SPRYSAK- WINTER 2023

Table of Contents

UNIT #1: INTRODUCTION TO CANADIAN INCOME TAX LAW 3
- Source of Income Tax Law 3
- Purposes of Income Tax Law 3
- Important Components of a Commercially Published Act 4
- Income Tax Regulations 5
  - Subordinate Legislation 5
- Tax Treaties 5
- Persons Involved in the Creation and Administration of Income Tax Law 6
  - The Canada Revenue Agency 7
- Overview of the Legislative Process 7
- Tax Cases 8
  - Tax Court 8
- Canada Revenue Agency Publications 9
- UNIT #2: WHO IS SUBJECT TO TAX? 11
- General Requirements 11
  - Tax payable by persons resident in Canada 11
  - Who is a Person? 11
  - What does it mean to be a "Resident in Canada"? 12
  - Canadian Taxation of Non-Residents 21
- Taxation of Indigenous Peoples 22
  - *The Royal Proclamation, 1763* 22
  - S 87 of the *Indian Act* and Key Jurisprudence 22
  - Recent Developments in Indigenous Tax Planning 24

UNIT #3: A BRIEF OVERVIEW OF THE TAXATION OF CORPORATIONS AND TRUSTS? 25
- A Brief Overview of Corporations 25
- Residence of a Corporation 27
  - Statutory Deeming Rules 27
  - Common Law Test 27
- A Brief Overview of Trusts 29
  - Types of Trusts 29
  - Purpose of Trust 29
  - Trusts and Taxes 29
  - Residence of a Trust 32

UNIT #4: THE ADMINISTRATION OF INCOME TAX LAW 34

General Overview of the Tax Administration Process 34
Miscellaneous Points about the Tax Dispute Resolution Process 38
Disputes and Interest 39
The Burden of Proof in Tax Appeals 39
Settlements 41
UNIT #5: THE MECHANCS OF INCOME TAXATION 41
Overview 41
What is taxable income? 42
Tax Deductions vs Tax Credits 49
Deductions 49
Credits 50
Utilizing Tax Deductions and Tax Credits 50
When Does Taxable Income Have to be Calculated and Reported? 51
UNIT #6: Employment Income 51
Overview of the Taxation of Employment Income 51
Characterizing the Relationship between a Service Provide and Service Recipient for Income Tax Purposes 52
Tax and Non-Tax Implications of being in an Employment or Business Relationship 53
Determining the Characterization of a Service Provider for Income Tax Purposes 55
The Role of Parties' Intention in Characterizing their Relationship 58
Incorporated Employees 58
What is included in employment income? 59
Taxable (and Non-Taxable) Allowances and Reimbursements 60
Allowance 60
Reimbursement 60
A Brief Overview of Selected Statutory Taxable Benefits 61
S 6(1)(a)- Taxation of Other Employment Benefits 62
Statutory, Common Law, and Administrative Exceptions 63
Valuation 64
Employment Deductions 64
UNIT #7: Business and Property Income 66
What is a Business for Income Tax Purposes (and what is not)? 66
Business Income Distinguished from Property Income 67
Types of Property Income 69
Business Income Distinguished from Capital Gains 70

Characterizing an Asset vs Characterizing the Income from that Asset 72
The Election for Capital Gains Treatment 72
The Calculation of Income from a Business or Property 73
An Overview of the Deductibility of Employment Expenses and the Inclusion of Employment Income . 77

UNIT #1: INTRODUCTION TO CANADIAN INCOME TAX LAW

Source of Income Tax Law

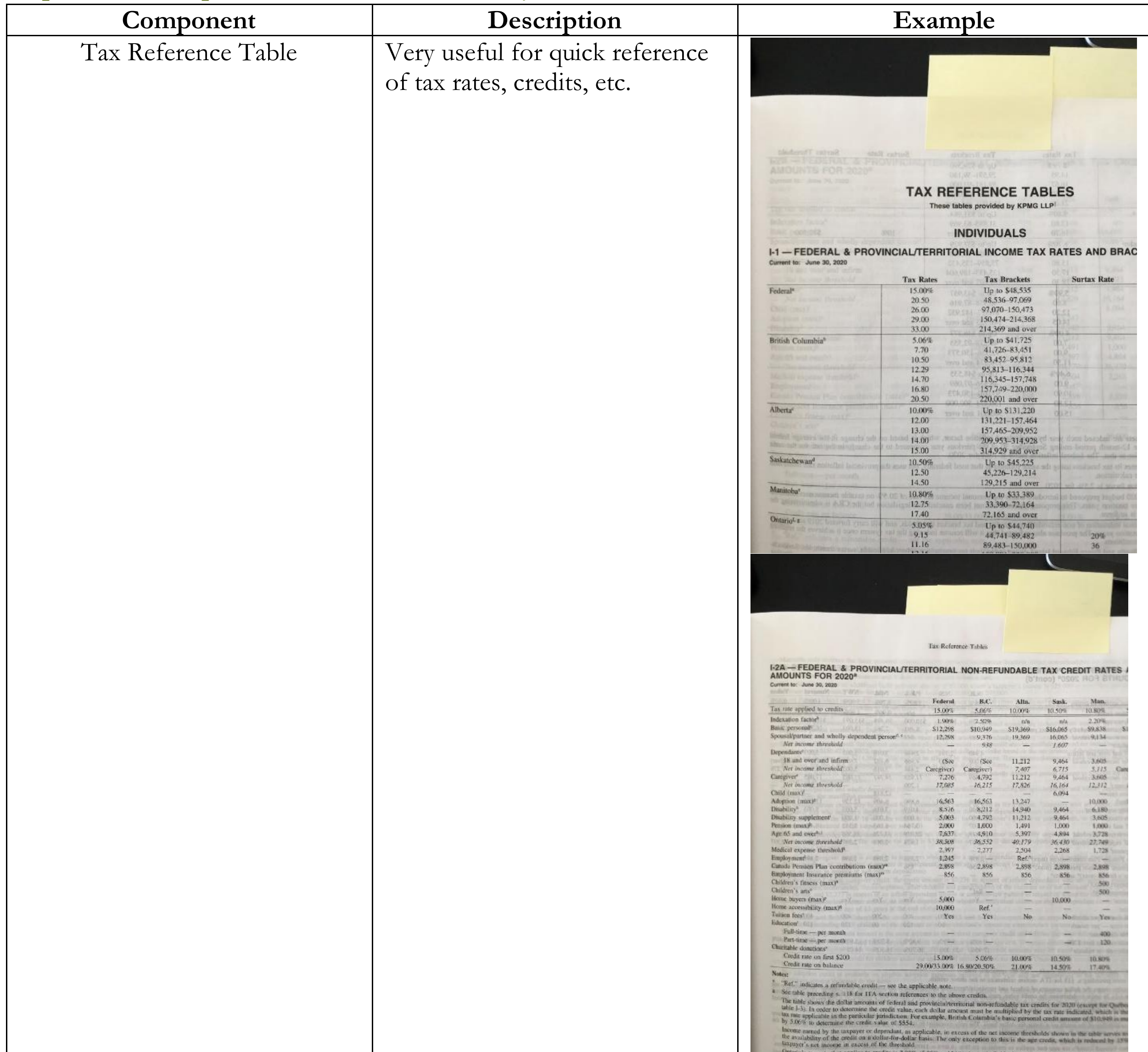
- The primary source of income tax law in Canada is the *Income Tax Act* as amended.
  - This is a Federal legislation that imposes Federal income taxes
  - The Act levies incomes taxes on individuals, corporations and trust and thus constitutes an extremely important revenue stream:
    - Approx. $316 billion in 2020/2021
      - $175 billion from personal income tax (55%)
      - $54 billion from corporate income tax (17%)
      - $32 billion from GST (10%)
- Each province and territory have enacted their own legislation for provincial/territorial taxes
  - Generally, these legislations use the Act to calculate net income and taxable income and then tax these with their own enacted tax rates and tax credits different from the federal tax.
    - With the exception of the Alberta corporate income tax and Quebec personal and corporate income taxes, which are "stand-alone" legislations.
  - While provinces also receive much of their revenues from taxes, generally speaking:
    - Taxation revenue as a percentage of total revenues is less significant than federally, and
    - Is more balanced between income taxes and consumption taxes
      - With exception of AB not having a GST, but making up for it in other resource-related revenues.

Purposes of Income Tax Law

- **Primary purpose is to Raise Revenues** as discussed above.
- **Tax Expenditures**: In addition to raising revenues, countries typically use their income tax regime to provide benefits (in form of credits, deductions, or exemptions) to its constituents.
  - An expenditure because it costs the government money, normally in foregone taxes.
  - For some programs, the government will pay the recipient money if the recipient is not taxable. This is referred to as a "refund".
  - Generally speaking, these programs could be administered outside of the income tax regime as a separate "spending program", but instead, the government has incorporated them into the Act.
    - For example, government could pay each post-secondary student $1000 to assist with educational costs, but instead our current regime is to given students a tax credit.
  - The reason the Act includes tax expenditures is because it requires a person to complete a tax return to access benefits which encourages and enhances compliance and regular reporting.
    - It is also more efficient.

- Each year the government creates a tax expenditures report which quantifies the cost of all tax expenditures.

Important Components of a Commercially Published Act

Component	Description	Example
Tax Reference Table	Very useful for quick reference of tax rates, credits, etc.	

TAX REFERENCE TABLES

These tables provided by KPMG LLP[1]

INDIVIDUALS

I-1 — FEDERAL & PROVINCIAL/TERRITORIAL INCOME TAX RATES AND BRAC

Current to: June 30, 2020

	Tax Rates	Tax Brackets	Surtax Rate
Federal[a]	15.00%	Up to $48,535	
	20.50	48,536–97,069	
	26.00	97,070–150,473	
	29.00	150,474–214,368	
	33.00	214,369 and over	
British Columbia[b]	5.06%	Up to $41,725	
	7.70	41,726–83,451	
	10.50	83,452–95,812	
	12.29	95,813–116,344	
	14.70	116,345–157,748	
	16.80	157,749–220,000	
	20.50	220,001 and over	
Alberta[c]	10.00%	Up to $131,220	
	12.00	131,221–157,464	
	13.00	157,465–209,952	
	14.00	209,953–314,928	
	15.00	314,929 and over	
Saskatchewan[d]	10.50%	Up to $45,225	
	12.50	45,226–129,214	
	14.50	129,215 and over	
Manitoba[e]	10.80%	Up to $33,389	
	12.75	33,390–72,164	
	17.40	72,165 and over	
Ontario[f, g]	5.05%	Up to $44,740	
	9.15	44,741–89,482	20%
	11.16	89,483–150,000	36

Tax Reference Tables

I-2A — FEDERAL & PROVINCIAL/TERRITORIAL NON-REFUNDABLE TAX CREDIT RATES A AMOUNTS FOR 2020[*]

Current to: June 30, 2020

	Federal	B.C.	Alta.	Sask.	Man.
Tax rate applied to credits	15.00%	5.06%	10.00%	10.50%	10.80%
Indexation factor	1.90%	2.50%	n/a	n/a	2.20%
Basic personal	$12,298	$10,949	$19,369	$16,065	$9,838
Spousal/partner and wholly dependent person	12,298	9,376	19,369	16,065	9,134
Net income threshold	—	*938*	—	*1,607*	—
Dependants					
18 and over and infirm	(See	(See	11,212	9,464	3,605
Net income threshold	Caregiver)	Caregiver)	*7,407*	*6,715*	*5,115*
Caregiver	7,276	4,792	11,212	9,464	3,605
Net income threshold	*17,085*	*16,215*	*17,826*	*16,164*	*12,312*
Child (max)	—	—	—	6,094	—
Adoption (max)	16,563	16,563	13,247	—	10,000
Disability	8,576	8,212	14,940	9,464	6,180
Disability supplement	5,003	4,792	11,212	9,464	3,605
Pension (max)	2,000	1,000	1,491	1,000	1,000
Age 65 and over	7,637	4,910	5,397	4,894	3,728
Net income threshold	*38,508*	*36,552*	*40,179*	*36,430*	*27,749*
Medical expense threshold	2,397	2,277	2,504	2,268	1,728
Employment	1,245	—	Ref.	—	—
Canada Pension Plan contributions (max)	2,898	2,898	2,898	2,898	2,898
Employment Insurance premiums (max)	856	856	856	856	856
Children's fitness (max)	—	—	—	—	500
Children's arts	—	—	—	—	500
Home buyers (max)	5,000	—	—	10,000	—
Home accessibility (max)	10,000	Ref.	—	—	—
Tuition fees	Yes	Yes	No	No	Yes
Education					
Full-time — per month	—	—	—	—	400
Part-time — per month	—	—	—	—	120
Charitable donations					
Credit rate on first $200	15.00%	5.06%	10.00%	10.50%	10.80%
Credit rate on balance	29.00/33.00%	16.80/20.50%	21.00%	14.50%	17.40%

Notes:

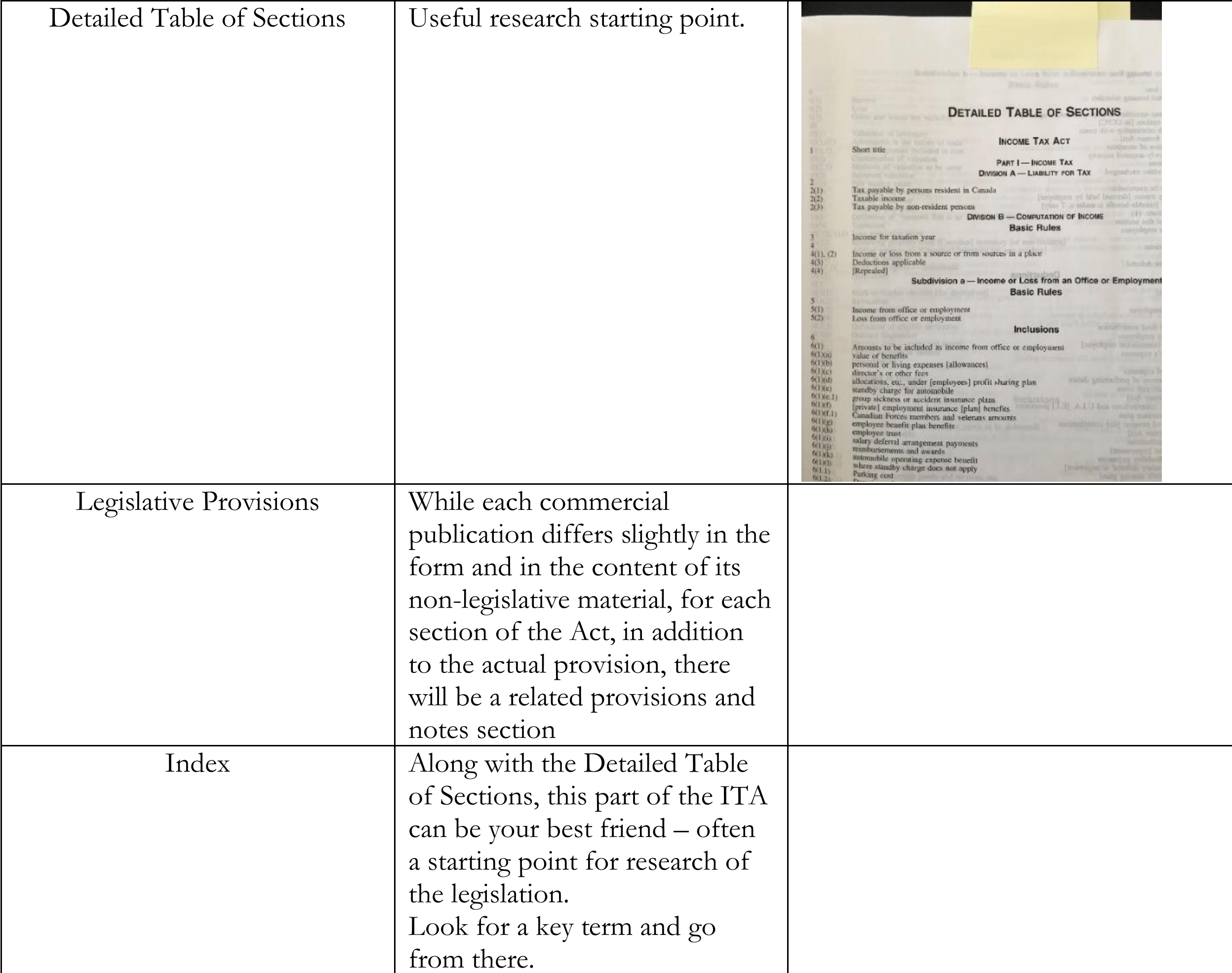
* "Ref." indicates a refundable credit — see the applicable note.

a See table preceding s. 118 for ITA section references to the above credits.

The table shows the dollar amounts of federal and provincial/territorial non-refundable tax credits for 2020 (except for Quebec table I-3). In order to determine the credit value, each dollar amount must be multiplied by the tax rate indicated, which is the tax rate applicable in the particular jurisdiction. For example, British Columbia's basic personal credit amount of $10,949 is m by 5.06% to determine the credit value of $554.

Income earned by the taxpayer or dependant, as applicable, in excess of the net income thresholds shown in the table serves the availability of the credit on a dollar-for-dollar basis. The only exception to this is the age credit, which is reduced by 15% taxpayer's net income in excess of the threshold.

Ontario's tax rate that applies to credits is 7.88% (5.05% × 156%) for an individual who is subject to the 56% surtax

Detailed Table of Sections	Useful research starting point.	
Legislative Provisions	While each commercial publication differs slightly in the form and in the content of its non-legislative material, for each section of the Act, in addition to the actual provision, there will be a related provisions and notes section	
Index	Along with the Detailed Table of Sections, this part of the ITA can be your best friend – often a starting point for research of the legislation. Look for a key term and go from there.	

Income Tax Regulations

- **Paragraph 221(1)(a)** provides that the Governor in Council may make regulations "prescribing anything that, by this Act, is to be prescribed or is to be determined or regulated by regulation:
- Some of the more common/popular Regulations are those that specify the rates of depreciation for certain capital assets for tax purposes, and the tax-free mileage allowance that an employer can pay to an employee for work-trips- which in some cases are updated on a yearly basis.

Subordinate Legislation

- More efficient
- In the tax world, the federal government will have main authority over provisions, and then the smaller stuff that needs to be adjusted yearly (like how much can be paid into TFSA) can be made through delegation.

Tax Treaties

- Canada levies income taxes in two general situations:
  1. On **persons** who have a **close connection to Canada**
     - Specifically, where such person is a resident of Canada
     - Canada taxes a resident's WORLDWIDE income
  2. On **income** that has its **source within Canada**

  - Source taxation applies where the person earning the Canadian-sourced income is a non-resident of Canada
  - In this situation, Canada will only tax this Canadian-source income
    - In many cases, non-residents will have to file a Canadian income tax return to report (only) their Canadian source income
    - In some cases, the Canadian resident paying the non-resident will have obligations in respect of those payments (even though it is the non-resident's income ad associated Canadian tax liability)
- Most countries levy incomes taxes based on similar connections (residency and income connections)
  - Other connections include citizenship and domicile.
    - USA is one of the two countries in the world that taxes ALL citizens even if you do not live or work in the USA on their worldwide income.
    - Domicile = a place that you live AND intent to live indefinitely.
- As a result of people living and working in different places, it is not uncommon for a person to be subject to "double tax" on some or all of their income.
  - Example: Canadian resident who sources income from US would be subject to paying both Canada and US taxes on their worldwide income
  - To alleviate this "double-tax" problem, bi-lateral tax treaties exist.
    - These treaties effectively override a country's domestic tax legislation in certain specified situations and prevent one of the countries from taxing the person or income.
      - Tax treaties don't make or impose taxes, but create law on which provisions cannot be created to prevent double taxing.
    - A person seeking treaty relief must be eligible for it and generally must elect for the treaty to apply.
    - In addition to tax treaty relief, or in some cases when tax treaties do not exist, the Act contains foreign tax credits which can be used to reduce or eliminate double taxation.
- While the elimination of double-tax was the initial motivation for the creation of bi-lateral tax treaties, they are also used to:
  - Assist in the mutual enforcement of each country's tax legislation
  - Share tax information
    - In recent year, Canada has been entering into Tax Information Exchange Agreements with several countries with which it does not have a tax treaty.
- Included in all commercial publications of the Act are the Canada-US Tax Treaty and the Canada-UK Tax Treaty.

Persons Involved in the Creation and Administration of Income Tax Law

- 4 key players involved in the creation and administration of income tax law in Canada:
  1. **The Department of Finance:**
     - Makes key tax policy decisions (with input from PM's Office and Cabinet) and drafts the associated tax legislation
  2. **The Department of National Revenue:**
     - Administers the Act through the CRA
     - CRA administers both federal and provincial tax collection because it is more efficient
  3. **The Department of Justice**
     - Represents the Minister of National Revenue/CRA in court
       - DOJ is not really CA's lawyer because the DOJ is responsible for making sure the law is properly enforced.

        - Do not protect CRA when they are breaking the law, and do not follow CRA"s instructions.
        - DO what is right to make sure justice is being served
4. **The Court System:**
    - Interprets and applies the legislation as well as supplements such legislation through its common law decisions

The Canada Revenue Agency

- Technically speaking, the CRA does NOT make the law, it just enforces it and must comply with it just as all tax payers do
- However, it effectively makes some law through their interpretations of the law as well as their administrative positions/policies on how they will apply the law

Overview of the Legislative Process

- Generally, the enactment of new (federal) tax legislation typically begins with the Minister of Finance delivering the government's Budget in the House of Commons
    - Tax law DOES have to go through same process as all other bills being passed
        - BUT the formation of the law may not be a public/consultation process as we do not want to change public behaviours and create some uncertainty about what changes will be made
        - That being said, in more recent year, the government has been more transparent by announcing consultations on a particular topic of potential tax reform.
- At the time the budget is announced, the government releases of Notice of Ways and Means Motion to amend the Act, which is generally drafted using "ordinary language"
    - They will also release a draft of the proposed legislative changes, accompanied by Explanatory or Technical Notes intended to explain the purpose of each amendment.
        - In practice, these explanatory and technical notes are extremely valuable to taxpayer, practitioners, and judges as they give some insight into what the government was concerned about and trying to accomplish with the new legislation
            - Whether the government was successful in realizing its intention is ultimately determined by the courts though
- Following the delivery of the Budget, there is a debate on it in the House of Commons
- Sometime after the delivery of the Budget and debate, the government will introduce a Bill to the House of Commons to implement the proposals set out in the Notice of Ways and Means Motion
    - Just as other bills, it will go through 3 readings in the House, be debated and refined and sent to Parliamentary subcommittees, and be reviewed by the Senate before receiving Royal Assent
- When the bill becomes law upon receiving Royal Assent, the general practice is that at the time of Royal Assent, the legislative amendments become **effective retroactive to the Budget date when they were first announced** (unless otherwise specified to be a particular date or event)
    - This prevents taxpayers and practitioners from being able to plan into the existing ules or proposed amendments
- Amendments are shown in commercial publications of the Act by shading prior to receiving Royal Assent and are generally followed as if they were law
    - The government has never not passed a tax law, to do so, would be chaos.
    - If a new government gets elected, they would just make new legislation that would overturn the legislation they did not like, and the old would still apply up until the date of the new legislation.

