 547 hours for this extra time.

BUSINESS EXPENSES – Prove It!

In a June 20, 2013 Tax Court of Canada case, at issue was whether the taxpayer, Mr. L, *operated a business* activity providing consulting services, whether the expenses he claimed were deductible, and whether *gross negligence penalties* should be applied.

In his 2007 Tax Return, $2,000 in professional gross revenue and $17,154 in expenses for a loss of $15,154 were reported. In 2008, no gross income and $12,190 of business expenses were claimed.

Taxpayer loses

The Appeal was denied and the costly gross negligence penalty left in place. The Judge noted, "There was no *credible explanation* that would indicate that any of the amounts that Mr. L reported on his tax returns in respect of his purported consulting business were incurred for the purpose of gaining or producing income. At best, I believe that Mr. L was indifferent as to whether the expenses that he claimed on his tax return were accurate or not. More likely, I believe that Mr. L knew the expenses he claimed on his returns were false and claimed them anyway."

3RD PARTY DISCLOSURE OF UNREPORTED INCOME

In an April 10, 2013 Tax Court of Canada case, CRA reassessed a taxpayer to *include* approximately $28,000 of income. CRA based this income inclusion on the results of the audit of a different company which listed the taxpayer as a Subcontractor.

Taxpayer wins

The Court indicated that, "It is simply *insufficient to tax* a person solely because *another person under audit points* to them and provides their name and address. Names and addresses are readily available publicly and the companies *could* just as easily *have given* CRA almost *any* Canadian's *name*, this would include mine." In allowing the appeal, the Court indicated "it is unfortunately *entirely possible* that *the taxpayer* did work for, and got paid by, these companies. However, the *evidence* of that, such as it is, *falls very short* of allowing me to conclude that, on a balance of probabilities, he did."

OLD TAX RETURNS: They can be reopened!

In a May 31, 2013 Tax Court of Canada case, at *issue* was whether *shareholder withdrawals* of $28,791, $32,173 and $23,351 for the 2004, 2005 and 2006 taxation years, respectively, could be added as *personal income*.

CRA generally has *three years from* the date of their initial *assessment* to revise its assessment of an individual or Canadian-controlled private corporation's income tax return. At the time of reassessment, the 2004 and 2005 years were *past this deadline*. Any *misrepresentation* that is attributable to *neglect*, *carelessness* or *willful default* is subject to reassessment, even if the usual deadline has passed.

Taxpayer loses

The Judge noted that, *meaningful books do not exist* for the Company or the Appellant, and if they do, they were not produced at the Hearing nor were any source documents regarding actual receipts, vouchers or invoices relevant to specific business expenses. As the reconciliation of the shareholder's loan account was rendered impossible by the *absence of an ascertainable flow of funds*, the Court did not allow for a reduction in personal benefits received other than for a minor amount.

The Judge found that the CRA discharged its onus of proof thereby *allowing the reassessment* of these years *past the usual deadline* on the basis that the returns were signed with such *imprecise expenses*, shareholder advances and benefits that a misrepresentation was presented due to *carelessness*.

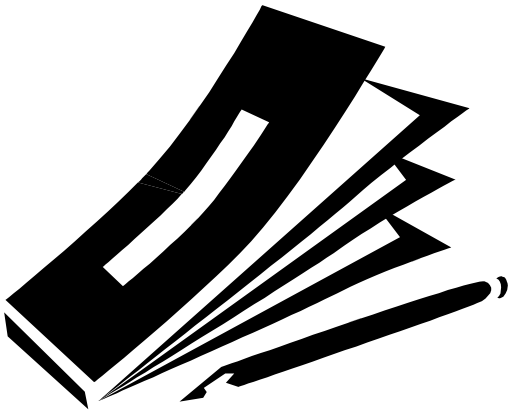
Taxpayer wins

The Court, however, did *not* find that the errors were the result of *dishonesty or deceit* and, therefore, did *not* fall within the threshold for the imposition of *gross negligence* penalties of 50% of the underlying taxes.

RENTAL PROPERTY: Receipt Retention Issue – more than 6 years!

On August 31, 2010, CRA had advised the taxpayer that his income tax return for the 2007 year was under review and that he was required to provide information and documents concerning a rental property sold in 2007.

The taxpayer had *disposed of the rental property* for $285,000. CRA included this amount on the *2007* Personal Tax Return but *reduced the Adjusted Cost Base* (ACB) claimed by the taxpayer by the estimated $52,810 of renovation expenses which the taxpayer had added.



The dispute was settled in a July 3, 2013 Tax Court of Canada case. The taxpayer could *not provide any corroborating evidence* of the renovation costs, therefore, the Court did not accept this as part of the ACB.

The taxpayer referred to the expiration of *six years* as being the time for which he had to *keep receipts*.

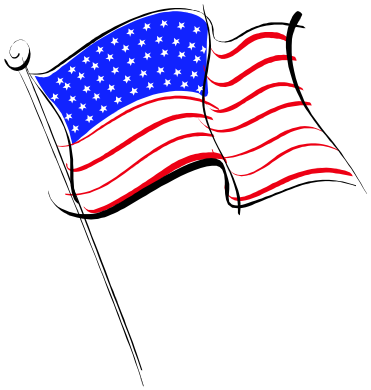
CRA successfully argued that this *six years* commences *after the year* to which the *costs relate*. Therefore, costs which become part of the ACB of the property must be maintained for *six years* after the property is *disposed*, not six years after the costs are incurred.

Related to the above, in a June 14, 2013 Technical Interpretation, CRA noted that permanent documents must be kept for a period ending two years following the dissolution of the corporation and the *general documents* must be kept for a period

ending *six years* following the last year for which they *relate*, unless the corporation is dissolved, in which case the period ends two years following the dissolution of the corporation.

It should be noted that, at the Tax Court, the *onus is on the taxpayer* to *prove the CRA is wrong*, not the other way around. "Innocent until proven guilty" is a principal of criminal law, and most tax disputes are not criminal in nature.

U.S. SNOWBIRD: Watch Out for the new U.S. Visa!



U.S. immigration reform legislation proposing to allow Canadians aged 55 and older to spend *240 days in the country* without a Visa is still on track to become law.

It is, however, noted that *provincial healthcare limits* on time spent out of the country ranging from 6 to 7 months could reduce the amount of time that an individual could spend regardless of the U.S. Visa changes.

Although immigration reform is being proposed, *taxation law* is not likely to significantly change. This means that individuals staying in the U.S. more than, say, 121 days in a year (based on complicated calculations) may still be deemed resident and find themselves exposed *to additional U.S. filings, tax*, and an assortment of other taxation issues. Individuals may be able to obtain some relief if they stay up to 183 days if they are considered to have a closer connection with Canada and complete the appropriate form.

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