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TAX TIPS & TRAPS

In this edition:

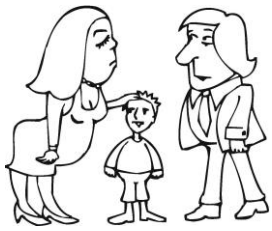
This publication is a high-level summary of the most recent tax developments applicable to business owners, investors, and high net worth individuals. Enjoy!

TAX TICKLERS… some quick points to consider…

- The amount of income an individual can earn without paying tax (**basic personal amount**) will **begin increasing in 2020**. In the first year, it will rise to $13,229 (from $12,069 in 2019), and will reach $15,000 in 2023. The benefit will begin to be phased out when an individual has earnings of approximately $150,000.
- The purchase of a **zero-emission vehicle**, if associated with an income earning purpose (e.g. used in a **business**), may be eligible for a **100% immediate write-off** as long as the federal government purchase incentive was not obtained.
- **TFSAs** – As of 2017, the **average number** of **contributions** per individual was **14.49**, the average **fair market value** of each account was **$19,633**, and the average **unused space** was **$30,947**.
- There are **2.21 million corporations** in **Canada** (according to 2016 statistics that were recently released). Total tax payable for 2016 was $72.21 Billion.

ADOPTION EXPENSES: Step-Child

In a June 20, 2019 **Technical Interpretation**, CRA was asked whether a taxpayer **legally adopting** the **child** of his or her **common-law partner** would be eligible to claim the costs under the **adoption expense tax credit** ($16,255 @ 15% for 2019). CRA opined that the **credit could be claimed** by the **adoptive parent**, but **not** by the **biological parent**, despite the usual ability for spouses to split this credit. CRA also noted that the provincial adoption law would have to be reviewed to determine whether a step-parent could legally adopt the child. In this case, noted as being in Alberta, provincial law allows the claim.



ACTION ITEM: Ensure to provide receipts associated with the adoption of a step-child when delivering your personal tax information.

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MOTOR VEHICLE EXPENSES: Total Kilometres Driven

In a September 17, 2019 **Tax Court of Canada** case, at issue was the deductibility of vehicle expenses, and in particular, the portion of total vehicle use that was for **employment** purposes. While initially challenged by CRA, the Court eventually **accepted the credit card statements** as support for the amounts expended. The taxpayer held and produced a T2200 which indicated that motor vehicle expenditures were requirements of employment.

Taxpayer loses – vehicle expenses

The taxpayer had initially **claimed 90% employment usage** but later asserted that only 1,015 of her total 1,353 kilometres travelled (75%) were for employment purposes. This percentage is used to determine the portion of total vehicle expenses that can be deducted. The Court then noted that the **total kilometres** driven for the year were more likely **approximately 10,000** based on the odometer readings listed on the **third-party garage repair invoices** provided throughout the year. As the reported employment kilometres (which were supported by a vehicle log) were about **10% of the total** reported on the invoices, only **10% of expenses were allowed**.

ACTION ITEM: In addition to employment/business travel logs, CRA may ask for support of total travel. Retain records that support total kilometres traveled such as repair receipts.

EMPLOYMENT EXPENSES: Costs of an Assistant

A November 5, 2019 **Tax Court of Canada** case reviewed the deductibility of **employment expenses** by a manager **overseeing** the **Canadian sales force and operations** of a multinational manufacturer of dental instruments and products. The taxpayer's **employer** had **no Canadian office**, and she **travelled extensively** to meet with sales representatives, dealers and customers throughout Canada.

Expense of assistant

Almost half of the taxpayer's claimed expenses, which exceeded $80,000, related to her **husband's** role as **her assistant**. The Court noted that a deduction can be claimed for **salary paid to an assistant**, but that there were **several problems** with her claim, including the following:

- The taxpayer's husband was treated as self-employed and **not as an employee**. Any deduction **must be for salary**, requiring it be **paid to an employee**. This alone was fatal to the deduction claim.
- The amount was **not paid** to her husband. Rather, they simply had a single joint bank account through which they both transacted. Lack of payment alone would prevent any deduction.
- The taxpayer's employer indicated it was **the taxpayer's decision** whether she **required an assistant**. As her **employer did not require** her to hire an assistant, **no deduction** was available. This item alone would also prevent any deduction.
- The husband's **services described** were largely clerical, administrative, secretarial or driving, for which his hourly fee of $75 was **not** "anywhere close to the range of **reasonable**".
- The husband's **hours** set out in quarterly billings were **not supported** – he could only account for a small fraction of the hours invoiced.
- The husband claimed business expenses of almost 75% of his fees; however, the couple could not describe what expenses he incurred. The taxpayer "was sure this was a mistake".

No deduction was allowed for these costs.

ACTION ITEM: Support and documents are often requested by CRA when deductions against employment income are claimed. Ensure to retain all such support. If no T2200 has been provided for the current year, enquire with your employer as to whether one is available for the next.