Tax Cases

- The primary court of first instance for tax cases today is typically the **Tax Court of Canada,** which was created by the *Tax Court of Canada Act* in 1983.
  - **Section 12:** This Court has **exclusive original jurisdiction** to hear appeals with respect to various matters and statutes including the *Income Tax Act*.
- However, not all tax matters come before the Tax Court as the court of first instance as it depends on the issue at hand.

  For example:
  - **Criminal matters** (such as s 239 tax evasion) will be heard either in **Provincial Court or Court of King's Bench** (depending on if summary or indictment) and any available election
  - **Application for judicial review in respect of CRA decisions** where the Act gives CRA discretionary decision-making powers (ie. power to waive interest and penalties on outstanding assessments) must be done in **Federal Court**
  - **Applications in respect of the CRA's use of its audit and investigatory powers** under the ITA (ie. search and seizures, requests for info from 3rd parties, e) must be done in **Federal Court or a superior court in the province**
  - **Appeals from CRA decisions with respect to the registration and deregistration of charities, pension plans** and other entities under the ITA- appeals must be initiated at the **Federal Court of Appeal** (without first having a hearing before a trial judge)
  - **Determinations of residency for provincial/territorial tax purposes** are done in the **Court of Queen's Bench** of the relevant/seeking province unless said province ITA specifically gives the Tax Court this power (which no province has done)

Tax Court

- **Section 20** provides that the Tax Court has the ability to make its own Rules of Court
  - Which it has done, so make sure you consult it as the rules might be different than those in your province
- Tax Court is a national court that hears cases throughout the country
- Two types of hearings:
  1. **General Procedure** cases:
     - Have all the trappings of a KB case including:
       - Examinations of discovery/documents
         - Per subsection 17.3(1), the right to an oral examination for discovery may be restricted if the amount in issue is $50,000 or less.
       - Expert witnesses
       - Full precedential value
         - Decisions will form part of the common law
         - Tax Court is bound to follow decisions of superior courts
         - If bi-lateral presidential hearing, the decision will be very influential
       - Cost awards
       - Appeal rights
     - Per section 17.1, only a lawyer or the taxpayer herself can run this type of case
     - Per subsection 17.1(2), there is no special "tax bar", any lawyer can appear before this Court.
  2. **Informal Procedure** cases:
     - More stream-lined and intended to be faster, less costly and more accessible to the general public
       - Analogous to Small Claims Court
     - These cases do not follow the full litigation procedure and:

        - Not bound by the rules of evidence as per subsection 18.15(3)
            - Tax Court Justices still look for evidential safeguards, particularly when evidence is being provided by a taxpayer or taxpayer's witness.
        - No general right of appeal (confined to judicial review)
        - No full schedule of costs
        - No precedential value as per section 18.28
            - Still persuasive though
    - For income tax cases, to qualify for informal procedure, **amount of federal tax and penalties in dispute for each taxation year, excluding interest, must be $25,000 or less** as per section 18
        - If more than $25,000, can elect to dispute only $25,000 in informal procedure
            - This means to give up and pay the rest owing.
    - Does not have to be a lawyer or the taxpayer to run the case
        - Can be accountant, husband, etc.
            - Courts have said they prefer accountants if someone cannot get a lawyer.
    - Appeals from the Tax Court are to the Federal Court of Appeal and then to the SCC (by leave of the Court)

Canada Revenue Agency Publications

- To assist taxpayers (and tax practitioners) in complying with the Act, the CRA issues a variety of different publications.
    - Some of the more common and comprehensive ones are:
        - **Income Tax Folios**
            - These publications are currently being issued to replace Interpretation Bulletins.
            - Both Folios and Interpretation Bulletins are intended to provide people with **summaries of the law and the CRA's interpretation of the law** on a subject-area basis
                - Neither the summaries or interpretations are binding upon the CRA nor should they be blindly relied upon by taxpayers as reflecting the current law
                    - That being said, where taxpayers have relief upon CRA advice and it turns out they have an outstanding tax liability (when the correct law is applied), the court will typically direct the CRA to waive any associated interest and penalties if assessed.
            - A secondary source whose goal is to provide information on a topic basis of not only the law but the CRA's interpretations and polices of administration.
        - **Information Circulars**
            - Provide information on **how to comply** with the Act rather than summaries and interpretations of substantive tax law
        - **Advance Tax Rulings:**
            - Rulings given by the CRA (Income Tax Rulings Directorate) on a proposed series of transactions as to what they believe the tax effects will be.
                - There are a number of informational requirements that must be satisfied to constitute a valid ruling request.

- Stated purpose of a ruling "is to promote voluntary compliance, uniformity, and self-assessment by providing certainty with respect to the application of Canadian income tax law to proposed transactions"
    - There is no "appeal" from an ATR
- It is important that the system is perceived to be fair to ensure compliance, re-election, lower administration costs, and harmonious living with your neighbour.
- To obtain an ATR, a taxpayer and her advisors must furnish the CRA with complete disclosure of the facts or transactions contemplating along with a cheque for services to be rendered.
    - As of April 1, 2022, the hourly rate is $221.44 (and increases to $281.22 on April 1, 2023).
- The CRA states that it will abide by its ATR subject to any qualifications stated in the ruling
- However, when there is a material omission or misrepresentation in the statement of relevant facts or the proposed transactions submitted by the taxpayer or the taxpayers authorized representative, the advanced income tax ruling will be considered invalid and the CRA will not be bound by it.
    - Further, if the law changes prior to the transactions being fully completed/implemented, then the ATR will similarly not apply.
- To assist other taxpayers, ATR's are published by commercial tax publishers (after taxpayer specific information is removed)
- The CRA is under no obligation to issue an ATR and can refuse to issue one
    - It has stated that it generally will not issue a ruling where the request concerns "primarily a factual or legal determination"
        - Ie. residence, income vs capital, or carrying on a business
- The CRA is also willing to do a pre-ruling consultation to discuss a particular (usually novel) tax issue to determine whether the taxpayer should submit a ruling request.
    - Allows for a taxpayer to discuss with the Directorate any unique, new technical issue that is critical to the structuring of a definite transaction that a taxpayer is contemplating in advance of submitting a Ruling request.
    - There is a fee for a pre-ruling.
    - Pre-ruling requests must be issued in writing.
    - Pre-ruling consultation is a teleconference to receive comments b the Directorate.
- Essentially helps taxpayers who are contemplating doing something by telling them what the potential outcome could be from doing it.

- **Technical Interpretations (Tis)**
    - Similar to ATRS in that you are asking the CRA for their interpretation/position
    - A Ti "explains the CRA's interpretation of specific provisions of Canadian income tax law. It might not extend to all situations and is not determinative of the tax treatment of a specific taxpayer's situation."
    - Generally speaking, a TI:
        - Is of a particular provision rather than to a proposed transaction

- Is done on a "no-names" basis (as opposed to full disclosure)
- Is not subject to any fees from the CRA, and
- Is not biding on the CRA (although they likely would follow it – it would also have value in defending against possible gross negligent penalties)
  - PARA 7 for when CRA may not issue a TI.
  - Where a tax professional or corporation makes a request for a TI then the requester must include a detailed analysis.

UNIT #2: WHO IS SUBJECT TO TAX?

General Requirements

Tax payable by persons resident in Canada

- **Subsection 2(1)** provide that "every person resident in Canada at any time in the year" will be subject to Canadian income tax on their "taxable income"
  - This means that for ALL of your taxable income to be subject to Canadian income tax, you must:
    - Be a "**person",** and
    - Be "**resident in Canada**"
  - If you are not a person, then you are not subject to Canadian income tax.
    - Generally speaking there are common Canadian entities that do not constitute persons.

Who is a Person?

- This is a question of statutory interpretation. Therefore, the proper approach is as follows:
  - First see if the legislation or case law has a special definition of the word for purposes of the legislation.
    - Here, we look to the definitions in s 248(1) which is an inclusive definition (meaning you should also consider dictionary definition):
      - Includes corporations
      - Includes tax exempt entities as defined in s 149(1)
        - Charitable organizations
        - Churches
        - Schools
        - Governments
        - Non-profits

        All whom still must file a tax return (or else status may be revoked)
      - Includes both *inter vivos* and testamentary trusts.
      - Includes the individual (even though not specifically mentioned in this section)
  - If not in legislation, general rule is that the ordinary dictionary definition applies or past jurisprudence interpretation of the word.
- Things that are NOT persons:
  - A partnership.
    - Very generally, partners will be taxed on their share of partnership income as if the partner's, not the business, earned it directly.

- However, some provisions explicitly state for certain purposes a partnership is deemed to be a person.
  - Example= s 96(1).

- If you are a person and not resident in Canada then all your taxable income will NOT be subject to Canadian income tax, BUT:
  - Pursuant to subsection 2(3) (as supplemented by section 115) and section 212 (and subsequent sections in Part XIII), certain income that can be sourced to Canada will be subject to Canadian income tax (unless eliminated by an applicable tax treaty).

What does it mean to be a "Resident in Canada"?

- Just as determining who is a person, the starting point is the legislation.
  - Other than the definition of "ordinarily resident" in s 250(3), there is no general definition of a resident in the Act.
    - S 250(3): "In this Act, a reference to a person resident in Canada includes a person who was at the relevant time ordinarily resident in Canada"
      - This provisions makes a person a Canadian resident in an "extraordinary" year if they were ordinarily a Canadian resident.
  - However, there are statutory deeming rules which provide that such a person will be deemed to be a resident where the requirements are satisfied.
- Generally speaking, when a person's residency for income tax purposes is in issue, the person is usually hoping not to be a Canadian resident, as that will require them to pay Canadian income taxes on their worldwide income.
- Therefore, to determine whether a person is a resident for Canadian income tax purposes, we have to consider (in this order):
  - The applicable common law definition/test, and
    - The common law residency tests are generally applied to the person's "ordinary facts" and not their extraordinary, unusual, or temporary facts
      - For instance, if an Edmonton family takes a 2-week Disney vacation, then that won't generally change their Canadian residency status (as the holiday is extraordinary)
  - Any applicable statutory deeming rules.

  If either of the tests are satisfied, then you are found to be a common law resident.
- To assist taxpayers and tax practitioners in answering this very important issue in respect of individuals, the CRA has issue Income Tax Folio S5-F1-C1: *Determining an Individual's Residence Status*

Common Law Test

- The leading authority is *Thomson v Minister of National Revenue*

  Facts:
  - T was born in NB and spent the next 50 years living and working Canada
  - After retiring from his business activities and getting into a property tax dispute, he decides to cease being a Canadian citizen and move to Bermuda.
  - While he rented a home in Bermuda and obtained a Bermuda passport, he did not actually spent much time there

- He spent most of his time in North Carolina and NB, first in rented homes and then in homes owned by his corporation.
- He was very careful not to stay more than 183 days in Canada per calendar year to avoi the "sojourner rule"
- For the 1940 tax year he was assessed as a Canadian residence and hence subject to tax his worldwide income.

Issue: Is Thompson a Canadian resident?

Analysis:

- Residence for income tax purposes is "chiefly a matter of the degree to which a person in mind and fact settles into or maintains or centralizes their ordinary mode of living with its accessories of social relations, interests, or conveniences at or in the place in question.
  - The quote above is also set out in Folio S5-F1-C1 para 1.5
- In defining a resident, Justice Rand also looked to the dictionary definition of residence:
  - **To dwell permanently or for a considerable time, to have one's settled or usual abode, to live, in or at a particular place.**
- Justice Rand also distinguished "ordinarily resident" from "occasional, casual, or deviatory" residence, which is essentially sojourning.
- In a concurring decision, Justice Estey defined ordinarily resident as "the place where in the settled routine of his life, he regularly, normally, or customarily lives"

- **Comprehensive Factual Analysis:**
  - To ascertain if an individual is resident in Canada, one mut conduct a comprehensive factual analysis to see if the definition of residence in the common law test is satisfied.
  - Five main categories of ties/connections an individual may have to Canada (not the other country), namely:
    1. **Residential ties**
       - Where the individual in question currently lives in Canada and/or has available to live in Canada either immediately or in the short term, then this will be a very strong factor supporting the individual being a Canadian resident under the common law/
       - Look to potential living arrangements people can have in Canada while living abroad.
         - Renting out your place where you live abroad for a time will sever residential ties so long as you cannot come home and kick renters out.
           - So should sign a longer term lease (min. a year)
           - Cannot rent to a friend or family member
         - If you have your place listed to sell or rent, then court will look to intention.
           - Are you actively trying to sell and putting in effort?
           - If there is clear intention to try and get id of a place, then it is more likely to sever residential ties.

        - **Residency Inertia**: While technically, residency is determined at a point in time, once someone is properly found to be a Canadian resident under the common law test, then this status will be assumed to continue absent very significant factual changes in the person's situation.
            - Generally, unless an individual severs all significant residential ties with Canada upon leaving, the individual will continue to be a factual resident and subject to Canadian tax on their worldwide income. (*Folio S5-F1-C1*)
        - **Relevance of Family Residential Ties:**
            - The courts have generally found that if immediate family members (dependent children/spouse) continue to reside in Canada this counts as a strong residential tie.
                - This is based on the rebuttable presumption that immediate family members generally live together.
                    - So if they are apart this is a temporary situation and not a severance of ties to the country unless credible evidence can be provided.
            - Non-immediate family (grandparents, siblings, parents, independent adult children) does not count as a strong residential tie.
        - **Physical Absence from Canada:**
            - No specific amount of time an individual must be absent from Canada to guarantee a finding that the individual is a non-resident.
                - CRA used to have a policy that min. time out of country had to be 2 years, but this no longer exists.
                    - However, many individuals (including professional) continue to believe in the "magic 2 year" rule.
            - A factual analysis will still be performed in all cases.
            - If return to Canada is foreseen, (ie a set employment contract abroad), then this count's as the individual still having remaining ties in Canada. (*Folio S5-F1-C1*)

2. **Location of Personal Property**
    - For example, selling your home but putting all your furniture in storage comes across as the individual perhaps showing intent to come back and reside in Canada.
    - Keeping a car in Canada.

- Logic here is that if there was true intention to not come back, you would get rid of personal property and bring it over.

3. **Economic ties**
   - Where does a person work and earn a living/generate income?
4. **Social ties**
   - What organizations does the individual belong to and participate in?
   - Where are these organizations located?
   - Maintaining memberships to certain gyms or club that cannot be used elsewhere indicates a tie to Canada.
5. **All other ties/connections**
   - Landed immigrant status or appropriate work permits in Canada
   - Canadian hospitalization and medical insurance overage
   - Driver's license
   - Canadian passport

- Most influential are residential ties, but all should be considered.

Part Year Residence

- **Section 114:** Where an individual is resident in Canada for part of a taxation year and a non-resident for the other part, the individual's worldwide income will be taxes for the period of time they were a resident and tax only the Canadian-sourced income for the other part of the year.
- Can be part-resident under common law rule, but not under statutory deeming rule.

Miscellaneous Points on Individual Residency under Common Law

- Every person has at least one resident for tax purposes at all times.
  - It is impossible to not be a resident of a country for tax purposes.
  - If a Canadian resident purports to sever their residency but does not appear to acquire a new residence, then the individual's remaining ties to Canada "may take on greater significance and the individual may continue to be resident in Canada" (*Folio 5-F1-C5*)
- A person may be a resident in more than one country at a time (which is something that leads to the double-tax problem)
  - Generally, being resident in another jurisdiction does not prelude an individual from additionally being a Canadian resident.
  - It is an examination of the residential ties (or lack thereof) to Canada which will govern the result for Canadian tax purposes – as opposed to establishing the residential ties to another jurisdiction.
    - Not about proving significant ties to another country, but about proving lack of ties to Canada
- Residence is primarily a question of fact.
  - So is the date of acquiring or severing residence (para 1.22 of *Folio S5-F1-C5*)
- While a taxpayer's intention to reside in a particular jurisdiction may be relevant in deciding whether a taxpayer is a Canadian resident, the intention is not determinative, but "must always be viewed objectively against all the surrounding facts"
  - Where intention has been considered by the courts, it has most often been an "objective manifestation of intention" (intention

derived from the facts in the case) as opposed to subjective manifestation by the taxpayer.
    - Further, there have been cases where courts have said intention is irrelevant
  - Standard of review in residency cases (at FCA and SCC level) is reasonableness
    - This means that to overturn the Tax Court's decision, the appellant must prove on a BOP that the Tax Court made a "palpable" and "overriding" error. (obvious error that changed the outcome of the case)
    - Basically, taking a residency case to court is your one and only appeal.
  - Given the uncertainty that always exists with using a factual analysis to answer a legal question, the CRA will provide a ruling on an individual's Canadian residency status if the individual submits a completed form NR-73 (if leaving Canada) or NR-74 (if entering Canada)

Provincial Residency for Individuals

- Once it is determined that an individual is resident in Canada using the common law indicia and has to pay federal tax, the next step is to determine where the individual is resident for provincial/territorial tax purposes.
  - This is significant as provinces have varying tax rates.
- Just as determining Canadian residency under the common law, the same basic test is used for determining provincial resident with one important medication.
  - For provincial tax purposes, the test is applied on **December 31 of the year** and the results of the test determine the individual's residency for the entire taxation year.
    - Where an individual ceases to be a Canadian resident before the end of the year, then the test is applied as of the last day the person was a Canadian resident (and then applies for that taxation year up to the point in time that the individual ceased to be a Canadian resident)
    - This does not mean whatever province you are physically present in on December 31 is the province you pay taxes to. It just means you can only be resident of ONE province for the ENTIRE year and Dec 31 is the day you apply the common law test for facts and circumstances on that day!
- Further, where an individual has residential ties in 2+ provinces on Dec 31, then **Regulation 2607** provides that you "break the tie" by selecting that province which may reasonably be regarded as the person's "principal place of residence."
  - Look to all ties to each province.
  - Where do you intend to return to if traveling between two province?
  - Address is not determinative of place of residence.
- This test creates a tax planning opportunity.
  - Specifically, if you are moving from a higher-taxed province to a lower one, you want to do that before Dec 31 to enjoy this year's tax savings.
  - Conversely, if you are moving from vice-versa you want to do the opposite.
- ***R v Smale***

Facts:

- S was born, raised, and educated in Sask.
- Up until Feb 2005, S lived and worked in Sask with his wife and two children. (Their house was jointly owned)
- S was fired and could not find a new job in Sask, but did find one in Calgary.
- He moved to Calgary Nov 2005 to begin work, leaving his wife and kids behind (who would join him in Calgs in June 2007 after the daughter gradated high school)
- S purchases an apartment, moved furniture over and changed address of all his banking to his Calgary home, within a year he had obtained AB Health care and drivers licence.
- S went back to Sask every 6 weeks or so to spend time with his family on the weekends.
- S claimed AB residence on his 2005 income tax return, but the CRA reassessed his primary resident to Saskatchewan.

Issue: Where was S's residence for provincial tax purposes for the 2005 taxation year? ALBERTA.

Analysis:

- The Minister's assessment is presumed to be correct pursuant to s 152(8). Consequently, the initial legal burden is on the taxpayer to disprove the Minister's assessment.
- Assuming that the taxpayer overcomes the initial legal burden, then it shifts to the Minister to bring sufficient evidence and make sufficient arguments to support its assessment (which if successful shift burden back to taxpayer, etc.)
- Even though S moved to Calgary in Nov 2005, assuming he indeed acquired AB residency then as we have discussed, he was entitled to report and pay tax on his entire 2005 income using Alberta rather than Saskatchewan provincial income tax rates.
- Generally, the Tax Court has exclusive original jurisdiction over tac cases, there are several exceptions.
    - This type of case is one of them since it deals with provincial as opposed to Canadian residency.
    - So this case was actually heard by the SKQB.
- **What facts tie S to Sask as of Dec 31, 2005?**
    - Owns a house that is readily available to him
    - Family is living and continues to live there
    - Visiting family often
    - Working/severance pay in and from SK
    - Bank accounts/instruments in SK
    - Only brought a carload of personal items with him
- **What fact tie S to AB as of Dec 31, 2005?**
    - Plans for family to move and live in AB (weak)
    - Permanent job in Calgary (economic tie)
    - Has an apartment (only a rental)
    - Changed his banks and professional registration addresses
    - Bought personal property with him to AB

        - Bought $3k of furniture
        - Got an AB driver's license → important because you can use any other valid Canadian license across province, so shows permanence intention.
        - Applied for AB healthcare (same as driver's license argument)
    - Minister's argument for SK residency:
        - Came down to economic documentation showing SK tax slips and investment income.
        - Also huge factor was his immediate family living in SK (as per rebuttable presumption)

    Holding: Court overturned CRA's reassessment and concluded he was an AB resident for income tax purposes because:
    - Has clear intention to be in AB, not trying to mislead.
    - Interpretation of S's behaviour in this situation.
    - Plan for family to come move to him, but they hadn't yet because of school
        - Speaks to credibility as this is a good reason to not move immediately.
- **NOTE:** Cannot assess stuff that happened in 2006 or 2007 because the test is as at Dec 31, 2005.

ON AN EXAM SAY: Not only does this specific residential tie exist, but here is why it is significant and here is how much weight it should be given.

Statutory Deeming Rules

- In addition to the common law rules for establishing residency, there are also statutory rules which deem an individual to be a Canadian resident for Canadian income tax purposes.
    - **These rules are separate and apart from the common law test described above.**
    - An individual may be found not to be a Canadian resident using the common law test, but will still be a Canadian resident by virtue of the statutory deeming rules.
- These deeming rules are contained in section 250 and can be broken down into 2 categories:
    1. **Sojourner Rule- s 250(1)(a)**
        - Deems an individual to be a resident in Canada for the entire year if that individual "sojourned" in Canada for **183 days or more** in a particular calendar year.
            - Sojourn means something temporary or extraordinary.
                - Different then commuting which means being in and out of Canada in the same day.
            - Unlike the common law factual analysis, this is a bright-line/strict test: If you are in Canada for 183 days or more, then the rule applies, if 182 days or less, then the rule does not apply.
        - "Sojourn" is not defined in s 248(1), so the courts have relief on the dictionary definition which is "to stay temporarily in a foreign land as opposed to ordinary residence; to make a temporary stay in a place; to

remain or reside for a time; a place where one unusually, casually, or intermittently visits or stays."

