

TAXING TIMES



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NOTICE TO READER

The following commentary has been prepared by Parker Garber & Chesney, LLP based on information available to the public on the date of publishing.

Readers are cautioned that this commentary is informational only and that any issues specific to the reader's needs be addressed with the appropriate tax professional.

The reader is cautioned that this document is not meant to provide advice specific to the reader's particular situation and that advice cannot be given in such a manner.

TAX CASES

MEALS AND ENTERTAINMENT

Ever since subsection 67.1(1) the Income Tax Act was amended in 1985 denying 50% of the cost of meals and entertainment, businesses have found the sweeping rule to be unfair and not related to the realities of entertaining. Reasoning such as the fact that a business may pay for a dinner for 10 people, nine of whom are clients, but only be allowed to deduct 50% of the cost was not considered fair or reflective of the true nature of the expense. Likewise, if a business provided tickets to a show or athletic event that was attended only by the client, the similar 50% restriction would apply even though the business incurring the expense had no use or enjoyment of the activity.

Along has come Mark Stapley, a self-employed real estate agent, who provided his clients with vouchers and tickets for meals and entertainment, none of which he benefited from personally. Naturally CRA took the position that he was entitled to only deduct 50% of the expense while the taxpayer had claimed the full amount of the expense on the basis that it was an expense incurred in order earn income and he had not received any personal benefit.

Interestingly, the Tax Court of Canada ruled that the specific limitation of 50% does not override the general deductibility section 9(1) of the Income Tax Act. Since the taxpayer had no use or enjoyment of the food or entertainment and these expenses were incurred in the pursuit of income, the Court ruled that the expense was fully deductible by the taxpayer.

While this was an informal procedure case, CRA did not appeal the ruling. Often, CRA has taken the position that they are not bound by the decisions of the Tax Court of Canada, though they would never say that in front of a judge, it leaves the door open for us to reconsider the treatment of such expenses.

GENERAL ISSUES

EMPLOYEE BENEFITS

Many questions are asked by both employers and employees about the taxation of various employee benefits. Over the years the Minister of Finance has slowly eliminated the tax-free status of many benefits.

As a matter of course, one of the first steps in the audit of a business is the review of the benefit of company cars and vacation properties. While more and more employers are ensuring that the automobile benefits and standby charges are properly recorded many do not realize that GST/HST is due on the benefits. Basically, when a taxable benefit is provided to an employee that has a GST/HST



component, the assumption is that the employer has claimed an ITC on the supply. The benefit included in the employee's income must include the GST/HST on the benefit and the employer must include that same amount when calculating the GST/HST remittance.

The following is a list of the most common benefits that must be included in income but is not a complete listing:

- personal use of employer provided vehicles (leased or owned);
- un-reimbursed personal automobile expenses paid by the employer;
- automobile allowances other than those paid based on CRA dictated per kilometre rates;
- gifts, awards and prizes (\$500 exemption for non-cash gifts);
- interest-free and low-interest loans (below prescribed rates);
- stock option benefits (subject to special rules);
- education costs not related to the employee's work;
- rent-free or subsidized housing (subject to special rules for remote work sites);
- personal use of frequent-flyer points (valuation problems may arise);
- group term life insurance;
- employer-provided parking;
- premiums for provincial medical plans (but not private plans);
- medical expenses unless handled through a properly structured insurance plan;
- employer-provided social events costing more than \$100 per person.

RRSP BENEFICIARY DESIGNATIONS

Taxpayers converting their RRSP to a RRIF, usually when turning 70, should be aware that the beneficiary designation does not automatically get carried to the RRIF. When transferring your RRSP, either to another RRSP or to a RRIF you should ensure that the beneficiary designation is properly completed in order to avoid the benefits being paid to your estate and triggering probate fees.

CRITICAL ILLNESS POLICIES

Critical illness insurance has become a growth industry in the past few years and many potential purchasers are concerned about the tax implications. It should be noted that the proceeds from these policies are not generally taxable but the premiums should not be paid by an employer.



GIFT PLANNING

Growing interest in charitable causes has resulted in some innovative techniques for donors to benefit their favourite causes. This has included the gifting of a life insurance policy to a charity. In order for the gift to qualify for a charitable receipt the charity must be the irrevocable beneficiary of the policy. The premiums paid after the gift would be eligible donations. If an existing policy is gifted then the value of the policy at the time of the gift would also be an eligible donation.

A gift of a portion of the policy would also be eligible and the premium would be pro-rated for charity purposes.

When providing for a charity on death it should be carefully constructed so that the gift is claimable by the taxpayer and not the estate. In order to protect from this problem the trustees or executors of the estate cannot have discretion in the awarding of the gift.

US TAX ISSUES

U.S. TAXPAYERS HOLDING SHARES OF CANADIAN CORPORATIONS

One of the most misunderstood and disregarded issues that face U.S. taxpayers with Canadian companies. Even though these companies may have no non-Canadian operations or sources of income and even if they are closely-held family holding companies, the inclusion of U.S. shareholders can require the company to file information and/or tax returns in the U.S.

Of particular concern are the U.S. anti-deferral rules for controlled foreign corporations (CFC) or passive foreign investment companies (PFIC). Many Canadian advisors suggest that clients leave retained earnings in the corporation if not needed personally in order to take full advantage of the preferred tax rates in the corporations, particularly small-business corporations. However, the U.S. views this as tax avoidance and therefore has these series of rules both controlled corporations and those that are not majority-owned by U.S. taxpayers.

These rules can work to tax the undistributed income in the hands of the U.S. shareholder but even if there is no tax implication, there is still a filing requirement and the penalties can be substantial.

