July 2020 | KURT ROSENTRETER | Phone 416-628-5761 EXT 230

SECOND QUARTER 2020

Kurt Rosentreter Tax Planning Tips Q2 2020

Tax Tickler. . . some points to consider . . .

- Canadian controlled private corporations accounted for 54% of all corporate tax paid.
- The 1% of Canadians who earned income in the top federal tax bracket paid 26% of the total personal taxes.
- Of the 27.8 million individual tax filers, 36% were non-taxable.
- The home buyers' plan maximum withdrawal increased from $25,000 to $35,000 for withdrawals made after March 19, 2019. Also, it is now available for use by those experiencing a recent breakdown in their marriage or common-law partnership.

Tips: Reporting Issues

Tips received by servers and other individuals in the service industry are taxable. However, since tips do not show up on T4 slips, some taxpayers are under the false understanding that they are either not taxable, or only partially taxable.

Contents

Special Interest Articles

See Kurt's Comments Inside!

Tips: Reporting Issues (con't)

Kurt's Comments:

If you have service staff, remind them that tips are taxable and that they will now matter for various reasons. There is more incentive for CRA to review them, and they have had success applying gross negligence penalties.

In a February 3, 2020 Federal Court of Appeal case, the Court upheld the Tax Court decision that tips received by the taxpayer from his employment as a slot attendant at a casino were properly included in income and were not a windfall or gift. Further, the Court upheld gross negligence penalties (an extra 50% of the taxes at stake) in coming to the conclusion that the taxpayer displayed a "dismissive and indifferent attitude" in failing to enquire as to whether he should report the tips.

The taxpayer also raised the issue of procedural fairness. The length of time CRA took to process his objection, the amount of interest owed, and the fact that CRA may have settled with other taxpayers were not relevant to the taxpayer's case.

Canada Emergency Response Benefit (CERB)
During the COVID-19 shutdown of many businesses, many servers have relied on receiving payments under the CERB. To be eligible, the individual must have received at least $5,000 in 2019 (or in the 12 months prior to application) and cannot have earned more than $1,000 during the applicable four-week claim period (this rule varied slightly in the first claim period). Tips earned while working and declared as income counts toward $5,000 required previous earnings. Tips count towards the $1,000 test as well.

Canada Emergency Wage Subsidy (CEWS)
This subsidy, which aims to cover approximately 75% of the first portion of salaries, is dependent on the amount of "eligible remuneration" received by employees prior to, and during, the COVID-19 crisis. Controlled tips are included in eligible remuneration (and reported on T4 slips), direct tips are not. Controlled tips are those that an employer receives, controls (or possesses), and then pays an employee. Direct tips are those paid directly to the employee, or those in which the employer is merely a conduit (the employer has no control over the amount or distribution.

Real Estate Sales: Taxable or Not?

In general, gains are fully taxable where the taxpayer buys a property with the intention to sell for a profit (sold on “account of income"). In other cases, half the gain is taxable (sold on “account of capital”). When a sale on “account of capital” involves the sale of a principal residence, the tax may be reduced or eliminated by using the principal residence exemption.

In a December 13, 2019 French Tax Court of Canada case, at issue was whether two apartment buildings sold by the taxpayer were on account of capital (as filed by the taxpayer) or income (as assessed by CRA).

After acquiring the two apartment buildings, the taxpayer paid the tenants to voluntarily vacate their leases. The buildings were then renovated and sold for a profit. The taxpayer argued that it was only after the discovery of fundamental structural problems with the properties that the original plan to rent the units changed, and that the taxpayer decided to resell both buildings.

Taxpayer loses
The Court did not accept the taxpayer’s argument that the corporation did not have the funds to finance the renovations required due to the substantial structural problems, as it paid large amounts to the tenants to vacate the property. Also, it concluded that it was highly improbable that, at the time of acquisition, the taxpayer was not aware of the extent of the problems affecting the properties.

The following factors were also considered to indicate the property was acquired for resale:

- the period of ownership (up to 18 months) was very short;
- the director of the corporation was an experienced real estate businessman, indicating that he would likely have known he could make a profit by buying and selling the buildings quickly;
- the buildings were located in a popular and highly sought-after area of Montreal; and
- one of the buildings was funded fully by debt, with the other largely financed by debt. A portion of the purchase price was not due until a number of months after sale.

The Court ruled that, on the balance of probabilities, the intention of the taxpayer was to resell the properties at a profit. The sale was therefore on account of income and fully taxable.

Kurt’s Comments:

Retain documentation, (emails, letters etc.), which occurred at or around the time of purchase to support your position as to whether the property was acquired on account of income or capital.

Qualifying renovation

Taxpayer wins

The Court indicated that the taxpayer satisfied almost all, if not all, of the legislatively required purposes that the renovation assists with: gaining access to a dwelling, or mobility, access, functionality or reduction of harm within a dwelling (only one of these five purposes is required to satisfy this component of the definition). In addition, the Court observed that the renovations were of an "enduring and integral nature to the dwelling".

Home Accessibility Renovation Credit: Increase in Home Value?

When applying for the home accessibility tax credit (HATC), valued at 15% of up to $10,000 in expenditures per year, does it matter if the renovation increases the value of my home? Yes, and No.

In a December 12, 2019 Tax Court of Canada case, at issue was whether the taxpayer was eligible for a HATC claim for $10,000 of qualifying renovations for the 2016 year, the first year of this credit. The taxpayer's spouse was 76 years old and suffered from reduced mobility. The taxpayer incurred $11,000 in renovation costs at the taxpayer's home to remove steps the Court referred to as "rickety" and which had no railing or landing area with a very sturdy deck including a 5-foot wide stairway and aluminum railings.