- *Folio S5-F1-C1* states that sojourning means "to make a temporary stay in the sense of establishing a temporary residence, although the stay may be of a very short duration"
- These definitions do not refer to or care about the purpose of the visit; it does not matter if stay is for work, play, stopover on a flight, etc.
  - The exception to this is commuting where an individual comes into Canada for the day to work and then leaves Canada once she is finished for the day. (*R&L Food Distributors Ltd v MNR*)
    - This exception allows for an individual to live in Seattle, US and commute to work in Vancouver, BC and not have their worldwide income be subject to tax in Canada.
      - However, this individual would still be subject to Canadian tax on their Canadian sourced income as per s 2(3) and 115 unless alleviated by a Canada-US Tax Treaty.
    - The CRA's position is that if the individual does not return home after working that day but instead stays overnight, this exception will not apply and that stay will count as sojourning.

- What constitutes a "day" has not been defined by the Act.
  - *Folio S5-F1-C1* states that as a general rule, the CRA considers any part of a day to be a "day" for the purpose of determining the number of days that an individual has sojourned in Canada in a calendar year.
    - The *Folio* goes on to state that the nature of each stay must be examined separately to determine whether the individual is sojourning or not.
    - For example:
      - If you fly into Vancouver from the US at 11 pm Friday evening and then fly out at 2am Saturday morning, the CRA would count this as 2 days.
  - This position has not been unanimously accepted by the curt.
    - Generally, courts have rejected the notion that the day requires a continuous 24-hours
    - Some agree with CRA that any part of the day counts as one day
    - Other have stated that you do not count the day you enter Canada, but you do count the day you leave Canada (where you are in Canada over 2 days)
      - For example, you fly in Friday and leave Sunday, this would be 2 days, whereas CRA would say 3.

            - So better to just be weary and say 3.
- The sojourner rule is applied on a calendar year basis, with each calendar year treated separately or distinctly.
- As confirmed by *Folio S5-F1-C1,* the sojourner rule DOES NOT APPLY to factual resident. Therefore, by implication, this sets out the ordering of the 2 tests: start with common law test first, sojourner rule second.
- **Example:** A is a common law resident of Canada for the first 5 months of 2021 (assume 151 das). She then severs all of her Canadian residential ties and establishes new residential ties in Palm Springs, USA, where she continues to reside to today. However, during the remaining 7 months of 2021, she spends 60 days in Canada visiting her Canadian friends. How is A's 2021 taxation year treated for Canadian tax purposes?
    - For the first 5 months she is a common law resident.
        - This means as per s 2(1) she will be taxable in Canada on her worldwide income for those 5 months.
    - For the remaining 7 months of 2021, she is not a Canadian resident under the common law because she does not have significant residential ties.
        - S 144 recognizes that in the year you acquire or sever Canadian residency, you can divide your income based on when she was a common resident to when she left
    - Further, the sojourner rule does not apply to deem her to be a Canadian resident for the entire year because she has not sojourned in Canada in 2021 for 183 days or more.
        - She has only sojourned in Canada for 60 days; the 151 days she spent as a common law resident are not counted as sojourning days as per s 2(3) and 212.
    - Best answer would say: The facts say to assume she was a common law resident. If not, the sojourner rule would apply and her worldwide income would be taxable in Canada. However, it is better to take the position that she was a partial common law resident for 5 months and then she would only be taxable on her world wide income for 150 days, not her worldwide income for the entire year."
- While meeting the sojourner rule deems you to be a Canadian resident for the entire year, the sojourner rule does not deem the individual to be a resident of a particular province.
    - Therefore, s 120(1) imposes a federal surtax in lieu of the provincial tax the Canadian resident would pay.
    - Note that sojourners do not get any provincial credits or benefits either.

2. **Special Individuals rules- s 250(1)(b)-(g)**

- Identifies several groups of individual who typically/regularly work for/on behalf of the Canadian government abroad, namely:
    - Members of the Canadian Armed forces
    - Government officers/servants
    - Children and certain spouses of the above

- Because these individuals (and their families) are living and working abroad, it is unlikely that they will be found to be Canadian residents under the common law test, but s 250(1) deems them to be residents and taxable on their worldwide income
  - To prevent such individuals from being double-taxed on their income, the foreign country will typically either deem them to be a non-resident or non-taxable.
  - Canada makes foreigners under this category in Canada (such as diplomats or military) non-taxable as per s 149(10(a) and (b).

Canadian Taxation of Non-Residents

- Focusing first on **Part I** of the Act, **subsection 2(3)** provides that where a person who is not taxable under subsection 2(1):
  a) Was employed in Canada
  b) Carried on business in Canada, or
  c) Disposed of a taxable Canadian property,
     - "Taxable Canadian property" is extensively defined in s 248(1) to include a variety of items including:
       - Real property situated in Canada (ie. land)
       - Property used in carrying on a business in Canada,
       - Shares of a privately-held corporation and interests in partnership or trust where more than 50% of the value can be attributed to certain types of property located in Canada
       - Shares of a publicly-traded corporation

  Then the income/gains from those activities/assets, but ONLY those activities/assets, will be subject to Canadian income tax.
- It is important to be aware that non-residents an be subject to Canadian income tax on certain activities, and
- **Canadian persons may have Canadian tax obligation in respect of the non-resident's Canadian-taxable activities.** For instance:
  - If a non-resident is providing services in Canada, the recipient of such services may be required to make withholding for Canadian income taxes (or become personally liable for such amounts, plus possible penalties for non-compliance with the Act); and
  - If a person purchases Canadian real estate from a non-resident, that purchaser might be required to withhold and remit a portion of the purchase price to the Receiver General in respect of the non-residents (potential) Canadian tax liability; and
  - Further tax research/advice is most likely required.
- In addition to non-residents being subject to tax under Part I of the Act as per s 2(3) on certain types of income sourced to Canada, the Act provides for taxation of other Canadian source income in Part XIII of the Act/
  - Specifically, s 212 lists several types of passive income that will be subject to a special withholding tax of 25%(unless there is a tax treaty) on the gross amount paid to the non-resident. Passive income types include:
    - Management fees
    - Interest
    - Rents
    - Royalties
    - Pension benefits

        - Dividends
    - Technically, this is not an income tax- but a withholding tax on gross revenue/payments
    - Once again, Canadian payors of such amounts may have obligations to withhold and remit to the Receiver General amounts in respect of such payments (or become personally liable for the amounts plus possible penalties for non-compliance
        - For example, if your purchase Canadian real estate from a non-resident and unless they make certain disclosures, then purchaser may be liable to pay 25% of purchase price to the CRA in respect to pay for vendor's purchase liability.
            - Section 166 provides information on if the purchaser in good-faith has no reason to believe that seller is non-resident, then they do not have to pay liability.

Taxation of Indigenous Peoples

- S 2(1) provides that if you are a "person" who is "resident in Canada" then you "taxable income: regardless of where it is earned/generated, will be subject to Canadian income tax.
    - This section is NOT the appropriate starting point in determining the legal, equitable, and just taxation of Indigenous peoples' income because:
        - They live on reserves which are special territorial zones in respect to Canadian law
        - The Canadian state was imposed on them
        - They are their own nation as recognized in the Charter/Constitution and its not possible for one nation to impose its taxes on another
        - They have their own law
        - Did not voluntarily enter the Canadian social contract.

The Royal Proclamation, 1763

- In officially claiming North America as British territory, King George III issued a proclamation containing "guidelines for the European settlement of Aboriginal territories".
- The Proclamation stated:
    - "… that the several Nations or Tribes of Indians with whom We are connected, or who live under our protection, should not be molested or disturbed in the Possession of such Parts of Our Dominions and Territories as, not having been ceded or purchased by us, are reserved to them…"
        - The highlighted portion could at least be arguably interpreted as exempting First Nations peoples from taxation.

S 87 of the *Indian Act* and Key Jurisprudence

- Based on the *Royal Proclamation*, section 87 of the *Indian Act* was enacted as follows:

> **87(1) Property exempt from taxation-** Notwithstanding any other Act of Parliament of any Act of the legislature of a province, but subject to s 83 and s 5 of the *First Nations Fiscal Management Act*, the following property is exempt from taxation:
>
> **(a)** The interest of an Indian or a band in reserve land or surrendered lands; and
>
> **(b)** The personal property of an Indian or a band situated on a reserve.
>
> **(2) Idem-** No Indian or band is subject to taxation in respect of the ownership, occupation, possession, or use of any property mentioned in 1(a) or (B0 or is otherwise subject to taxation in respect of any such property.

(3) Idem- No succession duty, inheritance tax or estate duty is payable on the death of any Indian in respect of any property mentioned in paragraphs (1)(a) or (b) or the succession thereto if the property passes to an Indian, nor shall any such property be taken into account in determining the duty payable under the Dominion Succession Duty Act, chapter 89 of the Revised Statutes of Canada, 1952, or the tax payable under the Estate Tax Act, chapter E-9 of the Revised Statutes of Canada, 1970, on or in respect of other property passing to an Indian.

- **So, in order for s 87 to apply, the exemption must be of a TAX and must be claimed by a "Indian".**
- While technically not necessary, s 81(1)(a) provides:

81(1) Amounts not included in income- There shall not be included in computing the income of a taxpayer for a taxation year

> **(a) Statutory exemptions [including Indians]-** an amount that is declared to be exempt from income tax by any other enactment of Parliament, other than an amount received or receivable by an individual that is exempt by virtue of a provision contained in a tax convention or agreement with another country that has the force of law in Canada.

- **Before considering the associated jurisprudence, very generally, apply s 87 by looking at:**
  - **The government amount in issue must constitute a "tax" (as opposed to a fee for service or other charge)**
  - **The person claiming the s 87 exemption must be an Indian or a band, and**
    - In *Daniels*, the SCC held that Metis and non-status Indians constituted Indians for purposes of s 91(24) of the *Constitution Act, 1867*.
    - However, the Federal government has taken the position that this decision does not change who is an "Indian" under the *Indian Act*.
      - **S 2(1) of the *Indian Act* defines an Indian as "a person who pursuant to this Act is registered as an Indian or is entitled to be registered as an Indian."**
      - It also contains a definition of band to be "a body of Indians (a) for whose use and benefit in common, lands, the legal title wo which is vested in Her Majesty, have been set apart before, on or after September 4. 1851, (b) for whose use an benefit in common, moneys are held by Her Majesty, or (c) declared by Governor in Council to be a band for the purposes of this Act.
  - **The tax must be or in respect of the Indian's or Band's (a) Interest in reserve or surrendered lands, or (b) Personal property situated on a reserve**
    - *Norwegijick v R*; personal property include income and taxable inome
    - *Mitchell v Peguis Indian Band*; the overall nature and purpose of s 87 is as follows:
      - In summary, the historical record makes it clear that sections 87 and 89 of the *Indian Act*, the sections to which the deeming provision of section 90 applies, constitute part of a legislative "package" which bears the impress of an obligation to native peoples which the Crown has recognized at least since the signing of the Royal Proclamation of 1763. From that time on, *the Crown has always acknowledged that it is honour-bound to shield Indians from any efforts by non-natives to dispossess Indians of the property which they hold qua Indians, i.e. their land base and the chattels on that land base.*
      - It is also important to underscore the corollary to the conclusion I have just drawn. The fact that the modern-day legislation, like its

historical counterparts, is so careful to underline that exemptions from taxation and distraint apply only in respect of personal property situated on reserves demonstrates that *the purpose of the legislation is not to deal with the economically disadvantaged position of the Indians by ensuring that Indians may acquire, hold, and deal with property in the commercial mainstream on different terms than their fellow citizens. An examination of the decisions bearing on these sections confirms that Indians who acquire and deal in property outside lands reserved for their use, deal with it on the same basis as all other Canadians*

- *Williams v R*; that to determine whether income is situated on a reserve, one must use the "**connecting factors test"** which requires a court to first identify all of the potentially relevant facts that might locate the income or property on or off the reserve and then assess the wight to be given to each of these facts in light of
    - The purpose of the section 87 exemption
    - The type of income/property in question, and
    - The nature of the taxation of that income/property
        - *Bastien* and *Dube* have confirmed that there is no separate commercial mainstream test or that income earned in the commercial mainstream impacts the situs of the income under the connecting factors test.
- Example:
    - If issue is trying to determine whether employment income of a reserve Indian is personal property situated on the reserve and not taxable, look to:
        - Where the employer is situated and carries on business
        - Where is the work performed
        - Does the Indian reside on or off the reserve?
        - Is the work performed a benefit to the Indigenous peoples on the reserve (logging, fishing, adjacent hospital)

- Using the above foundational principles, Indians and bands have tried to structure their affairs to fall within the section 87 exemption. This has resulted in an abundance of jurisprudence – much of which found that the exemption did not apply on the facts
- To assist in the understanding and application of these principles, the CRA has released several publication over the years.

Recent Developments in Indigenous Tax Planning

- Given the general lack of success using s 87, Indians and bands have expanded their tax planning to consider other possible avenues of relief
    - Such as the exemption given to public bodies performing a function of government in Canada contained in s 149(1)(c) and the exemption given to corporations owned by a public body performing public functions in government contained in s 149(1)(d.5)
- In addition, with the creation of self-governing agreements and other treaty arrangements (in which the First Nation is generally required to waive the application of s 87), First Nations have begun levying their own taxes – most commonly on property occupied by non-First Nations persons.

UNIT #3: A BRIEF OVERVIEW OF THE TAXATION OF CORPORATIONS AND TRUSTS?

A Brief Overview of Corporations

- Under Corporate Law, such as the *Business Corporations Act* and *Canada Business Corporations Act*, a corporation is a legal entity that is distinct from its owners, its employees, and anyone with whom it deals.
  - This is important – particularly for individuals who own all of the shares of a private corporation. In my experience, it is not uncommon for such individuals to think that because they own all of the shares of the corporation, the assets belong to them as opposed a separate and distinct legal entity.
    - This line of thinking often results in "tax trouble"
    - For instance, s 15 may require a shareholder to report as income (and pay income tax on) a benefit received/enjoyed from the corporation.
- The corporate legislation under which a corporation is incorporated will set out:
  - How the corporation is brought into legal existence (through incorporation),
  - Its capacities and powers (ie. to enter intro contracts, carry on a business, own property etc)
  - How it can raise funds using equity and/or debt, and
  - The rights and responsibilities of its directors, officers, shareholders, etc.
- A corporation is a person for tax purposes, meaning that pursuant to s 2(1), if the corporation is resident in Canada, it is required to calculate its worldwide taxable income for its taxation year and pay Canadian corporate income taxes.
  - Once such taxes have been paid, the corporation is free to distribute its after-tax corporate income to its shareholders as dividends.
  - How such dividends are taxed to the shareholder will depend on:
    - What type of dividend it is (eligible, non-eligible, or capital), and
    - Who the shareholder receiving the dividend is (corporation, individual, trust, non-taxable entity)
  - So, the question is… if individual shareholders are taxed when they receive dividends from a corporation, then why tax corporations too? Is this not a double tax problem?
    - The answer is very general. If our tax system did not tax corporations, then some individuals (particularly those who generate business and/or investment income) could use corporations to inappropriately/indefinitely shelter/defer their income from taxation.
      - As discussed later, individuals who earn employment income generally cannot use a corporation for this purpose, whereas individuals who earn business and investment income can – arguably creating an inequity in society.
    - A similar issue exists with respect to trusts.
- While there are usually two levels of taxation with respect to corporate income that is distributed to an individual shareholder (ie. the corporation and individual shareholder levels), **Canada's tax system has been designed to try to ensure that the total taxes levied on such income is equal to the amount of tax that the individual shareholder would pay if they earned the income personally.**
  - This is referred to as the principle of integration as is often accomplished using the "dividend gross up and tax credit mechanism"
  - The Act contains a rather clever way to generally avoid income earned by a corporation being double-taxed.

Simple Example of the Concept of Integration of Corporate and Personal Income Taxation

Assume:

- A Canadian resident individual carries on a business that generates $1,000 of pre-tax income per year
- The applicable tax rates are:
  - 40% for individual taxpayers
  - 25% for corporate taxpayers

Scenario 1: The Individual Carries on the Business Personally (ie. unincorporated)

Business Income	$1,000
Personal Tax (pre-tax income x tax rate)	<400>
After-Tax Personal Income	$600

Scenario 2: The Individual Carries on the Business through a Corporation

Corporation:	Business Income	$1,000	
	Corporate Tax	<250>	
	After-Tax Corporate Inc	$750	
Individual:	Dividend Received	$750	
	Net Personal Tax	<150>	(Note #1)
	After-tax Income	$600	

Note #1: To calculate the appropriate amount of personal tax on a dividend, one must employ the "gross up and dividend tax credit regime", illustrated below:

Actual Dividend Received	$750	
Notional Gross Up	250	(gross up is the amount of tax paid)
Grossed Up Dividend	$1,000	(what the income would have been if the corporation did not exist)
Personal Tax	<400>	
Dividend Tax Credit	250	(should be equal to the amount of tax paid by the corporation, so there is not double tax)
Net Personal Tax	<$150>	

- A person may want to incorporate their business for the following reasons:
  - Limited Liability
  - Corporation to exist even when you die
  - The ability to raise more financing and drum up capital
  - Take advantage of the lower corporate tax rate compared to the applicable person income tax rate
    - Corporate tax rate depends on:
      - Type of corporation
      - Ownership fo corporation
      - Type of income the corporation earns
      - Where the income is earned

        - In the case of Canadian controlled private corporations (CCPCs) as defined in s 125(7), the CCPC's first $500,000 of "active business income" (also defined in s 125(7)) is taxed at a combined federal/provincial rate of between -12%, due primarily to the application of the "small business deduction" contained in s 125(1)
        - To take advantage of this lower corporate tax rate, income earned by the corporation must remained in the corporation – as opposed to being paid out to shareholder as a dividend (which triggers the associated personal tax).
    - Allow other family members to become shareholders and create income split
- So basically, even thought after-tax income is the same, being a corporation is a tax deferral strategy, not an avoidance strategy.

Residence of a Corporation

- There is a common law test and statutory deeming rules for determining the residence of a corporation for Canadian income tax purposes.
    - One must consider both tests but there is no implicit order in which they must be applied.

Statutory Deeming Rules

- The most common rule is contained in **s 250(4)(a**), which provides that **if a corporation is incorporated in Canada after April 26, 1965,** then from that point forward (unless continued into another country or another rule applies) it will be a Canadian resident corporation.
    - This covers the vast majority of Canadian-incorporated corporations in existence and any incorporated today and in the future.
- If a corporation is incorporated in Canada (say Sep 1) and then is **continued to the US** (on Sep 3), then for tax purposes, **as per s 250(5.1), it is treated from the point of continuation to have been incorporated in the US (and not have ever been incorporated in Canada)**
    - Conversely, **if a corporation is incorporated in another country and then continued into Canada, s250(5.1**) will deem that corporation to **have been incorporated in Canada as of the date of continuance**

Common Law Test

- Based on *De Beers Consolidated Mines Ltd v Howe*:
    - "In applying the conception of residence to a company, we ought, to proceed as nearly as we can upon to analogy of an individual. A corporation cannot eat or sleep, but it can keep house and do business.. A company resides for purposes of income tax where its real business is carried on… I regard that as the true rule, and the real business is carried on where the **central management and control** actually abides"
    - Therefore, the test is known as the **"central management and control" test and**, like the *Thomson* test for individuals, is **primarily a question of fact** (but practically speaking, not as difficult to apply and uncertain in result as the factual test for determining whether an individual is resident in Canada)
- To determine where a corporation's central management and control is exercised, court will look to where the corporation's Board of Directors (or fundamental decision-makers) meet and make decisions.
    - Generally, the residence status of the corporation's shareholders is irrelevant in determining the corporation's residence for Canadian income tax purposes.

- However, where one or more shareholders are effectively controlling the corporation (ie. the Board is the shareholders' puppet) then central management and control will be found to be exercised where the shareholders make the important corporate decisions.

- Example: *Landvouwbedriff Backz B.V. v The Queen*

Facts:

- The Backxes were the initial directors (and shareholders) of their Netherlands corporation and were residents until they decided to immigrate to Canada.
- At this time, they resigned as directors and appointed a sister, who continued to reside in Netherlands to be the sole director.
  - Sister had no experience in the corporation's business of farming or in business generally;
  - The sister acted in accordance with the shareholders' instructors (as opposed to independently) and implemented the shareholders' decisions;
  - The sister was not involved in the discussion with the corporation's accounting and tax advisors

Issue: Where is the company's central management and control occurring? CANADA, SO CANADA TAXES SHOULD BE PAID.

Analysis:

- "Cogent evidence is required to displace the well-established notion that *de jure* directors hold primary responsibility for the management and control of a company. Such evidence must clearly establish that the "outsider" has effective or independent management and control"
- The Backxes were the *de facto* Directors – and hence **where they made decision regarding the corporation constituted the place where central management and control was being exercised.**
  - If the Bacxes got on a plane and flew back to the Netherlands every time it was necessary, they would have satisfied the common law test and corporate residency would be in the Netherlands.
- Burden is on Directors to show they are doing business in another country than they are residents.

Holding: Presumption that Board exercised central management and control was not warranted on the facts and the Backxes were exercising central management and control from Canada.

- This case also confirms the principle that it is generally not possible to use the principle of estoppel to prevent the CRA from properly applying tax law to facts

- In decided in which jurisdiction to incorporate and who will be the directors, consideration should be given to the implications to the corporation's residency status for income tax purposes.
  - More specifically, if you want a corporation resident only in Canada, then you should incorporate it in Canada and make sure the Directors are Canadian residents who meet and make fundamental corporate decisions in Canada
  - Conversely, if your client wants a non-Canadian resident corporation, then you need to incorporate it pursuant to foreign legislation and appoint non-Canadian resident directors to the Board who properly exercise their Board functions outside of Canada.
    - **IT IS WHERE THE BOARD EXERCISE ITS RESPONSIBILTES, AS OPPOSED TO WHERE THE BOARD MEMEBRS LVIE, THAT DETERMIENS WHERE CENTRAL MANAGEMENT AND CONTORL IS BEING EXERCISED.**

- While generally not relevant for residency purposes, consideration should also be given to the residency status of the shareholders- particularly if dealing with a "private" corporation (ie. not traded publicly on stock exchange)
    - "Canadian controlled private corporations" as defined in s 125(7) are subject to several benefits under the Act (including potential access to the "small business deduction")
    - To preserve this benefit, you want to ensure that no controlling shareholder are non-residents of Canada.

A Brief Overview of Trusts

- A trust is (a) **a relationship, (b) with respect to property, (c) whereby there is a separation of legal and equitable interests,** such that the legal owner of the property (the trustee) holds such legal ownership for the benefit of the equitable owner (the beneficiary) in such a manner that the law finds the trustee to have a fiduciary duty to the beneficiary.
    - **Under the general law, a trust is not recognized as a separate legal entity like a corporation is; the law recognizes the trustee as the legal owner and the beneficiary as the equitable owner.**
- Three certainties for a trust to come into existence:
    1. **Certainty of Intention:** to create a trust (not a gift, bailment, lease, etc.)
    2. **Certainty of subject matter:**
        a. Certainty of the property that is subject to the trust and
        b. Certainty of the respective shares/interests each beneficiary has in such property
    3. **Certainty of object**: which usually refers to the beneficiaries that the trust is created for, but could also refer to the purpose/use of the trust (and trust property)
- It is not uncommon for a court to find that a trust hasn't been created because it has not satisfied all of the requirements to be a trust.
    - This has significant negative consequences, especially where a trust is used as a tax strategy.