TRAVEL EXPENSES: Shareholder-Employees

For an employee to deduct **travel** or **motor vehicle expenses** against **employment income**, the employee must be normally **required** to **work away** from the **employer's place of business**, be **required** to **pay** the **travel expense** under the contract of employment, and have a signed and completed T2200. Also, the employee cannot receive an allowance excluded from income.

In 2017, CRA began **denying travel expenses** claimed on the personal tax return of many employees who were also **shareholders** of the employer or **related** to a **shareholder**. After receiving concerns from stakeholders regarding this

new assessing practice, CRA reversed their assessments, indicating that "clear guidelines for taxpayers and their representatives" were important to the Canadian self-assessment system and that additional consultation and guidance was needed in this area.

In September of 2019 CRA released the promised guidance. It noted that the following conditions had to be met for employment expenses incurred by shareholder-employees to be deductible:

1. The expenses were incurred as **part of the employment** duties and **not as a shareholder**.
2. The worker was **required to pay** for the expenses personally as **part of their employment** duties.

When the **employee is also a shareholder**, the written **contract may not be adequate**, and the implied requirements may be more difficult to demonstrate. However, CRA noted that both of these conditions may be satisfied if the **shareholder-employee** can establish that the expenses are **comparable** to expenses incurred by **employees** (who are **not shareholders** or related to a shareholder) with **similar duties** at the company **or** at **other businesses** similar in size, industry and services provided.

ACTION ITEM: Instead of deducting amounts against employment income, consider whether it would be better for the company to reimburse expenses of shareholder-employees, or perhaps, pay a tax-free travel allowance. If amounts will continue to be paid personally, retain support that shows how the travel expenditures are reasonable as compared to those of other similar arm's length workers.

CPP/EI RULINGS: Do they Trigger Payroll Audits?

In a June 7, 2019 **Technical Interpretation**, CRA commented on whether a **CPP/EI ruling triggers follow-up assessing and review**. These rulings often determine whether a worker is a contractor or employee, and therefore whether EI and/or CPP should be submitted to CRA. They also often consider whether an employee that is a family member of the owner is earning insurable amounts. Rulings can be initiated by the worker, the business, or another party with an interest, such as CRA.

CRA noted that after the completion of a ruling, a **referral** to the **Trust Accounts Examination Division** (often leading to a payroll audit) is **not automatically** sent. **However**, it is sent in situations such as where:

- the ruling **changed the worker's status** from employee to self-employed, or vice versa;
- a related worker was determined to be **dealing at arm's length** and, therefore, insurable, but no EI premiums had been remitted; and
- an employee relationship was confirmed but there were **no source deductions** remitted or **T4 submitted**.

When a referral is received, an examination officer will **contact the employer** for an appointment to **review the payroll books and records**. Deduction and remittances for the period covered by the CPP/EI ruling will be confirmed and validated.

The officer will **also review** CRA's database to determine whether there are any **outstanding GST/HST returns**. If found non-compliant, the **GST/HST books** and records will also be **reviewed**.

ACTION ITEM: If CRA challenges the categorization of a worker (employee vs. contractor), keep in mind that the implications of a reclassification could be significantly greater than the costs associated with the individual worker.

TAX ON SPLIT INCOME: The 20 Hours Test

The **tax on split income** (TOSI) can subject various income sources, with taxable private corporation dividends being the most common, to **personal tax** at the **highest marginal rate**. One of the exceptions from TOSI occurs when the income recipient is **actively engaged in the business**. An individual will be **deemed** to be **actively engaged** in any year in which the individual **works** in the business at least an average of **20 hours per week** during the portion of the taxation year that the business operates.

Statutory holidays, sick days, vacations

In an August 6, 2019 French **Technical Interpretation**, CRA opined that days that an individual is **paid for time** that they **do not actually work** (such as **statutory holidays**, **sick days**, and **annual vacations**) should **not** be **considered hours worked for the computation**. For example, if an individual is paid for five days for a week, but only actually works four days due a statutory holiday on one of the days, only four days of work should be considered in the computation.

Less than 20 hours required

In a June 7, 2019 **Technical Interpretation,** two spouses contributed an equal amount of effort to a business that **only**

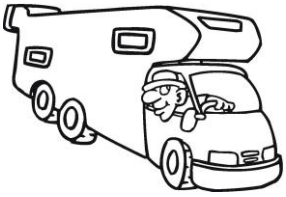
required 10 hours of weekly work (5 hours each per week). Where the 20-hour test is not met, the spouses may still not be subject to TOSI if they can demonstrate that they were actively engaged on a **"regular, continuous and substantial basis"**.

While it is a question of fact, CRA stated that it is **possible for this exception** to be available in this scenario. Consideration should be given to the **ongoing nature and labour requirements** of the business for the particular year. In general, whether an individual is actively involved in a business will depend on the **time**, **work** and **energy** that the individual spends on the business.

The more an individual is involved in the **management or day-to-day operations**, the more likely they will be sufficiently involved.