CRA denied the claim on the basis that the renovations did not meet the definition of a "qualified renovation" and even if they did, they would be ineligible as they were made to enhance or maintain the value of the house. Note that a taxpayer is precluded from claiming the HATC where the primary intention of the renovation is to increase or maintain the value of the property. There was no dispute as to the wife being an "eligible individual", the house being an "eligible dwelling", and the taxpayer being a "qualified individual".

Working From Home During COVID-19: Home Office Expenses

In order for home office expenses to be deductible against employment income, the employee must be required by contract to incur such expenses, and one of the following has to be met:

i. The home is where the employee principally (more than 50% of the time) does their work.

ii. The employee uses the space exclusively to earn employment income, and it is used on a regular and ongoing basis for meeting clients, customers or other people in the course of performing employment duties.

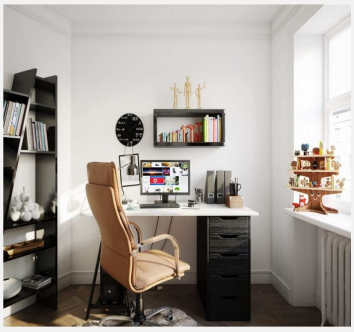
Given that the COVID-19 pandemic has required many to work from home, many more will likely be eligible under (i) than in previous years. However, at question is whether the workspace must be the main place of work in context of the entire year or just a specific period, such as the several months dictated by preventative COVID-19 measures. While CRA has not yet provided their comment, the tax preparation community has been pushing for guidance in time for next tax filing season.

If qualifying under provision (ii), a problematic issue is the requirement for regular and ongoing meetings. CRA has stated that those meetings must be in person; many tax publishers and journalists have noted that position is outdated and should include video and teleconference meetings as well.

What expenses are deductible?
A portion of household costs can be deducted, such as electricity, heating, water, rent, security and maintenance. If, and only if, the individual is a commissioned salesperson, a portion of property tax and insurance can also be deducted. No employee (neither commissioned sales persons nor regular employees) can deduct mortgage interest or capital cost allowance.

Kurt's Comments:

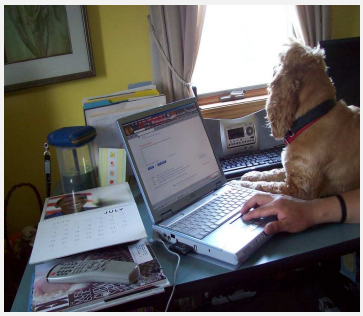
Make sure to keep all receipts for renovations that may qualify. Some renovations may also be eligible for a medical tax credit.



Working From Home: (Con't)

Kurt's Comments:

Make sure your employer agrees you need a home office and you pass the CRA rules.



When calculating the deductible percentage, a reasonable basis should be used, such as the area of the workspace divided by the total finished area (including hallways, bathrooms, kitchens, etc.). Expenditures that relate solely to the workspace and employment duties do not have to be prorated.

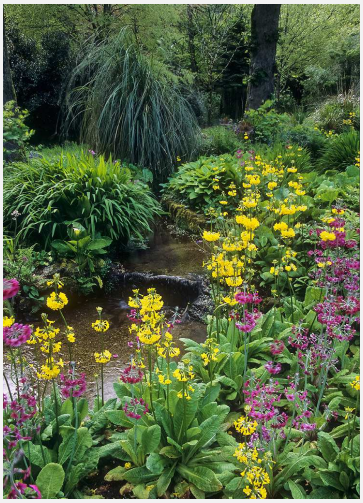
Other cautions

In addition, the employee must:

- obtain a completed T2200 (Declaration of Conditions of Employment) from the employer;
- prorate the personal usage based on space (portion of house) and time (portion of the day used for work);
- prorate expenses that do not relate to the portion of the year when working from home; and
- limit expenses to the amount of related income earned during the year.

For more information, see CRA Guide T4044.

Business Use of the Home: Eligible Expenses



A November 27, 2019 French Tax Court of Canada case reviewed various deductions claimed against the taxpayer's business income derived from engineering and arbitration services related to the business use of his home. The taxpayer and CRA had agreed that 35.83% of the home, mainly the basement which was used as a business office, was used for business purposes.

CRA had disallowed gardening and swimming pool maintenance costs which the taxpayer argued were business related as he met clients at his home and sometimes conducted arbitrations in the garden. He also argued that there was no personal use of the pool, but clients sometimes used it. CRA had also disallowed costs for repair and renovation of the living room, which the taxpayer argued made that room suitable for hosting arbitrations.

Business Use of the Home: (con't)

Kurt's Comments:

Consider which portions of the home, and which expenditures clearly tie to the business use of your home. Retain and obtain documents (like client emails and photos of work-spaces), which demonstrate how different portions of the home were used for business, and to what extent.

Taxpayer wins – in part

The Court accepted that the gardening expenses were ordinary home maintenance costs, deductible in proportion to business use of the home (35.83% as noted above), allowing a deduction of $1,271. The pool expenses were not allowed, on the basis these were not ordinary expenses of a business of this nature, and the Court was not convinced that clients used the pool. It was not relevant that the taxpayer and his wife did not use the pool.

Claims for repairs and renovations to the living room were denied as the taxpayer had ample space in the basement office and the garden to host arbitrations and conduct his other business activities. The living room was not part of the floor space making up the agreed 35.83% business portion of the home. As well, the evidence showed the renovations were required to comply with city regulations, including removal of a wood fireplace.

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