Types of Trusts

- If a settlor creates a trust when they are alive, then it is an *inter vivos* trust
- If the trust is created as a consequence of the settlor's death, then it is a testamentary trust.
    - An "estate" can be defined as "the real and personal property that a person possesses at the time of death and that passes to the heirs or testamentary beneficiaries"
    - While an estate is technically not a trust (for tax purposes), it is generally treated and taxed as a "graduated rate estate" as defined in s 248(1)

Purpose of Trust

- **To preserve assets** for the use of certain persons without giving such persons complete control over those assets, and
    - Example: Trust to benefit children without giving children full ownership over the trust assets
- **To protect assets** from others
    - Example: trust for children by putting personal assets and saving into it, so that if you get sued, creditor cannot take away these assets and hurt the family.

Trusts and Taxes

- While the law generally does not recognize a trust as a distinct legal entity, **Canadian tax law does recognize a trust(and an estate) as a "person" separate and distinct from the settlor, trustee, and beneficiary** as per s 248(1).
    - A trust, if resident in Canada, must calculate and reports its taxable income and taxes on a trust (T3) tax return.

- General rules include:
  - S 104(1) provides that trusts and estates are generally treated the same for tax purposes, and
  - S 104(2) provides that a trust/estate is generally treated as if it was an individual taxpayer – unless there is a specific provision in the Act which provides special tax treatment for trusts (of which there are many)
- Exceptions to general rules:
  - S 122(1) which generally provides that all of trust's income (other than income from "graduated rate estate") is taxable at the highest marginal rate for individuals (as opposed to all of the marginal rates/brackets applicable to individuals)
  - A "graduated estate" is defined in s 248(1) as:
    a) The deceased's estate for up to 36 months after the deceased's death,
       - After the 36 month period expires, if the estate is still in existence, the estate loses its special status as a GRE and is taxed as a testamentary trust (at the highest marginal rate)

    b) That has been designated as the deceased individual's GRE for income tax purposes

    Which is entitled to all of the marginal tax brackets and rates as if the trust was an individual taxpayer.

  - S 122(1.1) which provides that trusts cannot claim personal tax credits (which individual taxpayers may be eligible to claim.
- In some respects, the relationship between a trust and its beneficiaries is analogous to the relationship between a corporation and its shareholders for tax purposes. More specifically:
  - Corporations and trusts are persons for income tax purposes distinct from their respective shareholders and beneficiaries
  - To the extent that corporations and trusts earn income, they may be required to complete a tax return (T2 for corporations, T3 for trusts) and pay taxes;
  - Similarly, to the extent that shareholders and beneficiaries receive distributions from their corporation or trust, the shareholders and beneficiaries may have to report such distributions on their tax returns and pay taxes;
  - Canada has structured its income tax regime to generally avoid such distributions being "double-taxed" – although the way the Act accomplishes this in the context of trusts and beneficiaries is different than for corporations and their shareholders.
  - That said, there are also significant differences in the tax treatment of (and the common tax strategies associated with) corporations and trusts.

Simple Example of the Taxation of a Trust and its Beneficiary

Assumptions:

- A Canadian resident *inter vivos* trust, with one Canadian resident individual beneficiary, earns $1000 of pre-tax investment income on its trust property
- The applicable tax rates are:
  - 50% for the trust (ie. highest marginal rate)
  - 25% for the individual beneficiary (whatever their bracket is based on their income)

Scenario #1: The trust retains the income its earns in the year

Trust	Investment Income	$1,000
	Personal Tax	<500>
	After-Tax Trust Income	$500 (Note #1)

Beneficiary	Trust Distribution	$0 (Note #2)

Note 1: Once income is taxed at the trust level, it becomes "trust capital" for income tax purposes. The significance of this is **that the trust can make a distribution of trust capital to its beneficiary (in a subsequent year) which will not be taxable to the beneficiary**. To make a trust capital distribution, the **trust must designate it as a capital distribution.**

Note 2: As the beneficiary did not receive anything from the trust in year 1, the beneficiary does not have to include anything in their tax return (which confirms the separate person status and tax treatment f a trust vis-à-vis beneficiary).

- If the trust subsequently distributes its after-tax trust capital, the beneficiary does not have to include it in their income.

In this scenario there is only one incident of tax (to the trust). Once it is taxed at the trust level, it ill not tax the beneficiary level.

Scenario #2: The Trust Distributes the Income it earns in the year

Trust	Investment Income	$1,000	
	Distribution	<1,000>	(Note #1)
	Taxable Income	0	
	Personal Tax	0	
Beneficiary	Trust Distribution	$1,000	
	Personal Tax	<250>	
	After-tax Income	$750	

Note 1: Distributions of income earned in the year by a personal trust are generally deductible for tax purposes. If the trust distributes all of the income that it earns in the year to its beneficiary, the trust will have no taxable income and no income taxes payable.

- Like Scenario #1, **there is only one incidence of tax –** but this time, tax imposed on beneficiary because the beneficiary received the trust's income for the year (which was not taxed to the trust)
- Can also have a scenario between the two, where some is transferred and some is not, and taxation will occur both ways.

Question: Which of the scenarios is better from a tax perspective and why?

- Clearly, given the assumptions, scenario 2 is better because it results in $250 less tax and $250 more after-tax income
- This is due to the beneficiary being subject to tax at the lowest marginal rate, whereas the trust being taxable at the highest marginal rate
- While there are many more tax rules to consider -including some anti-income splitting rules – this illustrates one of the common ways trusts can be sued to reduce taxes and increase after-tax income in a family situation

However, scenario #1 could be a tax effective strategy where…

- The trust is resident in a province that has a lower highest marginal tax rate than the tax rate the beneficiary will be subject to on trust distributions
- Prior to Premier Notley's government raising the provincial income tax rates for high income earners, Alberta's tax rate was a flat 10% - which meant that combined with the highest Federal tax rate (29%) prior to Prime Minister Trudeau's government adding another marginal tax rate, the top tax rate (combined) in Alberta was 39%. As the top marginal tax rates in other provinces (i.e. Ontario, Quebec, etc.) were/are in excess of 50%, one could reduce the overall taxes paid if a tax plan was properly executed involving an Alberta trust
- For this reason, most cases involving Canadian trusts that are litigated in Tax Court involve Alberta trusts, and often AB lawyers who act as trustees for such trusts
  - Given the higher rates in BC, QB, etc. AB trusts are still popular for tax planning purposes

Residence of a Trust

- S 94(3) deems an otherwise factually non-reisdent trust to be a Canadian resident for sme purposes (purposes don't matter for our course)
- Other than the above there are no statutory deeming rules, but only a common law test.
  - Test in *Garron Family Trust (Trustee of) v R* as reflected in Folio S6-F1-C1

Garron

Facts:

- A trust with a trustee (corporation) resident in Barbados and Canadian resident beneficiary
- When the trust sold its shares in ON corporations for a very sizable capital gain, the trust sought a treaty exemption from Canadian tax on the basis that the trust was resident in Barbados.
- Minister of National Revenue took the contrary position that the trust was resident in Canada and hence Canadian taxes applied to the gain.

Issue: Where does the trust reside?

Analysis:

- After acknowledging the similarities between a corporation and a trust:
  - Both hold assets that required to be managed
  - Both involve the acquisition and disposition of assets
  - Both may require the management of a business
  - Both require banking and financial arrangements
  - Both may require the instruction or advice of lawyers, accountants and other advisors; and
  - Both may distribute income

  The court **adopted the common law test used for determining residency of a corporation for trusts – the central management and control test.**
- **"**As with corporations, residence of a trust should be determined by the principle that a trust resides for the purposes of the Act where 'its real business is carried on', *which is where the central management and control of the trust takes place*"
  - While this will normally be where the named trustee resides and exercises power over the trust assets, it does not have to be.
    - The Court states "the residence of the trustee will also be the residence of the trust where the trustee carries out the central management and control of the trust, and these duties are performed where the trustee is resident."
  - More specifically, if someone other than the named trustee is exercising central management and control over the trust (and trustee is only providing administrative services), then the

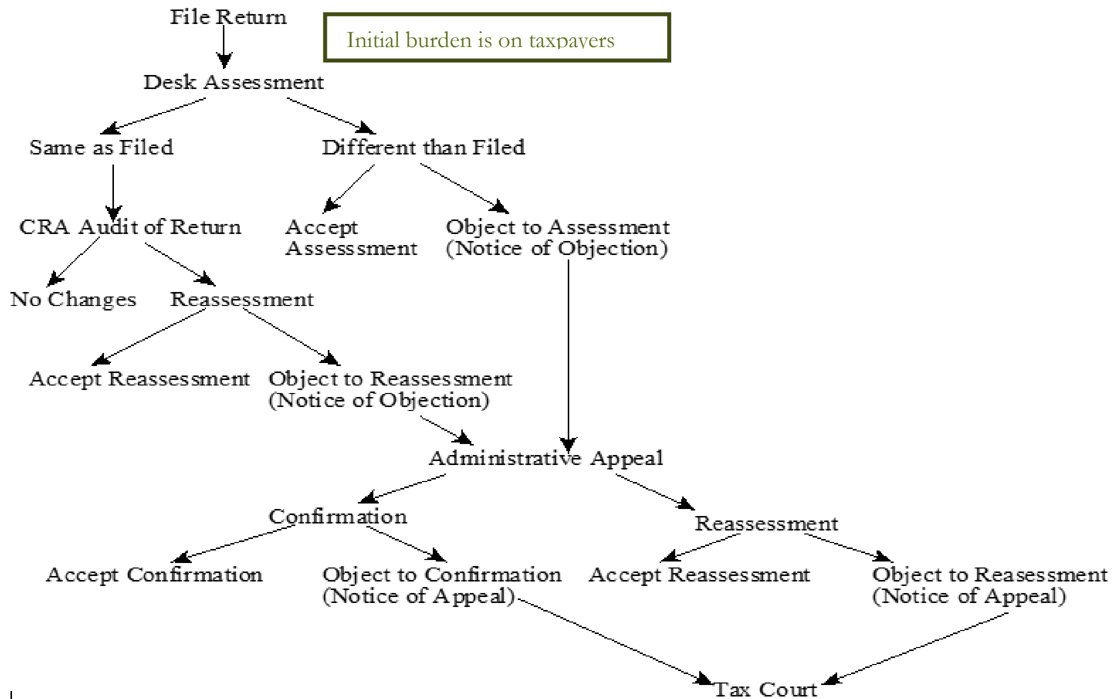
place that the other person is exercising central management and control over the trust will determine the residence.

Holding: Since the Canadian resident beneficiaries were exercising central management and control as opposed to the Barbados trustee, the trust resides in Canada.

- This test is a full factual analysis
  - Reliance on trust indenture and the residence of the named trustee is no longer sufficnet
- Key issue is "what functions, and the level of such functions, will constitute central management and control?" particularly where the argument by the CRA is that these functions are beign exercised by someone other than a trustee
- Examples of what central management could look like post-*Garron*:
  - Where a trustee has discretion and is exercising independent decisions
  - Seeking independent legal or tax advice where appropriate
  - Not just doing whatever beneficiary or settlor tells you to do, but acknowledging whether or not it can be done and how to do it
  - Ability to say no to demands
  - Asking for relevant information before acting/making a decision
  - Considering the likely implications to the Trust or beneficiaries of a particular proposed action
  - Declining the request of a beneficiary where the Trustee believed that it was prejudicial to one or more of the other beneficiaries; and
  - Holding back funds from distribution to the beneficiaries to cover the Trust's tax liabilities (and obtaining a Release, Discharge and Indemnity from the beneficiaries in favour of the trust)

UNIT #4: THE ADMINISTRATION OF INCOME TAX LAW

General Overview of the Tax Administration Process



STEP #1: FILING A RETURN (done by taxpayer)

- **General Rule:** S 150(1) provides that a taxpayer **generally** must prepare and file an income tax return for each year "without notice or demand" from the CRA
  - S 150(1)(d) requires that **individuals** file their return for the preceding "taxation year"/calendar year by **APRIL 30**
    - Where April 30 (or any other deadline) falls on a weekend/statutory holiday, deadline is extended until 11:60 PM of next business day.
  - S 150(1)(d)(ii) allows **individuals carrying on a business** until **June 15**, BUT interest starts accruing on the outstanding balance after April 30.
    - So most individuals just file by April 30 to avoid the interest.
  - S 150(1)(b) provides that deceased individual who die AFTER October of the year and before the day that would be the filing date for the year if the individual had not died, have until the **later of:**
    - **The date on which the return would otherwise have to be filed (April 30), or**
    - **The date that is 6 months after the date of death**
- Example: Stephanie passes away on February 10, 2022 without having yet filed her 2021 tax return. When does each return have to be filed.
  - 2021 return which is normally due on April 30, 2022 would need to be filed within 6 months of February 10, 2022, so August 10, 2022.
  - Still has to do a 2022 return for income earned between January 1-February 10, so due at normal time which is April 30, 2023.
    - Any income her estate accrues after the death date is filed by GRE.
      - GRE able to have a non-calendar taxation year if desired but only for the first 36 months of its existence
- **Exception to General Rule:** The general requirement to file a yearly tax return in s 150(1) is then modified by ss 150(1.1) and (2) as follow:

    - S 150(1.1)(b) provides that an individual does not have to file a return if they
        - do not have an outstanding tax liability,
            - To know if you do not have an outstanding tax liability, you complete a tax return lol
        - have not disposed of capital property (or otherwise capital gain), and
        - does not have a positive balance in a Home Buyers Plan or Lifelong Learning Plan, BUT
            - S 150(2) provides that an individual **must file a tax return if furnished with a demand to do so by the Minister** (even if the individual fits within the exceptions contained in s 150(1.1)
- Although an individual may not be required to file a tax return because of an exception, there are advantages to filing a yearly return on time, including:
    - To confirm that you do not have an outstanding balance
    - To received GST credit and certain government child support benefits
    - To be able to transfer tuition tax credits to a spouse, common-law partner, or parent
    - To acquire the ability to contribute to RRSP; and
    - Perhaps most importantly, to start the statutory limitation period clock
- **Summary:** Canadian resident individuals need to fille an income tac return when:
    - The individual has an unpaid tax liability for the year as described in s 150(1) and (1.1)
    - The individual wants access to financial benefits administered through the *ITA* or are determined using an amount calculated for income tax purposes
    - When the individual has disposed of capital property, regardless of whether a capital gain was realized as per s 150(1) and (1.1)
    - When the CRA issues a demand that a tax return be filed as per s 150(2).

STEP #2: DESK ASSESSMENT (done by CRA)

- Once the CRA receives the individual's tax return, s 152(1) and (2) require them to review it and assess taxpayer's tax, interest, penalties, tax refund, losses, etc for the year "with all due dispatch"
    - This Notice of Assessment is commonly referred to as a "desk assessment" or "initial assessment" as it is typically done from the CRA's office (as opposed to after conducting an audit)
        - The CRA has much tax information about each taxpayer that it receives from third parties (employer, financial institutions, etc) through tax information slips, etc. IN the course of performing a desk assessment, we know that it uses this information to verify the accuracy and completeness of the taxpayer's return. Of course, there may be a variety of other steps that the CRA takes as part of its desk assessment (that are not disclosed to the general public)
        - For most taxpayers, unless there are obvious/mechanical errors on the face of the tax return or the taxpayer has failed to include the information on one (or more) tax information slips, they will receive this Notice of Assessment, typically within a month, and it will match what the taxpayer filed in their return.
        - Generally speaking, the CRA does a fantastic job processing returns – for most individual, it is under a month (when you e-file mostly). That said, courts have given the CRA much leeway in applying the "all due dispatch" requirement – which seems reasonable given the vast magnitude of returns that it has to process/
- **Important points:**
    - The CRA does NOT have to wait for the taxpayer's return to issue a Notice of Assessment nor is it bound by the information contained in the return.
        - S 152(7) gives the CRA the power to issue a Notice of Assessment where the taxpayer has not submitted a return

            - This is commonly referred to as a "net worth assessment" as the CRA estimates the taxpayer's income over a period of time by comparing the taxpayer's net worth at the beginning and the end of that period.
            - Government gives the CRA this power because they want they money they are owed, and this stats the process of claiming that money.
    - The issuance of this assessment is important for a variety of reasons, including that it generally **starts the statutory limitation period during which the CRA can go back, audit, and reassess a taxpayer.**
        - For individuals, s 152(4), in conjunction with s 152(3.1) generally provides that this statutory limitation period is 3 years after the date the initial assessment is sent.
            - S 244(14) and (15) collectively create a rebuttable presumption that the date the assessment is made is the date on the assessment.
        - Consequently, if no return is submitted and no assessment is issued, the statutory limitation period does not start
            - Therefore, taxpayers who do not file their tax returns are never "in the clear" and the CRA can audit/assess them at any time
        - As further set out in s 152(4), there are several cases where the CRA will have a longer period in which to reassess a taxpayer.
            - **S 152(4)(a)(i)** states **where a taxpayer has "made any misrepresentation** that is **attributable to neglect, carelessness or wilful default, or has committed any fraud** in filing the return or in supplying any information under the Act"
                - Where the CRA is alleging that one or more of these requirements are satisfied (with the CRA bearing the burden of proof of the existence of the requirement), then the **CRA has an unlimited time** period in which to audit/reassess (as confirmed by s 152(4.01)).
    - S 152(8), an assessment (or reassessment) is "deemed to be valid and binding in spite oof any error, defect or omission" in it
        - This put the initial legal burden on the taxpayer to disprove an (re)assessment and applies to any (re)assessment issued by the Minister

STEP #3: THE AUDIT (done by CRA if assessment is different than return)

- While the CRA is tasked with issuing a Notice of Assessment in response to receiving the taxpayer's return, this does NOT end the administration of that tax return.
    - **For the next 3 years** (or longer in cases of neglect or fraud), the CRA has the ability to audit as per s 231.1 and, if necessary, reassess the taxpayer's tax return.
- A CRA may audit a taxpayer for a variety of reasons including:
    - Errors in the return in prior years that do not seem to be a "inadvertent mistake"
    - The taxpayer may be involved in any activity (cash business, construction, etc.) where there are typically more attempts to commit tax evasion
    - Random selection just to keep everyone honest.
- The CRA can "audit" a taxpayer in a variety of ways, including:
    - A request for specific information (receipt for union/professional dues, moving expenses, etc.)
    - A request for all supporting documentation for a particular tax return
    - A request for supporting documentation for three years of tax returns, and
    - A site visit by a CRA auditor
- **If the CRA decides to audit a tax-payer to see if their return complies with the act, s 231.1(1)(d) (along with other sections) imposes a positive duty on the taxpayer to assist the CRA in its audit.**

- However, fi the CRA is investigating whether the taxpayer may have committed tax evasion (s 239 or 238), which is a criminal offence, this duty to assist disappears and all of the *Charter* protections kick in
  - Any information obtained from taxpayer prior to criminal audit, is admissible and remains accessible to CRA. (not testable)
  - The moment they decide to do a criminal investigation, they must put taxpayer on notice immediately.

- At the end of the audit procedures, the CRA will decide whether a Reassessment is necessary,
  - A proposal letter will be given to taxpayer and advisor about why they're giving reassessment and gives them a 30-day opportunity to provide more information on why the assessment is wrong.

STEP #4: TAXPAYER'S COURSE OF ACTION IN RESPONSE TO NOTICE OF REASSESSMENT

- Assuming that the taxpayer has been audited and that the CRA has issued a notice of reassessment that increases the taxpayer's tax liability from what was reported on their return (because sometimes it can decrease), the taxpayer has two possible courses of action:
  - Agree with the reassessment and pay the additional taxes and interests (and penalties if any), or
  - Can dispute the reassessment
- **To dispute,** the taxpayer must file a timely **Notice of Objection** pursuant to s 165(1), which must set out the relevant facts and the reasons for disputing the Notice of Reassessment
  - **General Rule for Limitation Period:** A NoO must be submitted **on or before the later of:**
    - The day that is one year after the taxpayer's filing due-date for the year, or
      - i.e. for the taxpayer's 2021 tax return, which must be filed by April 30, 2022, the deadline to file an NoO is April 30, 2023,
    - The day that is 90 days after the date the CRA mailed the Notice of Reassessment
      - Date of mailing is assumed to be date on the NoR, and
      - It is 90 days after the date on the Notice, as opposed to the day the taxpayer received/opened it.
- Generally speaking, there is no official form/document that has to be completed to object to a Notice of Assessment, but the CRA has created Form T4000A *Objection-Income Tax Act* to help taxpayers (and practitioners) draft and file a proper Notice of Objection
  - Essentially, assessment should include the facts surrounding the controversial item and the legal reasons why you are objecting (contrary to case law, facts do not support results, etc)
  - The reasons for disputing the Reassessment must be based in the law or on the fac- NOT a fairness or economic hardship appeal
- Sprysak always recommends filing a notice of objection, because:
  - It preserves the taxpayers right to file a Notice of Appeal to Tax Court
    - A taxpayer must initiate an administrative appeal in order to preserve the taxpayer's ability to appeal to the Tax Court if the administrative appeal does not produce desired outcome
      - *ITA* does not permit to appeal a (re)assessment directly to the Tax Court
  - It puts the CRA's collections activities on hold, and
    - Once an objection is filed to an income tax assessment, the CRA is generally prohibited from collecting the amount outstanding on that assessment
  - It begins an "administrative appeal" of the taxation years objected to as per s 165(3).

STEP #5: ADMINISTRATIVE APPEAL (conducted by CRA)

- Once the taxpayer's NoO is received by the CRA, it and the auditor's files on the taxpayer then go to an Appeals officer within the Appeals Division of the CRA in order to conduct an administrative appeal
    - Appeals officer will be someone that has not been involved with the case up until this point.
    - Appeals Division is separate from Audit Division
- As part of the administrative appeal process, you are able to request the CRA documents supporting the (re)assessment (ie. reports prepared by the CRA auditor (unless privileged, CRA auditor working papers, copies of court decisions and relevant sections of legislation relief on by the CRA auditor, appraisal/valuation report relied on, and information obtained from 3rd parties to support the assessment, etc.)
    - Give an idea of the "CRA's case" as well as whether your client is giving you all the information (and correct information)
        - Can save a lot of time and make work more efficient and directed
- Once the taxpayer has obtained this information, the taxpayer will try to provide further information/evidence/make legal arguments to try to:
    - Resolve matters completely (and hence alleviate the need and cost to take the matter to court), or (at least)
    - Reduce the number of issues under dispute and clarify exactly what is being disputed
- This process can take anywhere from a few months to a few years
- After reviewing this matter, and considering any further submission from the taxpayer, the Appeals Officer will either **confirm the reassessment through a notice of confirmation or issue a new notice of reassessment**

STEP #6: NOTICE OF APPEAL TO TAX COURT (taxpayer does this if unhappy with administrative appeal)

- If the taxpayer is still not happy with the current status of their return after the administrative appeal, then the next step is to file a Notice of Appeal to the Tax Court of Canada in a timely fashion pursuant to s 169(1).
    - As set out in 169(1), before a taxpayer can appeal to the Tax Court, they must file a Notice of Objection as previously described
        - That said it the taxpayer is not happy with how the administrative appeal is progressing, the taxpayer is able to file a Notice of Appeal after the administrative appeal has been ongoing for 90 days (but before notice of confirmation or reassessment has been issued)
    - Timing of all these documents is critical. Failure to comply with a deadline could result in your client losing appeal rights and in a professional negligence claim against you and your insurer.

Miscellaneous Points about the Tax Dispute Resolution Process

- Roughly 90% of all NoO filed are settled/discontinued at the administrative appeal level
    - Of the remaining 10%, only approximately one third are actually heard by the Tax Court
- Of the roughly 400 tax cases the TCC hears each year, more than half are decided in favour of the taxpayer
- Less than 10% of TCC decision are appealed to the FCA; less than 10% of FCA decisions are granted leave to appeal to the SCC
- Like virtually all areas of law, there is an access to justice issue in taxation cases (even dispute the informal procedure rules)
    - ***Pytel v R***: An example of an informal procedure case conducted by the taxpayer (in which the taxpayer experienced must frustration and difficult with the process -which cumulated with him storming out of the courtroom at one point)

        - While this is typically fatal to an appeal, in finding for the taxpayer, Chief Justice Rip (as he then was) acknowledged the difficulties a layperson has trying to run his own tax appeal – even using the informal procedure rules – and made a plea for legal aid, pro bono, and student run ta litigation services.
- Generally speaking, the cost incurred in disputed a Reassessment are deductible under s 60(o) as to reduce the out-of-pocket expenses for taxpayers

Disputes and Interest

- Filing a NoO has 2 important functions:
    - 1st - it preserves/activates a taxpayer's appeal rights – no NoO (and administrative appeal, no ability t file a Notice of Appeal to the Tax Court; and
    - 2nd – it (generally) puts the CRA's collection activities on hold (cannot cease assets or garnish employment income, etc).
- However, filing a NoO and NoA) does not stop the "interest clock" on any outstanding tax liability (that is considered to be outstanding from the date the tax return was required to be filed and taxes paid)
    - Pursuant to s 161, interest is compounded daily at a prescribed rate (ie base rate + 4%) that changes quarterly (5% for first two quarters of 2022, 6% for 3rd quarter, and 7% for fourth quarter)
- **To protect a taxpayer from having to pay additional interest (beyond what has already bee assessed) if unsuccessful in their administrative/judicial appeal, **the taxpayer should consider paying the outstanding liability and include a letter which states that the payment is solely for purposes of stopping interest from accruing and not as an admission or acceptance of the additional liability.** This way:
    - If the taxpayer wins the appeal, then the payment is returned (along with interest), but
        - Like financial institutions, the rate of interest that the CRA pays on overpayments is less then the interest it charged on outstanding debts, and depends on who the taxpayer is
            - Ie. corporate taxpayers receive a lower rate than individuals
    - If the taxpayer loses the appeal, then no additional interest charges will apply.

The Burden of Proof in Tax Appeals

- Generally speaking:
    - In civil trials, the person initiating the Statement of Claim has the initial legal burden of proof (n a BoP); and
    - In criminal trials, the Crown has the burden of proof (BARD)
- For tax cases, s 152(8) presumed an (re)assessment to be "valid and binding", it is generally the case that the taxpayer bears the initial burden of proving that the (re)assessment is wrong on a BoP standard.
    - Confirmed in *Johnston v Minister of National Revenue* and *Northland Properties Corporation v BC*
    - IN contrast, where the Minister is alleging that taxpayer has committed a criminal offence, then the relevant burden of proof is BARD
        - Further, for criminal tax evasion cases, the Minister bears the initial legal burden of proving the *actus reus* and *mens rea* components of the offence BARD
- There are two primary ways that a taxpayer can succeed in overcoming this initial burden in disputing a (re)assessment, namely
    - By proving that the facts and assumptions on which the (re)assessment is based are wrong – and that when the correct facts are considered, a different assessment follows, or

- By proving that the Minister misinterpreted or misapplied the law (or both) to the correct facts
  - Or assessment not related to facts Minister says they are related to which is VERY RARE
- While there has bee much written by the courts about this burden of proof, particularly in respect to the factual challenge (1st ground) and how the taxpayer discharges this burden.
  - ***Hickman Motors Ltd,*** SCC stated:
    - "…The Minister, in making assessments, proceeds on assumptions… and the initial onus on the taxpayer to 'demolish' the Minister's assumptions in the assessment… The initial burden is only to 'demolish' the exact assumptions made by the Minister but no more".
    - "This initial onus of 'demolishing' the Minister's exact assumptions is met where the appellant makes out at least a prima facie case".
    - "Where the Minister's assumptions have been 'demolished' by the appellant, 'the onus shifts to the Minister to rebut the prima facie case' made out by the appellant and to prove the assumptions".
    - "Where the burden has shifted to the Minister, and the Minister adduces no evidence whatsoever, the taxpayer is entitled to succeed".
- While in the vast majority of cases, these comments have not caused any problems in the proceedings, in certain cases, concerns have been raised by both the litigants and the judges as to what these paragraphs from *Hickman Motors* mean – and more specifically, what a *prima facie case* means compared to "demolishing an assumption" and the "balance of probabilities standard"
  - In ***House v R,*** based upon *Hickman Motors*, that
    - (a) unless the Act requires supporting documentation, or
    - (b) the taxpayer's credibility is in question,
  - Credible oral evidence from a taxpayer is sufficient to demolish the Minister's assumptions notwithstanding the absence of records.
  - IN EXAM TALK ABOOUT WHAT WAS SAID IN *HICKMAN MOTORS* AND THEN DISUCSS BY SAYING, "MORE RECENTLY IN *HOUSE*"
- In the FCA decision of *Sarmadi*, Webb J specifically addressed this issue and proposed the following alternative approach of how a taxpayer overcomes their initial burden of proof:
  - 61 In my view, a taxpayer should have the burden to prove, on a balance of probabilities, any facts that are alleged by that taxpayer in their notice of appeal and that are denied by the Crown. In most cases this should end the discussion of the onus of proof since the assumptions of fact made by the Minister in reassessing the taxpayer would generally be inconsistent with the facts pled by the taxpayer with respect to the material facts on which the reassessment was issued.
  - 62 If there are facts that were assumed by the Minister in reassessing a taxpayer and that are not inconsistent with the facts as pled by that taxpayer, it would also seem logical to require the taxpayer to prove, on a balance of probabilities, that these facts assumed by the Minister (and which are in dispute and are not exclusively or peculiarly within the Minister's knowledge) are not correct. Requiring a taxpayer to disprove the facts assumed by the Minister in reassessing that taxpayer simply puts the onus on the person who knows (or ought to know) the facts. It also puts the onus on the person who indirectly asserted certain facts in filing their tax return that would be inconsistent with the facts assumed by the Minister in reassessing such taxpayer.
  - 63 Once all of the evidence is presented, the Tax Court judge should then (and only then) determine whether the taxpayer has satisfied this burden. If the taxpayer has, on the balance of probabilities, disproven the particular facts assumed by the Minister, based on all of the evidence, there is no burden to shift to the Minister to disprove what the Tax Court judge has

determined that the taxpayer has proven. Either the taxpayer has disproven the assumed facts or he, she or it has not

- In Stratas J concurring decision:
  - 69 I have read Justice Webb's reasons on the issue of the burden of proof in tax appeals. I commend him on his exploration of this issue.
  - 70 The issue has been considered before in this Court. My colleague's reasons somewhat revisit this issue and articulate it somewhat differently. I find much of what my colleague says to be thoughtful, illuminating and attractive.
  - 71 However, at this time and in these circumstances, I decline to express a definitive opinion on the correctness of his views on this fundamental point. The insights of commentators may be helpful. Judges in the Tax Court may also have useful insights. As well, in a future appeal in this Court where the issue matters, other counsel may also be able to assist.
- Since this decision, Justices from both the Tax Court and the Federal Court of Appeal have comment favourably on Webb J's articulation – and appear to be applying it (without specifically acknowledging that it might conflict with the SCC's comments (*Eisbrenner* and *Agracity*).

Settlements

- In ordinary civil litigation, parties will typically consider the costs and risks of litigation and may, to minimize them, decide to settle their case before trial.
  - Risks include uncertainty of outcome of the Judge, high costs, time consuming, etc
- This can occur in tax litigation, but not to the same extent
  - Technically speaking, both the CRA and Justice are under **a statutory obligation to assess tax in accordance with the facts and the current law.** This is commonly referred to as a "principled settlement/approach/basis"
    - This means a proper application of the law as it currently exists to the facts as currently knowing
    - Applying the law to the facts is not really a settlement at all.
      - There this is a principled settlement which means to preserve integrity of the tax system (to stop people from saying "he didn't pay his taxes and got this deal, so I want it to")
  - Unlike other litigation, it is not possible to settle on a "risks of litigation" or other basis that does not reflect and apply the relevant current tax law to the facts (*ITA*)
  - That said, the Minister does have the ability to "assume facts" – so in practice, many cases are settled by the parties agreeing on the relevant facts – and then applying to law to those "assumed facts"
    - Some assumed facts will be beneficial to taxpayers in certain instances, and other will benefit the CRA, but it must be justified and law still need to be properly applied to the assumed facts.

UNIT #5: THE MECHANCS OF INCOME TAXATION

Overview

- As discussed in Unit #2, the starting point for the taxation of Canadian residents I s 2(1), which states that "an income tax shall be paid, as required by the *Act*, on the taxable income for each taxation year of every person resident in Canada at any time in the year"
  - We know who a person is and when the person is resident, so now must discuss what taxable income is, how Canada taxes such income, and when that taxable income has to be calculated and reported.

What is taxable income?

- S 2(2) defines "taxable income" as "the taxpayer's income for the year plus the additions and minus the deductions permitted by Division C"
- S 248(1) further provides that "taxable income" cannot be less than 0.

Step #1: Calculation of Net Income for Tax Purposes

- The starting point for calculating a Canadian resident individual's tax liability is to calculate their **Net Income for Tax Purposes** as specified in Division B of the Act.
- As referred to in s 3, there are four main sources of income, namely, **employment, business, property and capital gains/losses.**
  - There are also other miscellaneous income inclusions (primarily contained in s 56) and deductions (in s 60) that are distinct from the other four sources – which collectively are referred to as "other" sources – so there are five sources in total.
- To calculate Net Income for Tax Purposes, a taxpayer must perform the following four steps:
  - Part A:
    - Pursuant to s 3(a), calculate their income from employment, business, property, and other sources, as applicable using the relevant rules for each application source – and the total the positive and nil amount.
      - These calculations are done distinctly for each source/activity (s 4). Put another way, a taxpayer cannot use deductible business expense to reduce employment income – or more correctly, not at this stage of the calculation.
        - Rule for calculating income for each source is somewhat different.
        - This is a net calculation → taxable revenues less deductible expenses
        - Capital gains/losses are not included in this first step
        - Only positive net amounts are aggregated at this step of the calculation – so if a calculation of taxable revenues less deductible expenses for a particular source of income results in a negative number, then a nil amount is recorded for the purposes of this step
        - In the case of the other source, only income inclusions are considered here
        - After completion of this step, the taxpayer will either have a positive or nil income balance.
  - Part B:
    - Pursuant to s 3(b), a taxpayer then calculates the amount by which their taxable capital gains exceed allowable capital losses, as well as the taxpayer's net listed personal property gains
      - A capital gain/loss arises from the (actual or deemed) disposition of capital property, and
      - Generally speaking, only 50% of capital gains are taxable and only 50% of capital losses are deductible from income tax purposes – with the other 50% being outside the scope of the Act
      - When the inclusion rate is applied to a capital gain/loss it is referred to as a "taxable capital gain" and "allowable capital loss"
        - IN contrast, if a document refers just tp a capital gain or loss, this refers to the entire gain/loss without the 50% rate being applied yet
      - An allowable capital loss that cannot be used in the uear incurred can be carried back or forward to offset a taxable capital gain in a prior or

subsequent year. When an allowable capital loss is carried, it is referred to in the Act as a net capital loss.

    - Just as for the first step, if the net amount if negative, a nil amount if reported for this step.
  - Part C:
    - Pursuant to s 3(c), the positive amounts calculated in part a and b, are aggregated and then any applicable deductions contained in the other source (ie. moving and childcare expenses, RRSP contributions, etc. contained in s 60) are claimed.
  - Part D:
    - Pursuant to s 3(d), any employment, business, property, and allowable business investment losses that were calculated, but not reported earlier in this process are deducted, but only to bring taxpayer's Net income balance to nil (at the lowest).

Step #2: Calculation of Taxable Income

- To calculate an individual's taxable income, s 110 requires the taxpayer to take their Net Income for Tax Purposes (found in step1) and reduce it, as applicable, by he amounts contained in Division C, which includes:
  - An amount in respect of employee stock options (s 110(1)(d), (d.01), ad (d.1))
  - An amount for "payments" – most commonly workers comp and social assistance,
  - Any lifetime capital gains deductions claimed under s 110.6, and
  - Any loss carry overs from other taxation years
    - When going from net income to taxable income, we are reducing it by losses incurred in a previous taxation year
    - Losses incurred in current year MUST be applied in that year IF POSSIBLE.
      - Include net capital losses, or property losses.

Step #3: Calculation of Taxes Payable

- Once Taxable Income has been calculated, then the next step is to calculate Taxes Payable. This is generally accomplished by multiplying Taxable Income by the appropriate Tax Rate, and then reducing that amount by any appliable tax credits
  - **Formula: Taxable Income x Tax Rate = Tax Liability**
- **Progressive Rate Regime Terminology:**
  - **Marginal Tax Rate:** the rate at which incremental income will be taxed
    - When considering the after-tax implications of earning more taxable income, the applicable marginal tax rates should be used
  - **Average Tax Rate:** This is calculated by taking total taxes payable and dividing it by total taxable income
    - In a progressive tax regime, the average tax rate will typically be less than the marginal tax rate
    - In a proportional tax regime, the average tax rate will be the same as the proportionate tax rate
  - **Effective Tax Rate:** This is calculated by taking total taxes payable and dividing it by total net income for accounting (financial statement) purposes
- ****When calculating Tax Liability make sure that each section of income is multiplied by the applicable tax rate… so can be multiple equations.**

Taxation Rate Regimes

- There are essentially 3 different taxation rate regimes that a government can adopt, namely:

1. **Proportional**: A proportionate tax regime is one where the rate of taxation does not change as income changes. Because of this defining feature, it is often referred to as "flat tax"
   - Alberta used to have this type of regime (excluding the application of tax credits) – by levying a 10% provincial tax on taxable income
   - Although the tax is a "flat tac", higher income earners will still pay a higher amount of tax than a lower income taxpayer. The key feature of a flat tac is that it will be the same percentage of their income.
   - Proponents of this approach justify it on the following grounds:
     - It does not put a disproportionate burden for taxes on a small higher-income group which may seem unfair
     - Proportionate taxation also performs a redistributive function – although not as severe as a progressive rate regime.
     - Progressive taxation might discourage work effort, risk taking, and savings.
     - Progressive taxation also encourages "income splitting" and "tax deferral strategies", which the government must then address with anti-income splitting and deferral legislation (which is inefficient)
       - Example of income splitting:
         - Bert and Ernie are a common law couple. Bert earns all of household's income of $200,000 – which is progressively taxed at rates from 25% up to 42%. If Bert and Ernie each earned $100,000 (so total household income stays the same at $200,000), they would have more after-tax income because their income would be taxed at rates from 25% up to 30.5%
       - Example of tax deferral:
         - Elon's company has recently sold some technology for $10 million. If his company distributes the entire amount of the after-tax corporate income to him this year, most of that dividend will be taxed at the highest marginal rate (i.e. 48% if Elon is an Alberta resident). However, if Elon has his company pay smaller dividends over a longer period of time, those dividends may be subject to lower taxation rates.
     - Progressive taxation is more complex
2. **Progressive**: A progressive tax regime is one where the taxpayer's tax rate increases with there income.
   - Our federal tax regime has always been progressive – and since October 1, 2015, Alberta's provincial tax regime has become progressive
   - In the case of individuals, progressivity is accomplished by first allocating the taxpayer's Taxable Income into the federal (and provincial_ brackets and applying the applicable rate to each bracket of income.
   - Governments will "index" which means to adjust the marginal brackets for inflation
     - This is importance because if the brackets were not indexed for inflation, then there would effectively be a slight increase in a taxpayer's taxes year-to-year due simply to inflation

Federal

Income	Rate

$0 - $50,197	15% (FIRST $14,400 SUBJECT TO BASIC TAX CREDIT SO NOT TAXABLE)
$50,198 - $100,392	20.5%
$100,393 - $155,625	26%
$155,626 - $221,708	29%
$221,709 +	33%

Alberta

Income	Rate
$0 - $134,237	10%
$134,238 - $161,085	12%
$161,086 - $214,780	13%
$214,781 - $322,170	14%
$322,171 +	15%

- Combining the Federal brackets and rates with the Alberta brackets and rates, in order to calculate the combined tax liability of an Alberta resident, results in the following rate schedule:

Income	Federal Rate	Alberta Rate	Combined Rate
$0 - $50,000	15%	10%	25% (federal and Alberta basic tax credit first)
$50,001 - $100,000	20.5%	10%	30.5%
$100,001 - $130,000	26%	10%	36%
$130,001 - $155,000	26%	12%	38%
$155,001 - $210,000	29%	13%	42%
$210,001 - $315,000	33%	14%	47%
$315,001+	33%	15%	48%

- **Note:** in practice, a Canadian resident will file two income tax returns – a Federal and provincial/territorial return – using the rate regime applicable to each return. For our purposes at this point in the Course, I have combined the rates to determine an Alberta resident's total tax liability (excluding the application of applicable tax credits)
  - Proponents of this approach justify it on the following grounds:
    - It better rectifies the inequality and unfairness of the market economy than a proportionate tax regime (redistributive justice argument)
    - It better accords with a taxpayer's "ability to pay" taxes
      - The argument here is that taxpayers with lower amounts of taxable income will likely use all of their income to satisfy their basic personal needs, so the rate of taxation should be low.
    - It allows a government to reduce the tax rate on lower amounts of income by increasing the tax rate on higher amounts of taxable income

3. **Regressive Taxation:** One where taxpayers pay a tax at a lower rate as their income increase
   - Proponents of this regime justify it on the following grounds:
     - It encourages economic growth
     - It may better reflect income demographics
       - Ie. the vast majority of the population has income at roughly the same level, with a very small upper class
     - Used in Scandinavian counties like Norway, Sweden, etc.

Step #4: Application of Tax Credits

- The final step in calculating an individual taxpayer's net tax liability is:
  - 1st – determine what tax credit the individual qualified for
    - All personal tax credits are contained in s 118(1)
  - 2nd – Multiply the bases amounts of the tax credits by the applicable tax rare (which is typically the lowest marginal rate), and
    - In the case of personal credits, the disability tax credit, and tax credits transferred from a spouse or person supported by a taxpayer, section 118.91 further requires that they be pro-rated where an individual is resident in Canada for only part of the year
  - 3rd- Take the calculated amount and use it to reduce the individuals tax liability as calculated in step #3
- **** Federal tax credits can only be used to reduce an individual's Federal tax liability, and the same goes for Alberta Tax Credits**

Federal Tax Credits:

- **Basic Personal Credit (s 118(1)(c))** which can be claimed by a single person and has a base amount for 2022 of $14, 398
  - Indexed for inflation by virtue of s 117.1
  - Only available to taxpayer's who have a total Taxable Income of $155,625 or less. (the top of the 2nd Federal marginal bracket)
    - If greater than that amount, it is reduced until the income is $221,8708 (the top Federal marginal bracket).
      - Once in the highest marginal bracket, the tax credit is $12,719.
  - This essentially means that the first $14,398 of every Canadian resident taxpayer's income is free from federal income tax
    - The actual savings is $14,398 x 15% -= $2159.70
  - Provinces have their own basic personal credit.
  - Government justifies this because every person should be given an amount of income they can earn that will not be taxed at all as part of the progressive regime as everyone has right to earn income for basic necessities and life which government estimates to be a certain amount every year.
- **Spousal/Common Law Partnership Credit (s 118(1)(a)** which provides that where an individual taxpayer is married or in a common law relationship, in addition to claiming the Basic Personal Credit for themselves, can claim this credit for their partner
  - EVERY TAXPAYER STILL FILES THEIR OWN INDEPNDENT TAX RETURN

- The base amount of this credit is generally the same as the Basic Personal Credit (unless the partner is dependent due to physical/mental infirmity, then the amount of the credit is higher)
  - Hence once the partner has their own income of $14,398 or higher, this credit is no longer available.
  - **Example:** If wife earns all the money, and spouse earns $0, then she would claim a Basic Personal return and the spousal credit return since the spouse does not get to claim a personal tax credit.
    - Additionally, if the spouse earns anywhere between $1 - $14,397, they would claim their own basic personal credit for that amount and the spouse would claim what ever is left as a spousal credit.
      - So no matter what, in a household with two partners, they get to claim two full amounts of $14,398.
- Only one partner can clam the spousal credit, so whoever is making more would claim it.

- **Wholly Dependent Person Credit (s 118(1)(b))** which is generally available to a single person who is not claiming a Spousal Credit who supports a person who lives with the taxpayer, is related to the taxpayer, and who is wholly dependent on taxpayer.
  - Ie. minor child or disabled person or elderly person
  - Like the Spousal Credit, the based amount of the Wholly Dependent Person is the same as the Basic Personal Credit (unless the dependent person is dependent because of physical or mental infirmity – in which case the base amount is higher) but is reduce by the dependent persons net income
- **Age Tax Credit (s 118(2))** which is available for individuals who turn 65 years of age before the end of the taxation year
  - For 2022, the base amount of the Federal Credit is $7,898, but is reduced by the individual's net income over a specific threshold.
  - Basically, if you're older it is assumed you have less money to pay for taxes.
    - Anyone 65 or older gets this credit UNLESS they are a high-income senior.
- **Canada Employment Tax Credit (s 118(10))** which is available for all individuals who have employment income
  - The base amount is $1287 (unless the individual's employment income is less than this amount, in which case it is the individual's employment income)
- **Charitable Donation Tax Credit (s 118.1)**
  - Unique in three respects:
    - First, while the first $200 of charitable donations that are claimed in the year are multiplied by the lowest marginal rate to determine the tax savings, any donations in excess of $200 are multiplied by the 29% Federal rate (unless the individual claiming the donation has income taxed at the 33% rate, in which that may be applicable, but beyond scope of the course)
      - Encourages people to donate
      - Must have charitable donation receipt to use this credit. (which are only given if it is a true gift, so nothing an be given in return for the donation)
    - Second, it is possible for charitable donations to be carried forward for up to 5 years before being claimed (ecological gifts carry forward period is 10 years) – which allows charitable donations made over several years be claimed on one tax return, maximizing the amount calculated at the higher marginal rates
    - Third, it is possible for couples to pool their donations and claim them on one return which also helps maximize the amount calculated at the higher marginal rates

        - Does not matter who claims the donation since the tax relief is based off the amount donated, not the income of the claims (unless 33% marginal rate, then use that person)
    - Generally speaking, the limit on the amount of donations that can be claimed on a particular tax return (other than year of death which is 100%) is 75% of the taxpayer's income.
- **Medical Expense Tax Credit** which allow individuals to claim credit for qualifying medical expenses over a specified threshold that have not been reimbursed by a health plan (unless the reimbursement must be included in the individual's income
    - Generally speaking, this credit allows on individual to claim <u>all the medical expenses for the household </u>over a 12-month period that ends in the years
        - Can be any 12 month period, so does not have to be Jan 1 2022- Dec 31 20221, could be Aug 1 2022, to Aug 1, 2023.
            - This is because medical expenses are sometimes incurred over a specific condensed period of time, so gives opportunity to pick 12 month period to put as many expenses as you can in that period
    - Because the credit is based on expenses over a specified threshold, and that threshold is lesser of a fixed amount ($2479 for 2022) or 3% of the taxpayer's net income for the year, it is generally advantageous for the lower income partner to claim the medical expense for the family as it allows more medical expenses over the threshold be claimed.
    - Medical Expense = something that is medically necessary, not more cosmetic in nature.
- **Disability Tax Credit (s 118.3)** which allows a person with a physical and/or mental disability that satisfies all of the requirements in the Act (including certification by a listed medical practitioner) claim a credit
    - One of the additional benefits of qualifying for and claiming this credit is that it may open the door to other tax benefits – including being able to participate in a Registered Disability Savings Plan (which other can make contributions to for a tax beneficial matter)
- **Tuition Tax Credit (s 118.5)** which allows students who incur eligible tuition fees to claim a Federal credit generally equal to 15% of those fees
    - Like the Charitable Donation Tax Credit, there is the possibility of carrying forward this credit (s 188.61) when the student does not have sufficient income in the year the tuition fees are claimed to full claim the tax benefit of the tax credit (although there is no maximum carry forward period)
    - Alternatively, where the student cannot fully utilize the tax credit, it is possible to transfer a portion of the credit to a souse/common lae partner (s 118.8) and or a parent/grandparent (s 118.9)

Alberta Tax Credits:

- **Basic Personal Credit** which can be claimed by a single person and has a base amount for 2022 of $19,814
    - The actual savings is $19,814 x 10% = $1981.40.
- **Charitable Donation Tax Credit:**
    - First $200 claimed is multiplied by 10%, any amount over $200 is multiplied by 21%
    - Combined Federal and Ab tax relief for donations in excess of $200 is 50%.
    - **DO ALL THE OTHER RULES FOR FEDERAL TAX CREDIT APPLY T AB TOO?**
        - Idk never said. SO irrelevant.

Tax Deductions vs Tax Credits

Deductions

- Tax Deductions and Tax Credits both reduce taxes, but do so quite differently
  - Tax Deductions are what we are allowed to claim and typically used in 1st step of calculation of net income.
    - **As deductions reduce the income of a taxpayer, the benefit of a deduction is taxpayer specific.**
      - **Example #1:** Taxpayer made $10,000 RRSP contribution
        - If they have an **income of $400,000,** they are over the highest income bracket by $80,000, therefore we can deduct the whole amount and they would still be over the highest marginal rate. Therefore, we can use a rate of 48%.
          - So tax savings = $10,000 x 48% = $4,800
        - If they have an income of $54,000, they are over the first income bracket by $4000. Therefore, have to deduce the amount in groups depending on tax rate.
          - So tax savings = ($4,000 x 30.5%) + ($6000 x 25%) = $2720
          - If we had an income of $60,000, the entire $10,000 could be deductible at the 30.5% rate.
      - **Example #2:** Taxpayer has an income of $130,000 and made a $100,000 RRSP contribution.
        - There would be three calculations:
          - $30,000 x 36%= $10,800
          - $50,000 x 30.5%= $15,250
          - $20,000 x 25% =$5,000
        - Tax Savings = $31,320
        - Net Economic Cost = RRSP Contribution – Tax Savings
          - ,$100,000 - $31,320 = $68,680
- As briefly discussed, net income (or profit) can generally be defined as "revenues less expenses" (or mor generally, "net receipts)
  - While often attention is focused on the revenue/receipt side of this equation, equally important is the expense/cost side
  - Very generally, "deductions" are expenses that are recognised/allowed for income tax purposes
    - They offset revenues and hence reduce a taxpayer's income (and taxes payable)

How to Calculate Tax Savings (when there's a deduction):

- **Formula: Taxable Payable without Deduction – Taxes Payable with Deduction = Tax Savings/Benefits**
  - So (Taxable Income x Tax Rate) – ((Taxable Income – Deduction) x Tax Rate))= Tax Savings
  - **OR SHORT FORMULA =** Tax Deduction Amount x Tax Rate = Savings
- **If an expense is deductible for tax purposes, then that does not mean the item/expense is "free" to the taxpayer – it simply means that for purposes of calculating taxable income and hence taxes payable, the item/expense will reduce taxable income and taxes payable.

IMPORTANT POINT: In calculating taxes payable, we always start at the bottom and work our way up through the marginal tax brackets. Conversely, when contemplating incurring a deductible expense, we start at the top and work our way down.

Credits

- Tax Credits also constitute a tax benefit to taxpayers, but they provide that benefit to taxpayer in a different way then tax deduction.
  - As noted above, tax deductions reduce a taxpayer's taxable income, which in turn reduces the taxpayer's tax liability (which is calculated by multiplying taxable income by the appropriate tax rates)
  - In contrast, tax credit do not affect as taxpayer's taxable income. Instead, they are calculated separately from the calculation of taxable income (and taxes payable)
    - Tax Credits are calculated in final step of process
- **Because tax credits do not alter a taxpayer's income (and are generally calculated at the same rate for all taxpayers), tax credits are **not taxpayer specific**
  - Assuming that two taxpayers both qualify for the credit, they will receive the same benefit regardless of their income (unless a rule states otherwise)

Utilizing Tax Deductions and Tax Credits

- If tax deduction exceed taxable revenues to create a net loss in respect of a particular source of income then that loss:
  - In cases involving income from any source other than capital gains, may be used to offset net income from another source in the CURRENT tax year (if any) but only to bring net income for the year to nil, (as Step1D indicates) and
  - If the net loss cannot be used in the current year's return, it can be carried back up to 3 taxation years or carried forward to offset taxable income in those tax returns (s 111) (as Step 2 indicates)
    - More specifically, if the loss is not a loss from the disposition of a capital asset, referred to as a "**non-capital loss**", then it can be carried **back up to 3 years** and **forward generally up to 20 years** and offset against **any source of income** in those years (s 111(1)(a))
    - However, if the loss is from the disposition of a capital asset, referred to as a "**net capital loss**" then the loss can still be carried **back up to 3 taxation years** and can be **carried forward until the taxpayer dies**, but can **only be used to offset net taxable capital gain**s in those years (s 111(1)(b))
    - This is why we prefer business losses over capital losses, because they are not reduced by 50% and they can be carried forward to apply to all sources of income, not just to reduce net capital gains.
  - Given this feature, the tax benefit of a deduction will generally be realized 0 either in the year that it is claimed or in a prior or subsequent year.
- In contract, for the majority of tax credits, if they cannot be used in the current year to reduce an existing tax liability (including a tax liability that has been covered by source withholdings or instalment payments during the taxation years), then they are of no use for that taxation year (and are not applicable against future r prior taxation years)
  - **Put more simply, if not used the benefit is lost forever**
  - For this reason, tax credits are generally described as being "non-refundable"
  - That said, there are some exceptions where tax credits can be used by someone other than the taxpayer(ie. tuition tax credits) or carried forward to a subsequent year (like tuition and student loan interest tax credits)

- A few tax credits can be refundable, meaning they can result in a tax benefit even if the taxpayer is not taxable (GST credit)

When Does Taxable Income Have to be Calculated and Reported?

- Section 249 and 249.1 collectively define the "taxation year" for each of the three "persons" recognised by the Act
    - For an individual, generally speaking, the taxation year is the calendar year (Jan 1 to Dec 31)
        - S 249(1)(c) states the calendar year is the default taxation year for anyone other than a corporation and a GRE
        - As trusts are generally treated ad taxed as if they are "individuals" under s 104(2), the default rule for trusts is that they will have a calendar year taxation year
        - In the case of GRE, the current rule is that the taxation year cannot end more than 12 months after the testator's death and can be off-calendar, but only for 36 months, at which point it will be forced to have a calendar year taxation year
    - For a corporation, the taxation year is its "fiscal period" which generally cannot end more than 53 weeks from when the period began
        - Effectively, this allows a corporation to choose whatever 365 day period as its "fiscal period"
            - Although once it selects this period, then generally speaking it is "stuck" with it unless it has a good reason to change it
            - In the corporation's first year of existence, it can have a fiscal period that is less than 36 days (which is typically the case to allow the corporation to select its fiscal year end)
                - This an be an importance issue (for both tax and non-tax purposes) that should be addressed with the corporation's management, accountants and tax advisors (and perhaps creditors) to determine the best year end
                    - Typically want to pick something of the year which is slow, so not Christmas, Black Friday, Boxing Day rushes.
- There are other provisions for which different reporting rules may apply – but are beyond the scope of this course. To be safe, please consult a tax professional to confirm that these other rules do not apply (or how to best apply them).

UNIT #6: Employment Income

Overview of the Taxation of Employment Income

- The taxation of employment income is very important for two primary reasons:
    - 1st more tax revenue is derived from the taxation of employment income than any other source taxed by the ITA and
    - 2nd each individual who earns employment income typically has a vote – so the government has to be very careful in how it taxes employment income as this could impact its ability to stay in power.
- Given this, it seems somewhat surprising (at least to me) that there are only 4 main section that cover the calculation of employment income (ss 5-8)

Characterizing the Relationship between a Service Provider and Service Recipient for Income Tax Purposes

- When an individual provides services to another person and generates revenues and/or incurs expenses, for tax purposes, it is important to first consider the capacity in which the person is providing those services
    - This will determine how the person's income form providing those services will be taxed under the Act, if at all
    - This can also have no tax implications such as vicarious liability, or whether one needs to comply with employment legislation, etc.
- There are 3 possible relationships for income tax purposes that can exist between a service provider and a service recipient namely: a personal relationship, an employment relationship, or a business relationship
    - So, first step is to determine what the relationship is.
        - **Option 1: Personal Relationship**
            - For our purposes, a person relationship is one that is done with no intention for profit; a "hobby" relationship
                - For example: shoveling neighbours walk
            - Because there is no intention to profit – and often no revenues – it is not a taxable activity – so you cannot claim/deduct expenses (if incurred as part of this activity
            - In tax literature and jurisprudence, an activity carried on with no (objectively-manifested) intention to create a profit is typically referred to as a "hobby:
                - Hobbies are not taxable under the Act if they generate inflows
        - **Option 2: Employment Relationship**
            - Act is not very helpful when trying to distinguish between employment and business relationships
            - S 248(1) provides the following definitions:
                - **Employed** means performing the duties of an office or employment
                - **Employee** includes officers
                - **Employer** in relation to an officer means the person whom the officer receives the officer's remuneration
                - MOST HELPFUL: **Employment** means the position of an individual in the service of some other person… and **servant** and **employee** mean a person holding such position
                    - Refers to being in the service of another – as opposed to providing a service (which will often be a business relationship)
                - **Office** means the position of an individual entitling the individual to a fixed or ascertainable stipend or remuneration and includes a judicial office, the office of the minister of the Crown, the office of a member of the Senate or House of Commons of Canada… and also includes the position of a corporate director, and **officer** means a person holding such office"
        - **Option 3: Business Relationship**

- Business is defined in s 248(1) as "including a profession, calling, trade, manufacture, or undertaking of any kind whatsoever and… an adventure in the nature of trade, but does not include an office or employment"
  - Practically speaking, the definition of a business is intentionally-broad such that the business source of income works as a "catch-all category" in the Act
    - Basically, if you are not an employee and source is not recognized in another category or not a capital gain/loss, this is intended to catch whatever else it may be.
  - In the context, when a business relationship is found to exist, the service provider is commonly described as an independent contractor.
- These activities are all mutually exclusive.

Tax and Non-Tax Implications of being in an Employment or Business Relationship

IF QUESTION ASKING PROS AND CONS OF EACH TYPE OF RELATIONSHIP, LOOK HERE.

Implication	Employment	Business	Which is Preferred? Why?
Non-tax: Commitment to an ongoing relationship (and associated costs)	Relationship is ongoing and often indefinite. Consequently, deciding to employ someone is a significant commitment.	Relationships are often establish to acquire a particular service. Once service has been provided, the relationship is over (may exist in future contracts)	**Service Recipient's perspective:** Business relationship because it reduce ongoing costs and commitment
Tax: Scope of Deductions	**S 8(2):** provides that unless a deduction is specifically allowed by s 8 (and meets all requirements), no deduction is allowed	**S 18(1)(a):** provides that if an expense is incurred for purpose of earning business/property income, it will be deductible for tax purposes unless another specific section denies the deduction.	**Service Provider's perspective:** Key reason for wanting a Business Relationship. Maximizes the number of expenses that can be deducted in calculating business income for tax purposes and minimize taxable income.
Non-Tax: Employment Insurance	Both employee and employer will be subject to employment insurance premiums (or employer may pay both)	Service recipient will not have to pay EI premiums in respect of the service provider. Therefore, when ic loses contract they cannot come to the CRA looking for EI support.	**Service Recipient:** prefers business relationship as it reduces costs and do not have to pay for EI. **Servicer Provider:** Prefers employment so it gives them EI when they cannot find work.
Non-Tax: Canadian Pension Plan	**Same as EI**	**Same as EI**	**Same as EI**

Non-Tax: Vicarious Liability	Employer is vicariously liable for employees' tortious acts	Employer is not vicariously liable for tortious acts of an independent contractor	**Service Recipient:** Business relationship because they are not reliable if the contractor commits a tort.
Tax: Payment and Withholding of Taxes	Employer has responsibility of withholding and remitting source deductions from employment income (s 153(1)(a)), which includes income taxes.	Generally no withholding requirements on the recipient of services, although the service provider, may be required to make instalment payments for income taxes in respect of their business income.	Does not really make a huge different to most service recipients as it is more of an administrative function and/or matter of timing/cash flow, rather than an addition of cost or savings.
Tax: Basis of Measurement	**S 5(1):** requires employment income to be reported by employees on a cash received basis.	Generally calculated on an accrual basis (when legally entitled to receiver payment). Under accrual method: - Business revenues are generally reported for tax purposes when the independent contractor has done everything to entitle them to be paid (though payment may occur sometime in the future) - Business expenses are generally deductible in the year in which (a) the independent contractor is legally liable for them and (b) the amount of the expense can be determined with reasonable accuracy	Depends on what you're looking for. Does not really effect either way.
Non-Tax: Participation in	Employees are entitled to supplementary benefits like health care,	Not entitled to benefits from employer.	**Servicer Provider:** Prefer employment relationship to receive

Employer Plans/Benefits	vacation pay, participation in employer's pension plan, etc.		benefits and reduce costs. **Service Recipient:** Prefer business to reduce costs cause they do not have to provide benefits.

Determining the Characterization of a Service Provider for Income Tax Purposes

Wiebe Door Services Ltd v Minister of National Revenue (approved by SCC in *Sagaz*)

Facts:
- W was in the business of installing and repairing (garage) doors in Calgary
- Rather than having a large staff of installers (which would be costly), W had contracts with a number of door installers and repairers, each of whom had the understanding that they would be running their own business with all its implications

Issue: Were these door installers and repair persons employees or independent contracts for tax purpose?

Analysis:
- **TEST:** IS THERE A CONTRACT OF SERVICE OR A CONTRACT FOR SERVICES?
    - Must do a comprehensive factual analysis which considers all aspects of the parties' relationship
    - Consider the following four tests: control, ownership of tools, chance of profit and risk of loss (entrepreneurial test), and integration.
        - ON EXAM LIST ALL 4 TESTS THEN SAY:
            - **"Unfortunately based on past case law I cannot guarantee the Court would come to the same conclusion I have, so I would seek further guidance from a professional, but they will likely only be able to provide you with some assurance as there is not necessarily any guarantee what the outcome would be until it is heard by a court."**
            - Since some courts will not recognize the integration test, or divide the entrepreneurial tests into two separate ones.
        - These tests will be analyzed individually and then in the end, must be considered together (along with any other relevant facts) to determine the essence of the relationship.
    - **Control Test:**
        - ARGUABLY THE MOST IMPORTANT
        - General rule: **the less control the payor can exert over the service provider, the more likely the relationship is a business relationship.**
            - So inverse is also true; the more control the payor can exert, the more likely the relationship is an employment relationship.
        - In applying this test, some judges have stated that if the payor controls only **what** is to be done, **then this is more indicative of a business relationship.**
            - Example: A client retains a lawyer to implement a real estate conveyance. The client does not tell the lawyer how to do the work.

- Alternatively if the payor not only controls **what is to be done but how it is to be done,** then this higher level of control is more indicative of **an employment relationship.**
  - Example: an in-house corporate counsel lawyer. The layer is likely subject to more supervision by their superiors than where a client retain a lawyer from an external law firm.
- Sometimes not very helpful as terms of business contract may, by necessity (or desire), be more detailed than would be necessary than in an employment relationship (in other words, the relationship contains a very high level of control on the part of the service recipient over the service provider.
- In other cases, this test breaks down in cases involving very professional and/or technically skilled employees – where the employer is not really capable of controlling how the employee performs the work
  - This does not mean that highly skilled service providers cannot be employees
    - Example: McDavid is an employee of the Edmonton Oilers.
- One of the indicia that some judges have found helpful in applying this test is **whether the service provider must do the work themselves or whether they can delegate/subcontract it to another person**
  - This is indicative of the service provider carrying on a business since employees do not have their own employees
  - If the service provider can hire helpers or someone else to do the job, then the courts have often found this fact to make the relationship look more like a business one
  - That said, just because the service provider must perform the services, it does not mean they are an employee.
- Another factor that courts often consider is **whether the services are more "indefinite" in nature** as compared to accomplishing a **"specific result"** – with the former generally more indicative of an employment relationship and the latter sometimes more indicative of a business relationship
- Other factors include:
  - mode and timing of payment (if it occurs same time and way they pay other employees, more indicative of employment relationship),
  - mandatory attendance at staff meetings (generally contractors do not have to attend staff meetings)
  - workers having to follow company policies (same as above)

- **Ownership of Tools Test**
  - ARGUABLY THE LEAST IMPORTANT TEST, more important in close cases
  - If the taxpayer owns all of the tools required to provide the contracted services, then this is typically viewed as more indicative of a business relationship
    - The underlying principle is that you expect the business to have everything it needs to provide its services.
    - Can still fall apart in particular cases (ie. no tools required or tools are hugely expensive and/or unique to service recipient)
      - Therefore, could have a rental agreement in place to use certain tools = indicative of a business relationship

            - **So, on exam say "Since it is necessary to use this places tools, I would recommend creating a second contract for the purposes of renting this equipment to protect from damages and also clarify need for using equipment"**
        - Also, if everything else is indicative of a business relationship, but they use the workplaces tools, this is not significant enough to alter the result and make it an employment relationship
- **Chance of Profit/Risk of Loss Test**
    - This test explores whether the taxpayer has the opportunity to profit and the risk of loss (generally two hallmarks of a business)
        - More then it's literal interpretation since employees "profit" through their remuneration
        - What this test if often getting at is that many employees make the same amount (per hour/month) regardless of their performance (in the short term)
            - As such, the chance of profit or the risk of loss compared to a businessperson, who can have a much better or worse year depending on their efforts, the market clients acquired and lost, etc.
        - Typically focuses on other investments that must be made by the service provider in order to provide those services.
        - Other examples include liability: employers are vicarious liable for their employees mistakes, whereas service providers will often invest in their own insurance as they would be liable for their own negligence or damages caused.
        - Another example is incentive pay: car salesman, brokers, anyone who is paid on commission. They have more chance of profit and risk of loss, but are still employees.
    - This indicia also acknowledges the fact that employees only offer their time and expertise to the relationship, whereas businesspersons often have to invest in assets/equipment to be able to provide their services and are at risk of not getting a reasonable return on those assets (but this starts to overlap with ownership of tools test)
    - A problem with this test in practice is that judges have been inconsistent in how they recognize the chance of profit and risk of loss in a relationship
    - For instance:
        - If the service provider is responsible for correcting any mistakes at their own cost, then some judges have found this to be indicative of a business relationship – which was the FCA's approach in *Wiebe Door*
        - That said, we also know that a person can charge by an hour and still be considered an independent contractor.
    - **Showing how the service provider has a chance of profit and risk of loss is a key strategic issue for counsel (and a great opportunity for council to demonstrate their creativity and persuasiveness)
- **Integration Test**
    - This test is to be applied **<u>from the service provider's standpoint</u>** (rather than the service recipient's standpoint) and **asks whether the service recipient is so**

integral to the provider's business that the activity would likely end/fail if the recipient ceases to be a customer/client
  - If the existence of a particular service recipient is not critical to the service provider's business (i.e just one of several clients), then this will be an indicia supporting characterization as a business relationship
  - Essentially asking how important is this particular client to this service provider if only one client, then it is critical and loss of client would end business, so therefore, service provider is integrated with the service recipient and that is one indica of an employment relationship.
- Principal is that if they have multiple clients, then loss of one or more does not fully effect them.
  - However, when you only have one client, it does not mean that this has to be an employment relationship, can still be a business relationship by LOOKING AT OTHER TESTS.
- As a service provider, should keep a record of all the marketing done and quotes given so that you can show you are trying to expand and not only rely on relationship with one specific service recipient
- This is sometimes known as the "economic dependence" test

The Role of Parties' Intention in Characterizing their Relationship

- Do the parties' (mutual) intention to create an employment or business relationship, as set out in a jointly signed written contract, play any role in the characterization of a service relationship?
  - **Traditional Answer:** In *Wiebe Door*, the FCA stated that the parties' intention that the installers "would be running their own businesses… was not determinative of the relationship between the parties and a court must carefully examine the facts in order to come to its own conclusion"
  - **New Answer:** FCA in ***Connor Homes*,** has take a different view. More specifically, it expands the analysis set out in *Wiebe Door* as follows:
    - **Step 1:** Consider "whether there is a mutual understanding or common intention between the parties regarding their relationship", and
      - As noted, this can be ascertained "either by the written contractual relationship the parties have entered into or by the actual behaviour f each party, such as invoices for services rendered, registration for GST purposes and income tax filings as an independent contractor"
    - **Step 2:** Where such a mutual intention is found, then consider "the relevant factors in light of that mutual intent for the purpose of determining if, on balance, the relevant facts support and are consistent with the common interest"
  - **The parties' mutual intention is not legally determinative. If present, then their mutual intention only creates a "prism" though which the *Wiebe Door* analysis is to be undertaken.
    - So, basically, are there any characteristics of the relationship in direct conflict with the parties intention?
    - If not, then the parties relationship for tax purposes should be characterized in accordance with their mutual intention.

Incorporated Employees

- Assuming that after performing a *Wiebe Door* analysis, as supplemented by *Connor Homes*, your professional opinion is that an employment relationship has been created, is it possible to change this

characterization for income tax purposes by have the service provider incorporate a company, who will then contract with and provide services to the service recipient? **NO.**
  - After all, as a matter of common sense, a corporation cannot be an employee or in an employment relationship (only human beings can)
    - In the Act, the individual actually providing the services, now as an employee of their corporation is referred t as an "incorporated employee"… So, NO, it does not work.
- To combat this inappropriate form of tax planning, the federal government create the definition of a "**personal services business"** in s 125(7) which has the following 3 characteristics:
  - A service business carried on by a corporation where,
  - The individual who provides the services on behalf of the corporation (the "incorporated employee") or anyone related to the individual is a "specified shareholder" of the corporation AND
    - Specified shareholder is defined in s 248(1) as a person who owns "not less than 10% of the issued shares of any class of the capital stock of the corporation:
  - The incorporated employee would reasonably be considered an employee of the service recipient but for the existence of the corporation, UNLESS
    - The corporation employes in its business throughout the year **more than 5 full-time employees**
- If a corporation is found to be carrying on a "personal service business" (PSB), then the 2 most significant (and taxpayer unfriendly) consequences are:
  - The income from such business is not eligible for the small business deduction (and other rate deductions) – meaning that it is taxed at full corporate rates, plus an additional corporate tax on PSB income (s 123.5), and
  - S 18(1)(p), the corporation is severely restricted in what expenses it can deduct for tax purposes in calculating its PSB income (to essentially what an employee could deduct under s 8)
- Put more simply, **there are no tax advantages to incorporating a corporation to carry on a PSB; indeed, this generally results in higher tax costs than simply earning the income personally**
  - Additionally, there are also non-tax costs of creating and maintaining a corporation.
    - If only providing services, on an exam say "I would seek advice from a tax or legal professional, as although you CAN incorporate, there are some significant consequences to incorporating. There may be some ways to get around this but that is beyond my knowledge, and what I am informed of becoming a "personal service business" result sin consequences of… DISCUSS."
      - Tell them information of positives form becoming a corporation, and then discuss negative tax consequences that come with personal business activity incorporation.

What is included in employment income?

- The starting point for determining what is to be included in employment income for tax purposes is s 5.
  - Answer two important questions:
    - What is to be included in employment income for tax purposes?
      - S 5(1) provides that a taxpayer's income from an office or employment is the salary, wages, and other remuneration, including gratuities, received by the taxpayer during the year.

            - S 6(1)(a) shows how broad the combination of these two provisions are in including things in employment income for tax purposes.
        - As important as what is said in s 5 is what is not said – that the salary, wages, and other, have to flow from the employer to the employee to constitute employment income to the employee
            - Consequently, gratuities flowing from a customer to the employee still constitute employment income and must be included in the employee's income for tax purposes.
        - S 6(3), which supplements s 5, by deeming certain payments to fall within the scope of s 5
            - i.e. an inducement payment or signing bonus to become an employee is employment income for tax purposes even though the payment(s) happen prior to the employment commencing
        - These sections lead to the "rule of thumb" that if an amount is received by an individual that has some connection to their employment, to assume that it is taxable as employment income
    - When such income should be calculated?
        - This is commonly referred to as the "cash basis" of income recognition (which was briefly introduced earlier in these notes) – you report your employment income in the taxation year in which it is received, as opposed to when the work is done.

Taxable (and Non-Taxable) Allowances and Reimbursements

- Allowance is paid prior to expense being incurred, whereas reimbursement is paid after the expense has been incurred.

Allowance

- Subject to list of exceptions contained in the provision (these non-taxable exceptions include "reasonable" allowance for travel (particularly where the employee sells property or negotiates contracts for their employer) and a "reasonable" allowance for the use of the employee's motor vehicle for work travel), s 6(1)(b) provides that **an employee has to report any allowances received from their employer as part of their employment income**
    - If an employment allowance is taxable to the employee, then the employee can mitigate this result by deducting the associated expense if allowed by s 8. However, if an employment allowance is non-taxable, then the employee cannot claim a deduction, even if otherwise allowed by s 8.
- An allowance has generally been defined by the courts as an amount that the employee is paid, for which they do not have to substantiate how it was spent
    - Because there is no accountability, the potential exists for the employee to pocket the money and/or use it for personal purposes and as such, increase their net worth
    - Put another way, an allowance has the potential to be additional remuneration and hence it is appropriate to tax it as such

Reimbursement

- If an employer reimburses an employee for a work expense (i.e. an expense primarily for the employer's benefit), then that reimbursement will generally not constitute a taxable benefit since the employee is not better of

  - A reimbursement is generally where an employee incurs an expense on behalf of their employer, then submits the expense to their employer and is reimbursed.
  - The CRA has defined a reimbursement as a "payment made to repay an amount an employee spent on a specific expense and for which detailed receipts are provided"
- **To get the "non-tax treatment" the reimbursement must be of a "work expense". If an employer reimburses an employee for a personal expense, then the employee has to report the amount as a taxable benefit since they are better off
- Where commercially feasible/practicable, it is better (for tax purposes) t structure a system whereby employees are reimbursed for work expenses rather than providing them with an allowance.

So, why are allowances taxable and reimbursements not?
- In a reimbursement situation, no potential for employee to keep the leftover money as they are getting paid exactly the amount to the expense they have incurred.
- In contrast, there's a possibility that the allowance given by an employer is completely pocketed by the employee.
  - In simpler terms, allowances allow for the potential that an employee will gain money where this is not possible with a reimbursement

Positives to Company for Reimbursements	**Positives to Company for Allowance**
Only paying out exactly what is needed	Limits maximum amount that can be spent, so potentially saving money
	Saves time and is more efficient because they do not have to go through all the forms and what not to refund a reimbursement

A Brief Overview of Selected Statutory Taxable Benefits
- In addition to the salary, wages, and other remuneration taxable under s 5, employees will be taxed on an taxable benefits they receive by virtue of their employment
  - These benefits may be subject to a specific provision in s 6 or might fall under the more general s 6(1)(a) which will be discussed in the next section.

Types of Benefits:
- **Imputed Interest Benefit:**
  - Where an employer makes a loan to an employee, then s 6(9) and 80.4 find that the employee has to report **a taxable benefit equal to the amount of the loan multiplied by the excess of the prescribed rate over the rate charged by the employer, less any interest payments made by the employee to the employer in respect of the loan** in the year or within 30 days of the following year.
    - For 2022, the prescribed interest rate is 1% for the first two quarters, 2% for the 3rd quarter, and 3% for the last quarter
      - The taxable benefit is the imputed interest that the employee does not pay to the employer in respect of the loan and not the amount of the loan itself.
    - However, if the employer forgives the loan, then s 6(15) deems the amount of the forgiven loan to be a taxable benefit in the year forgiven.
- **Automobile Benefits**
  - S 6(2) and s 6(1)(k) describe the standby and operating benefits that an employee may have to report on their tax return when an **employer provides the employee with a vehicle that the employee uses for personal purposes.**

        - Standby: relates to simply having access to the company vehicle and this number of complete months that the vehicle is available to the employee
        - Operating: relates to the operating costs incurred by the employer in respect of the employee's personal travel and is generally calculated by **multiplying the number of person use kilometres by a prescribed rate**. If the employee pays all of the operating costs, then there will not be a taxable operating benefit to the employee
      - Personal trips have generally been defined by the courts as home to work, work to home, and any personal travel that has no connection to work
      - Work trips have generally been defined by the courts as travel after arriving at the employee's primary place of work (and work to home) which includes a "work stop"
      - **Note:** where an employee uses the company vehicle solely for work trips, there is no taxable benefit to the employee.
      - Further, to the extent that the employee pays the employer for he personal use of the vehicle in the year or within the first 45 days of the following year, this will reduce/eliminate the taxable employment benefit.
      - This is basically the worst option from a tax perspective in Sprysak's opinion. (but still always consider other reasons to why this could be bets option for certain people)
  - **Second best situation in Sprysak's perspective: Where the employee uses their own vehicle for work** (as well as personal purposes) and **their employer pays all of the operating costs**, the s 6(1)(l) requires a taxable benefit to be reported by the employee
  - **Best option: Where an employee uses their own vehicle for work purposes, then the employer can pay the employee a reasonable allowance that will NOT constitute a taxable employment benefit. (**exception to general rule of allowances)

S 6(1)(a)- Taxation of Other Employment Benefits

- S 6(1)(a) requires an employee to include in their employment income "the value of board, lodging and other benefits of any kind whatever received or enjoyed by the taxpayer or by a person who does not deal at arm's length with the taxpayer, in the year in respect of, in the course of, or by virtue of the taxpayer's office or employment"
  - Typically, this provision is applied to include "non-cash benefits" in an employee's taxable employment income that are not covered by a specific legislative provision
- Very generally, for s 6(1)(a) to be engaged, the employee must (1) receive or enjoy a benefit., (2) in respect of in, the course of, or by virtue of the taxpayer's office or employment" that (3) is not excluded by the Act or the jurisprudence
- An **employment benefit** for tax purposes is defined as "an economic advantage or material acquisition, measured in monetary terms, that one confers on an employee in his capacity as an employee"
- ***R v Savage*** referred to *Nowegijick v The Queen*, defining what a benefit "in respect of, in the course of, or by virtue of" employment:
  - The words "in respect of" are, in my opinion, words of the widest possible scope. They import such meanings as "in relation to", "with reference to" or "in connection with". *The phrase "in respect of" [is] probably the widest of any expression intended to convey some connection between two related subject matters.*
  - As a result, Courts do not have difficulty finding the necessary relationship between the benefit and the employment relationship.

Statutory, Common Law, and Administrative Exceptions

**IN AN EXAM, ASSUME ONLY RELEVANT STATUTORY PROVISIONS ARE IN THE NOTES. SO DO ANALYZIZ AS IF IT IS INCLUDED IN 6(1)(A) OR NOTHING. Basically say, as for my knowledge involve 6(1)(a) the following WOULD OR WOULD NOT be included by the provision. However, I would recommend seeking further advice to see if there are other relevant provisions encompassing BLANK.

- If an employee receives a benefit measurable in monetary terms that is connected to their employment relationship, then a prudent starting point is to assume that it constitutes a taxable employment benefit
    - Next step is to consider where there is a statutory or common law exception that would change the characterization to being a non-taxable benefit
        - **Statutory Exceptions**
            - S 6(1)(a)(iv): Benefits from counselling services in respect of the mental or physical health of the taxpayer (or related person) or the re-employment or retirement of the taxpayer, and
            - S 6(1)(a)(vi): Education assistance to someone other than the taxpayer (ie. adult child) if it is reasonable to conclude that the benefit is not a substitute for salary, wages, or other remuneration of the taxpayer (such as a post-secondary scholarship that also has a grades component)
        - **Common Law Exception**
            - "The Primary Beneficiary Test" which asks who is the primary beneficiary of a particular item provided to the employee? **(*Lowe v Canada*)**
                - The FCA has described that as an "all or nothing" test
                - If the answer is that employer is the primary beneficiary, then employee will not have to report a taxable benefit (even if the employee did benefit somewhat) and vice versa.
                    - Employee main beneficiary, employee has to report taxable benefit.
            - While the text may seem quite straightforward, its application can result in various outcomes depending upon the particular facts in issue (and the particular judge deciding the appeal)
                - Some judges take the view that the test is to be applied more "objectively"
                    - Consider generic facts to determine generally who is the primary beneficiary of the expenditure
                - Other judge, more recently, take the view that in addition to applying the test generically, should also consider whether the particular taxpayer in the case "subjectively" enjoyed a benefit
            - Examples:
                - Parking: Employee is given a free parking spot, but does not use it. Therefore, employee is not subjectively enjoying the benefit. (unless employee is regularly required to use car, then this is non-taxable benefit).
                    - If free parking, then no economic advantage measurable in monetary terms, so no taxable benefit.

        - Fitness memberships: despite all of the health and productivity benefits to employees who exercise regularly, the courts have generally held that unless the employee's job has minimum physical requirements (i.e. a police officer, fire fighter, etc.), the employee is the primary beneficiary of an employer-provided fitness membership (and hence the provision of a gym membership by the employer will be a taxable employment benefit).
            - If provided an in-house fitness facility than the CRA's position is that it is a non-taxable benefit
        - Continuing Education: if the employer pays for the cost of an employee taking a course that is related to the employee's job responsibilities, then the courts have generally found the employer to be the primary beneficiary and, as such, the course is a non-taxable benefit to the employee
            - Conversely, if the course is unrelated to the employee's work (i.e. course on learning how to golf), then the courts have found the employee to be the primary beneficiary and hence a taxable benefit
    - **Administrative Exceptions**
        - The CRA has had a longstanding practice of taking positions (and publishing – unfortunately, in a variety of different forms) what it feels to be non-taxable benefits outside of what has been pronounced by the courts in specific cases.
            - While it generally does not justify its positions, it appears to me that it takes these positions in "more difficult situations" where
                - (a) it is unclear whether there is an actual (economic) benefit to the employee,
                - (b) it is unclear who is the "primary beneficiary", and/or
                - (c) it is very difficult to try to quantify the value of the benefit, etc.- all while till trying to maintain the spirit of s 6(1)(a)
            - So, if it is any of those three things, likely non-taxable benefit as per this exception.
        - Currently it publishes its views in its Employers' Guide: Taxable Benefits and Allowances (T4130).

Valuation

- After determining that an employee has received or enjoyed a taxable employment benefit, the next step is to value that benefit to determine the income inclusion.
    - The Act does not specify how to do this, which has resulted in some uncertainty and diversity in the case law where the value is not obvious and undisputed.
        - So, important to note that the value of a taxable benefit may sometimes be a contentious/litigated issue.

Employment Deductions

- S 8(2) provides that unless the deduction is specifically provided for in this section (or in the Act), an employee cannot claim a deduction in calculating their employment income.
- Common deduction in s 8 include:

- **Legal Expenses (s 8(1)(b)):** Where the legal expenses were incurred to obtain an amount that, if received, would be reported as employment income for tax purposes (ie. lost wages in a wrongful dismissal case)
- **Sales Expenses (s 8(1)(f):** includes non-capital expenditures (ie travel expenses and motor vehicle expenses) incurred by employees who earn commissions
- **Travel Expenses (s 8(1)(h)) and motor vehicle travel expenses (s 8(1)(h.1)):** available to all employees who:
  - Ordinarily carry on their employment duties away from the employer's place of business, and
  - Were required under their employment contract to pay these expenses
- **Due and other expenses of performing duties (s 8(1)(i)):** which would include the following expenses as long as they were not reimbursed by the employer:
  - Annual professional membership dues the payment of which was necessary to maintain a professional status recognized by statute
  - Office rent or salary to an assistant the payment of which… and which the employee was required by the contract of employment to pay
  - The cost of supplies that were consumed directly in the performance of the employment duties and for which the employee was required by the contract of employment to pay
    - Examples might include toner/ink het cartridges, pens, paper, etc. as long as no personal use or pro-rate appropriately
- **Motor vehicle costs (**s 8(1)(j)) would include "tax depreciation" which is referred to as "capital cost allowance" and interests costs pro-rated for the employee's work use
- **Home office expenses (s 8(13))** to claim an expense for a home office, the work space must either be
  - The place where the employee principally (ie more than 50%) perform their employment duties, or
  - Used exclusively for the purpose of earning employment income and used on a regular or continuous basis for meeting customers or other persons in the ordinary course of performing their employment duties
  - Further, the deduction can only be for non-capital expenses (i.e. a proportionate amount of rent, utilities, etc. but not such expenses as mortgage interest, property taxes, or insurance – unless the employee is a commissioned salesperson) and cannot exceed the employment income that is generated by the home office – with the ability to carry forward any excess expenses

- **CAUTION:** as indicated above, for several of these expenses – and particularly home office expenses, in order for them to be deductible, in addition to the employee being required to incur them as part of his/her employment, the employer must fill out a certificate (T2200 – Declaration of Conditions of Employment) as per subsection 8(10) which the employee must include in his/her tax return in order to get a deduction.
  - To alleviate these issues and allow more taxpayers to claim a deduction in respect of working at home due to COVID-19, the CRA has created an alternative "temporary flat rate method" for home office expenses relating to COVID-19
  - Under this method, employees are able to claim $2/day for each day that the employee worked at home – up to a maximum of $500 for 2022, which represents 250 working days at home

- Employees who claim an amount using this "temporary flat rate method" do not have to have/provide supporting documentation and do not require their employer to complete a T2200 form.

UNIT #7: Business and Property Income

What is a Business for Income Tax Purposes (and what is not)?

- S 248(1) defined a business as stated previously.
  - This is very general/broad definition – used as somewhat of a "catch all" category for activities that do not fit into other sources
- In *Smith v Anderson* which favourably referred to *Stewart*, SCC found that a business was described as anything which occupies the time and attention and labour of a man for the pursuit of profit.
- The "quintessential characteristics" of a business are **activity, enterprise, entrepreneurship, commercial risk, and the purist of profit"**
- **"An adventure in the nature of trade"** has been defined by the courts as "an isolated transaction (which lacks the frequency or system of a trade) in which the taxpayer buys property with the intention of selling it at a profit and then sells it (either at a profit or loss)"
  - The Courts have also generally stated that to be "an adventure in the nature of trade", there must be a "scheme for profit making" (although where a taxpayer's activity is very financially successful, it often won't take much for a court to find such an intention)
    - So, even doing something once can qualify it as a business dependant on intention
      - Purpose is to prevent on-time non-taxable gain; instead an adventure in the nature of trade will be taxable as business income

Stewart v R

Leading case on whether an activity constitutes a business (and hence a source of income for tax purposes)

Facts:

- S was an experienced real estate investor who purchased four condominium units (largely using debt) with the intention of renting out the condos to generate income (and pay off the mortgages)
- Given the high amount of debt and associated interest involved in the acquisition, S projects that it would take roughly 10 years before he paid off enough debt for the expected rental income to exceed the interest expense (and hence make the investment profitable)
- As it turned out, he was correct. During 1990-1992, S lost $27,814, $18,673, and $12,306 respectively.
  - Note that the losses are decreasing over time as S is paying down his mortgages and correspondingly reducing his mortgage interest expense
- The CRA denied the deductibility of the losses suffered by S for tax purposes on the basis that this investment did not constitute a source of income under the Act, and referred to it as a hobby
- After his appeal was dismissed by Tax Court and FCA, S was granted leave to the SCC

Issue: Are the condos hobbies or a source of income?

Analysis:

- To determine if an activity constitutes a "source of income", you must answer the following two questions:
  - (1) did the taxpayer intend to carry on the particular activity in question in pursuit of profit, and
  - (2) is there objective evidence to support that intention?
- **THREE POSSIBLE SCENERIOS:**

1. If the **activity was undertaken solely in pursuit of profit** and there is sufficient objective evidence to support this conclusion,(like in this case), then:

- The **activity is a commercial activity and constitutes a source of income for tax purposes;**
    - The next step is to determine (primarily by reference to the level of activity) whether the activity constitutes a "business" or a "property/investment" activity, and
    - The final step is to apply relevant legislative provisions (ie ss 9, 12, 18, 20, and 67) to calculate the taxable income from the activity
2. If the **<u>activity was carried out partially in pursuit of profit and partially for personal reasons/enjoyment,</u>** then:
    - Example: purchasing a rental property and occasionally renting it out to a family member at a reduced rate
    - In order for the activity to constitute a source of income for tax purposes, the activity must have **sufficient "indicia of commerciality"** (most difficult scenario for court's to determine)
    - In assessing whether this threshold is met, the CRA and Tax Court should consider the following:
        - Whether the activity has a "reasonable expectation of profit"
            - Said in obiter in *Moldowan*
        - What special skills (if any) the taxpayer possesses and uses to carry on this activity as a business – with the underlying principle being that presence of such "special skills" suggests that the taxpayer was carrying on the activity as a business opposed to a hobby
        - To what degree the taxpayer was acting like a person would who carries on this type of business
    - If this activity meets the threshold, then even though there may also be some "personal" reasons for engaging in the activity, **this does not preclude the activity from being treated as a source of income with any associated net income being taxable and any net losses from being deductible.**
        - **Note:** in virtually all of these cases, the taxpayer is trying to deduct losses suffered by the activity
    - Any personal expenses associated with the activity will be denied for tax purposes as per s 18(1)(a) and (h) (*Symes*)
3. If the taxpayer **did not intend to carry on the particular activity in question in pursuit of profit and there is insufficient objective evidence to the contract,** then the activity will be
    - Characterized as a hobby,
    - Will not constitute a source of incomer under the Act, consequently
    - The expenses (and associated income) will not be deductible.

Holding: Clearly was engaged in pursuit of profit and hence a source of income under the Act. Therefore, the appeal was allowed and S's losses were deductible.

Business Income Distinguished from Property Income

- As noted in *Stewart*, not a lot of difference between earning income from business and property income for tax purposes.
- The rules for calculating income from business and property are generally the same, beginning with s 9, which provides that "a taxpayer's income for a taxation year from a business or property is the taxpayer's profit from that business or property"
- That said, there are a few exceptions where it is necessary to distinguish between income from business and income from property. Some of the more common exceptions include:
    - **Access to the small business deduction (SBD) (s125(1)):**

        - While described in this Act as a deduction, it is actually a rate reduction that is only potentially available to Canadian controlled private corporations (CCPCs) earning up to $500,000 of "active business income" in its taxation year
            - **The SBD is only available to CCPCs earning ABI – not available to individual taxpayers
        - Where it applies, it reduces to combined Federal and Alberta corporate tax rate to 11% for 2022
        - For our purposes, corporate "active business income" is equivalent to "business income" earned by an individual
            - The SBD is not available in respect of property income earned by a corporation (which is called "specified investment business income" in s 125(7))
    - **Attribution Rules:** With a few limited exceptions (ie. spousal credit), Canada has chosen to tax individual as separate and distinct persons rather than households.
        - When this significant tax policy decision is coupled with the progressive tax regime, taxes, there is an incentive for families to try to equalize incomes
            - I.e. transfer income for taxation purposes from a higher-income taxpayer to a lower-income taxpayer to tax advantage of the lower marginal rates.
            - This strategy is commonly referred to as income splitting/sprinkling
        - Example:
            - Ellen and Portia live together in a common law relationship. If Ellen earns $100,000 of taxable income and Portia does not have any taxable income, then Ellen's tax liability (excluding tax credits) is $27,750 ($50,000* 25% plus $50,000*30.5%) and the couple's after-tax income is $72,250.
            - In contrast, if Ellen and Portia each earn $50,000 of taxable income, then each of them will have a tax liability (excluding tax credits) of $12,500 ($50,000*25%) and together, their after-tax income will be $75,000 – which is $2,750 more than if Ellen earned all of the couple's taxable income.
            - While in some cases, income splitting is allowed or even encouraged by the Act, in other cases, there are legislative provisions (commonly referred to as "attribution rules") which limit this tax saving strategy.
                - Such as s 74.1 and 74.1, and s 120.4 (which specifically subject split income to tax at the highest marginal rate)
                - With some exceptions, these anti-income splitting rules are generally directed to prevent income sprinkling/splitting of property income, but not business income.
                    - When families work together in a business, they will enjoy the tax benefits associated with income splitting as described above.
    - **Registered Retirement Savings Plans (RRSPs):**
        - Earning business income is one of the primary ways of accumulating the entitlement to contribute to an RRSP (with earning employment income being the other common way)
        - In contrast, earning property income and realizing capital gains do not give a taxpayer the entitlement to contribute to an RRSP.

        - Preference is to earn Business Income over Property Income if PPBC. If you make an RRSP you prefer business income over property income as it gives you opportunity to participate in RRSP.

Types of Property Income

- 4 main types: **interest, dividends, rents, and royalties**
    - For each of these types of income, the income is derived primarily from the ownership of the underlying property which generate economic rent
    - Where an individual earns one or more of these incomes, it will typically be characterized as property/investment income
    - However, this characterization is contextual and will additionally depend on the level of the taxpayer's activity in relation to the creation of this income
        - Where the level of activity is low, such that it can be fairly said that the individual is a passive investor who derives income from the mere ownership of the property, then it is likely that such income will be characterized as property income to that individual
        - However, as the level of activity increases, then it becomes more likely that the individual will be characterized for tax purposes as carrying on a "business"
        - Common examples:
            - Landlord (investment) vs hotel operator (business)
            - Purchasing a Canada Savings Bond (investment) vs Selling/Managing mortgages (business)

Taxation of Interest vs Dividend Income

- Generally, rent and royalty are taxed the same as interest income
- There are no special rules regarding the taxation of interest income
    - S 12(1)(c) provides that the full amount of interest "received or receivable" must be included in the taxpayer's return
- In contrast, dividend income, to satisfy the principle of integration, dividends received by an individual shareholder must be grossed up (in theory, to reflect the pre-tax corporate income) before the individual's applicable marginal tax rate is applied to determine the initial personal tax liability.
    - This initial tax liability is reduced by a dividend tax credit (to reflect the corporate taxes already paid on the corporate income used to pay the dividend)
- It is important to note that the tax treatment of dividends received by individual shareholders results in an effective lower tax rate than the tax rate on interest
    - Example: For an AB resident who has more than $315,000 of taxable income, putting them in the highest marginal tax bracket, the effective tax rate (after taking into account the gross up and dividend tax credit) is 34.31% for eligible dividends and 42.3% for non-eligible dividends.
        - Eligible dividends are dividends paid by public corporations that are not eligible for the SBD and hence are taxed at high corporate tax rates
        - Non-eligible dividends are dividends paid by CCPCs that have claimed the SBD and hence have been subject to low corporate tax rates
    - Note: the tax rate differential between interest income and dividend income exists at all taxable income levels. Indeed, if an AB taxpayer has no other taxable income, they can receive over $50,000 of eligible dividends or over $20,000 of non-eligible dividends without paying any personal tax (due to the dividend tax credit)

- **As dividend income is subject to preferential tax treatment at the individual shareholder level (to take into account the taxes already paid by the corporation), **to the extent that a shareholder/investor can get the same pre-tax return (and risk) from an equity investment as for a debt instrument, the after-tax return will be better on dividends rather than interest income**
    - In the case of owner-managed corporations, one must consider both the corporation and personal tax on business income and the principle of integration.

Business Income Distinguished from Capital Gains

- In the case of the provision of services, it is generally better from the service provider's perspective to provide such services through a business relationship, as the service provider is generally allowed to deduct more expenses than if the services are provided in an employment relationship.
- In the case of a **sale of an asset** (means property), the tax implications to the vendor are generally better if the vendor realizes a capital gain, due to the 50% inclusion rate (compared to the 100% rate of business gains)
- However a person would much rather have a business loss than an allowable capital loss, since:
    - Allowable capital losses are only deductible against taxable gains whereas business losses are deductible against any source of income, and
    - 100% of business losses are deductible, whereas only 50% of net capital losses are deductible
- Just as there are many similarities and sometimes subtle differences between businesses and property income, so too is the case of business gains and capital gains.
    - More specifically, in both cases, the taxpayer is selling an asset.
- To determine whether a gain/loss is a business or capital one, you must first characterize the asset being disposed of.
    - If it is characterized as a capital asset, then the gain/loss on disposition is capital
    - Vice versa for business assets.
- As the Act does not specify how to characterize an asset for tax purposes, we must look to the primary and secondary intention tests (***Friesen v Canada***)
    - Applied at the time of acquisition of the asset (not the sale)
    - **Primary Intention Test:** When the taxpayer acquired the asset, did they primarily intend to (a) sell the asset for a profit, or (b) use the asset (either to generate income or for personal purposes)?
        - "to flip" vs "to rent/live/drive"
        - If it is to sell for profit, then generally the asset will constitute a business acquisition and any subsequent gain/loss on the sale will be on account of business income
            - If this is the answer to the primary intention test, then you are done and do not need to consider secondary intention test.
            - However, if it is the latter, then the asset will constitute a capital asset unless the secondary intention test overrides this result.
    - **Secondary Intention Test:** Did the taxpayer have a secondary intention to sell the asset for profit if the primary intention was frustrated which motivated the taxpayer to purchase the asset?
        - If the answer is yes, then secondary intention test will override the results of applying the primary intention test and will characterize the asset as a business asset/gain.
        - Consequently, it is only where a taxpayer did not have such a secondary intention to sell the asset for a profit that the acquisition is a capital acquisition and the gain when the asset is sold a capital gain.
    - **Important Points**:**

        - **The secondary intention test is rarely applicable -** as noted above, in the few cases where the court has considered the taxpayer's "secondary intention", the courts have generally stated that the **possibility of early resale at a profit must have been a motivating/operating consideration at the time of acquisition of the property.**
        - **Selling property when no longer needed does not constitute a "secondary intention" for purposes of characterizing the property for tax purposes.**
            - Some judges have stated that this reflects common sense and good business practice.
    - To determine what the taxpayer's intention was, a court will give more weight to the taxpayer's actions and conduct rathe than any court statements (although to the extent that these statements are supported by their actions, they will be more credible)
    - More specifically, a court will consider:
        - **Number of Similar Transactions:** evidence of similar prior transactions could be viewed as evidence that the taxpayer is a trader and engages in this type of business – and that the current transaction under consideration was simply part of that general business activity
            - The greater the number of prior similar transactions, the greater potential for a judge to take this view – that the taxpayer is engaged in selling this type of asset for profit
            - **CAUTION:** This indicia has not generally been used successfully "the other way" due to an adventure in the nature of trade constituting a business for tax purposes.
                - I.e. that if this is the first time the taxpayer buys and sells an asset of this type for profit, it is more likely to be considered a capital asset
                    - Put another way, you do not get "one free house flip" that will e a taxable capital gain
        - **Return on Investment:** How could a reasonable person have expected to make money through the acquisition and ownership of the property?
            - If only way to get a reasonable rate of return is through the resale of the property, then this transaction is more likely to be viewed as being on account of business (or at least an adventure in the nature of trade) – with these types of assets regularly being characterized as "trading assets"
            - In contrast, assets with a potential to yield income are often viewed as capital assets with a common example being shares on which dividends can be paid
        - **How does this Transaction Relate to the Taxpayer's Business?**
            - There is a strong presumption that a transaction connected in any way with a taxpayer's usual business activity it is intrinsically part of that business (although this is rebuttable)
            - Example: stockbroker/daytrader who sells shares for a profit will likely have a challenge in claiming that the shares were capital assets and the profit a capital gain
        - **Degree of Organization:** where a taxpayer deals with property in much the same way as a dealer would with similar property, then any resulting profit is more likely to be characterized as business income.
            - This is effectively what an "adventure in the nature of trade" is

        - **Length of Ownership:** if an asset is bought and sold in a relatively short period of time, then this suggests that the taxpayer may have bought the asset with the intention to sell (and hence is inventory generating a business gain/loss)
            - That said, the courts have cautioned taxpayers that the converse is not necessarily reflective of a capital intention – particularly where the taxpayer really is not using it (or using it reasonably) during their ownership
            - **A business asset will remain a business asset despite being held for a long period of time
        - **Nature of Asset:** the nature of the asset can be important in characterizing property
            - Land is presumptively viewed as a business asset – bought to sell for a profit – but this is a rebuttable presumption (taxpayer can bring evidence to show that intention was to use the land to generate income)
            - In contrast, corporate shares entitled to dividends may be presumptively viewed as a capital investment

Characterizing an Asset vs Characterizing the Income from that Asset

- When a taxpayer acquires an asset, there are two tax questions that must be considered:

1) How will the asset be characterized for tax purposes?
    - Determines how to characterize the gain or loss on disposition.
2) How will any income derived from that asset be characterized?
    - Determines how to report the income generated by the asset while owned

- For example, with respect to the purchase of a condo:
    - It may have been purchased to sell for a profit – in which case when the condo is sold, the gain will be a business gain.
    - Alternatively, it may have been purchased to use – in which case, when sold, the gain will be a taxable capital gain
    - Regardless of which scenario applies, the condo might be rented during the period of ownership. Depending on the level of activity associated with renting the condo out, such rental income might constitute business (hotel) or property income (renting it out)
- In short, when you have an asset that is generating income, there are two characterizations that have to be made – the characterization of the income generated by the asset and the characterization of the fain/loss on disposition.

The Election for Capital Gains Treatment

- Given the uncertainty as to when a sale will be on account of income vs capital, s 39(4) was enacted to give taxpayers the option to elect that all dispositions of "Canadian securities" (s 39(6): share od the capital stock of a Canadian resident corporation) will be deemed to be on account of capital
    - Once a taxpayer elects to have gains from the sales of Canadian securities to be of capital, then all subsequent dispositions will be treated as such.
        - In other words, once the election is made, the taxpayer cannot pick and choose which share sales will be on account of income and which will be on account of capital.
    - This means that while any gains will be capital gains, losses will be capital losses.
    - Note: this election is generally not available to dealer/traders (so if business is buying/selling stock, cannot make this election)
- The election to be completed is a T123 election form.
    - Might not to do this right away, because once you do it precludes you from the position where you sold stock and therefore, a loss.

        - So, for taxpayers actively involved in securities, probably will not file this, cause they do not want to preclude saying a position was part of a business and therefore, a business loss.
        - Most taxpayers will wait until they have a big gain, because it can be reasonably interpreted to be a business gain
    - One and done for all Canadians securities, not a case-by-case basis.

The Calculation of Income from a Business or Property

- In calculating business income, there is, effectively, a 6 step approach (*Tonn*)
    - **Step 1:** Is there a source of income pursuant to s 3? (ie. a *Stewart* analysis)
        - Always first step.
        - Very easy to assume that a particular receipt constitutes income for tax purposes, but this is doing you client a disservice as it may not be the case
    - **Step 2:** Assuming that it is a source, (and more particular income from business or property) then next step is to apply s 9, which essentially imports a non-tax calculation of income as the starting point to the calculation of business/property income for tax purposes.
        - While the case law emphasizes that Net Income for tax purposes is a legal concept (and not something determined by the accountant, "generally accepted accounting principles" and/or international financial reporting standards), it is also important to note that we start with a commercial, GAAP/IFRS, number and then modify it to make it a "tax number"
            - By implication, this means there may be several possible ways to calculate profit" and they may all be suitable as starting points for tax purposes
                - The SCC has repeatedly stated that the taxpayer has the ability to choose – where there are different methods – how to calculate their net income (unless a specific provision to the contrary) – and if the CRA does not like it, it is required to show how its income calculation is more accurate.
        - Effectively, the test in s 9 is whether the expense (or revenue) would be included in the calculation of profit using "well accepted principles of business/accounting practice" or :well accepted principles of commercial trading" (*Symes*)
        - In practice, this can be more difficult than it sounds, since many expenses might be incurred both for an income earning purpose and for personal purposes (or to satisfy a "non-business need" – see Symes)
        - This section/test is also important in that it screens out "capital expenses", which are expenses that are generally incurred for the purpose of bringing into existence "an asset of enduring benefit" (i.e. a building, computer, etc.) and which are not generally included in the calculation of "profit" (since their useful life is more than one taxation year)
            - Instead of deducting capital acquisitions, they are generally reported on the balance sheet as an (capital) asset
            - As we will se in step 4, to be sure, there is a specific prohibition in s 18(1)(b) against deducting capital acquisitions in calculating Net Income for Tax Purposes
    - **Step 3:** Apply s 12 to (possibly) increase income for tax purposes
        - S 12 (income inclusions) effectively provides that there are certain amounts that have to be included in income/profit from a business or property for tax purposes even if

these amounts would not be included in the calculation of income for commercial purposes.

- The general rule is set out in s 12(1)(b) – you recognize revenue when you have done everything necessary to become entitled to payment even though you might not be entitled to payment at this time
    - This is the recognition event for business revenue – which looks to legal entitlement rather than receipt of cash (which of course it the recognition rule for employment income)
    - This revenue is more generally part of "accrual accounting"
    - On the expense side, you do not generally record an expense until
        - (a) you are legally liable for the expense, and
        - (b) you can estimate the amount of liability with reasonable accuracy
- **CAUTION:** There are many exceptions to these rules.
    - One of the most common exceptions is the "matching principle" which generally provides that for particular expenses that relate to particular revenue streams, you must "match" the expenses to revenue.
        - Example: Cannot order in summer to sell in winter and deduct from 20223 when you plan to sell them in 2023; have to deduct the expenses from when the items are actually sold.
- Other important rules in s 12:
    - S 12(1)(a): recognizes an amount that has been received in respect of services to be rendered or goods to be delivered in the future (brings prepaid revenue and deposits into tax revenue)
    - S 12(1)(g): recognizes any amounts received by the taxpayer that was dependent upon the use or production from property where it was an installment on the sale price of the property or not (excluding agricultural land)
    - **CAUTION:** This is a potentially punitive provision – converts what would otherwise be a taxable capital gain into a business gain – be careful
        - Basically, if you receive a payment dependent on the production or use of property, then that is taxable as business income.
            - Example: dangerous when you are selling a whole business, and basically saying "you're guaranteed to make $$" so every $ above or below would change the sale price. If this deal was not made, it would be a capital gain where only 50% would be taxable.
                - So, if you see something about making money based on the use or production on a test, recommend getting further tax advice based on this.

- **Step 4:** Even though a particular expense may be allowed for purposes of calculating "profit' using ordinary principles of commercial trading and well accepted principles of business, there are **certain expenses that are expressly prohibited from being deducted in calculating business and property income for tax purposes** by virtue of s 18. For example;

- **S 18(1)(a):** a general limitation against deductibility of expenses unless it was incurred for the purpose of gaining or producing income from a business or property.
  - Put another way, the expense must have been incurred within a business framework, bearing some relation to the income earning process
  - Also, it is important to note that this is a "purpose" test and not a "results" test. Consequently, even though the expense may not generate any business income, it will be deductible (assuming it otherwise satisfies all of the requirements)
  - Finally, it is generally the primary purpose of the expenditure that is relevant in determining its deductibility (ie greater than 50%)
- **S 18(1)(h)** is a restriction against the deductibility of "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
  - **Personal and living expenses are defined in s 248(1)** to include "the expenses of properties maintained by any person for the use or benefit of the taxpayer or any person connected with the taxpayer… and not maintained in connection with a business…"
    - This appears to set up a bright line test between business expenses, which generally will be deductible for tax purposes, and personal expenses, which generally will not.
    - As we have already discussed (and briefly set out in *Tonn*), it can be difficult to differentiate between business and personal expenses (since they could arguably belong in both categories) just as it can be difficult to distinguish between business and capital expenditures.
      - Examples of expenses that could be personal or also a business cost include taking a client to dinner, vehicle, phones, clothes, and childcare.
      - Example: Bike courier case- taxpayer deducted incremental food and beverage costs (such as Gatorade and power gels) as a business expense for his bike company. It was determined by FCA that he could do this saying it was similar to putting gas in a delivery truck.
  - Judges will determine whether an expense is a deductible business expense or a non-deductible personal and living expense based on its primary purpose. In "difficult" cases, like childcare, judges may consider: (*Symes*)
    - Whether the expense would be incurred (and to the same extent) regardless of the business activity?
    - What "specific business need" does the expense satisfy (and is the need intrinsic to the business)?
    - Does the expense make the taxpayer available to the business (which would constitute a personal expense) or is it part of the business (which would be a business expense)?
    - Historically, how has this particular expense been treated for tax purposes?

- **S 18(1)(b):** disallowed the deduction for tax purposes of an outlay, loss, or replacement of capital, a payment on account of capital, or an allowance in respect of depreciation, depletion, or obsolescence
  - This is the legislative basis
  - for the non-deductibility of capital expenses in calculating business/property income.
  - Interest expense is denied under s 18 on the basis that it was not incurred to produce income but rather was incurred to acquire a capital asset
- **S 67.1:** which generally limits the amount of "meals and entertainment" expenses incurred in the course of carrying on a business activity to 50% of the amount incurred (with some listed exceptions)
  - Policy for this is that if you take someone to dinner, you are getting a personal meal BUT you are still buying for somewhere else or something and therefore, 50% is deemed personal and the other is deemed a business expense.
- **S 67.5:** which sets out a list of "illegal payments" (including the bribery of foreign officials) that will not be deductible for tax purposes.
  - S 67.5(2) removes the limitation period for denying the deductibility of such expenses
    - Reason for this is to discourage these types of payments.
    - However, technically, those who get receipt of these payments should report it as income as discussed previously, that even criminal income should be reported for tax purposes.
- **S 67.6:** Which denies the deductibility of fines/penalties imposed by law
  - A penalty imposed by a contract – for say, late completion – would not be prohibited by this provision.
    - For example cannot deduct speeding ticket fine, but could deduct an fines or penalties from contract for things such as late completion or error of completion (since their income earning penalties)
  - However, CRA takes position that penalties issued by a self-regulating body (ie. Law Society of AB) would fall under this provision and not be deductible by the disciplined lawyer.

- **Step 5:** Despite s 18, which denies certain expenses from being claim, **s 20 will allow certain expenses to be deducted.** For example:
  - **S 20(1)(a):** allows a deduction for capital cost allowance (CCA)
    - Basically, the tax version of depreciation (ie. when property loses value over time and/or use)
    - Assets that decline in value through time and/or use are pooled in various classes defined in Schedule II in the Regulations.
    - For each pool, a maximum CCA rate is provided, which determines the maximum amount of CCA that a taxpayer can deduct in calculating Net Income for Tax Purposes for the year.
    - The amount of CCA claimed (up to the calculated max) is at the taxpayer's discretion
    - In theory, when a depreciable asset is sold, a taxpayer may have an income inclusion (if too much CCA was claimed) and possibly a capital gain (if sol

for more than its cost) or an additional deduction (if not enough CCA was claimed)

- **S 20(1)(c):** allows a deduction for interest expense paid or payable pursuant to a legal obligation to pay interest on borrowed money used for the purpose of earning income from a business or property.
  - ****IMPORTANT.** Lots of jurisprudence about what ca and cannot be deducted here, so on exam just say from my basic knowledge my understanding is BLANK BUT lots of history here, so see a lawyer to be sure
- **S 20(1)(l):** allows a deduction for bad debts on accrued revenues
  - **So , when you do not receive the money you are owed.**
- **S 20(1)(m):** allows a taxpayer to clam a reserve on goods and services that are to be provided in the next taxation year (but had to be included under s 12(1)(a) because the taxpayer had received the funds for those goods/services)
  - If receive prepayment for goods that are not to be delivered until next taxation year, can still claim the revenue when you receive it but then can claim a reserve on it.
  - So anything deducted here must be claimed again in the year goods/services are delivered.
  - Purpose for claiming and then deducting is to keep track of the payment and everything contained in a paper trail.

- **Step 6: S 67** is a general limitation regarding expenses – no deduction shall be made in respect of an outlay or expense except to the extent that it was reasonable in the circumstances (IMPORTANT SECTION but lacking jurisprudence from Court, so still very variable on what or what not is reasonable)
  - So can only deduct reasonable expenses and amounts, not outliers unless reasonable in the circumstances
  - This provision is generally applicable to any deduction claimed for tax purposes
  - It also incorporate both quantitative and qualitative components
    - How does the magnitude of the expense compare to the associated revenue vs in the context of the particular business, was it reasonable to incur this type of expense regardless of the amount

An Overview of the Deductibility of Employment Expenses and the Inclusion of Employment Income

- In all transactions there are two taxpayers to consider. A proper/comprehensive tax analysis should consider the tax consequences to each party despite the fact that you will typically be advising only one.
  - Obviously the ideal tax plan benefits both parties – but a close second is one that helps one without hurting the other
- If a taxpayer can deduct an expense, this means the expense is effectively paid out of pre-tax income (which is cheaper to the taxpayer)
  - Put another way, if an expense is deductible, it reduces the taxpayer's Net Income and Taxable Income and their associated tax liability
- In the context of employment expenses/income:
  - The typical scenario is that the amount will be deductible to the employer (as a business expense) and taxable to the employee (as employment income)

    - Put another way, the amount is subject to one imposition of tax to the employee (neutral situation/result)
    - Example: employment salaries will be deductible to the employer and taxable to the employees
  - In contrast, a "bad" situation (from a tax perspective) is where an amount is NOT deductible to the employer but is still taxable to the employee
    - Example: if the employer pays for a "personal expense" of the employee (which can be very common in an owner-manager private business), it will likely be
      - (a) non deductible to the employer (s 18(1)(a) and (h)), and
      - (b) taxable to the employee (s 6(1)(a))
    - Applied to the above example, it would be better from a tax perspective to just have the employer increase the employee's salary, so the employer gets a deduction and the payment is taxed only once
  - The third possible scenario- which is the best from a taxpayer perspective, is where the amount is deductible to the employer but non-taxable to the employee (because of a statutory, case law, or administrative exception)