ACTION ITEM: Document the activities in which individuals who may be subject to TOSI are involved in the business. When tracking time, do not include paid hours in which the individual was not working.

MOBILE HOMES, RV PARKS, CAMPGROUNDS: Loss of the Small Business Deduction?



In an August 29, 2019 **Tax Court of Canada** case, at issue was whether the taxpayer who operated a mobile home/RV park was eligible to claim the **small business deduction** for the 2012-2014 years. CRA argued that the taxpayer **primarily earned its income** from the **rental of seasonal and extended seasonal campsites** and the **storage of RVs** and, therefore, carried on a **specified investment business**. Specified investment businesses are **not eligible** for the **small business tax rate**. Instead, they are **taxed at over 50%** in all provinces and territories, although 20.67% may be refunded when dividends are paid.

The **taxpayer argued** that it carried on an active business providing a **significant** bundle of **services** that were integral to its operations.

The majority of the taxpayer's revenue related to fees charged to seasonal and extended seasonal campers. While shorter-term rents to daily campers occurred, these were much less common.

Taxpayer loses

The Court found that the seasonal and extended seasonal campers were effectively **paying** to **occupy** a **particular site** for either 5 or 10 months of the year and often that, for the **remainder of the year**, the mobile home or RV was **stored unoccupied** on site. The Court ruled that the **duration** of the **occupancy** agreements in particular (seasonal and extended seasonal versus daily or weekly) suggested quite clearly that the **principal purpose** of the business was to derive **rental income**.

While the taxpayer provided **other services** including garbage pick-up, limited event planning, office hours and "on-call" availability, the Court found that the services and amenities offered did **not reach the tipping point** where the provision of **services overcomes** the provision of **property**. Instead, these **features** were used to **entice customers** such that the **business** could **accomplish** its principal **purpose** of **earning rental income**.

NOTE: *Even if the principle purpose of the business was to earn rental income, an exception is available (making the small business rate available) if the business employs more than five full-time staff.*

ACTION ITEM: This case may have applicability to all corporations in which there is limited activity. In such cases, consider whether the income results more from the services provided, or for the use of the property. Consider what support or evidence you have that ties income earned to services provided.

FEDERAL CARBON TAX: Costs and Rebates

On **December 16, 2019,** the Department of Finance announced the **climate action incentive payment amounts** for **2020**. These payments are associated with the provinces that are subject to the federal backstop legislation. The following amounts may be claimed on the **2019 personal tax returns**:

Category	Ontario	Manitoba	Saskatchewan	Alberta
Single adult/first adult in a couple	$224	$243	$405	$444
Second adult in a couple or first child of a single parent	$112	$121	$202	$222
Each child under 18 not already included above	$56	$61	$101	$111

Baseline example for family of four	$448	$486	$809	$888

A **10% supplement** is available for those that live in **rural areas** (communities outside of census metropolitan areas, CMAs).

The 2020 climate action incentive payment payable to eligible Albertans will reflect fuel charge proceeds generated over a 15-month period. This consists of three months (January – March 2020) with a carbon price of $20 per tonne, plus 12 months (April 2020 – March 2021) with a carbon price of $30.

Also note that no federal incentive payments will be available for residents of New Brunswick this year since it will introduce a provincial program commencing on April 1, 2020 which removes the applicability of the federal backstop legislation.

ACTION ITEM: Ensure that changes in family status (marriage, new children etc.) are included in your 2019 personal tax return to get the full benefit of the program. Also note that most other provinces have similar rebate/incentive programs in place.

U.S. EXPATRIATES: New Relief Procedures

On September 6, 2019, the IRS announced **Relief Procedures for Certain Former Citizens**, a new process to facilitate **eligible individuals** in **becoming compliant** with their U.S. tax obligations, in conjunction with **renouncing their U.S. citizenship** (IR-2019-151). There was **no announced specified termination date**; however, a **closing date** will be announced in the future.

Eligible individuals will be required to **file U.S. tax returns**, including **all relevant disclosure filings**, including financial account disclosures, for the **year they renounce** their citizenship and the **five preceding years**. Eligibility criteria include the following:

- Only **individuals** (not corporations, trusts, partnerships, estates or other entities) are eligible.
- Past non-compliance must be **non-willful**.
- The individual must **never have filed** as a **U.S. citizen or resident** (an FAQ question indicated that prior filing of a 1040NR return, in the belief the individual was neither a resident nor a citizen will not disqualify them).
- The individual's **net assets** cannot exceed **$2 million** U.S. at either the date of relinquishing citizenship or the date of the submission under these procedures, and their average net income tax for the five years preceding loss of citizenship cannot exceed an inflation-adjusted amount ($168,000 U.S. for 2019).
- **Taxes payable** for the six years required to be filed **cannot exceed $25,000** in aggregate after foreign tax credits and before penalties or interest are calculated. This does not include the "exit tax" which might apply outside the procedure, but is also not reduced for any U.S. withholdings.
- The individual must have **relinquished U.S. citizenship** after **March 18, 2010**.
- The individual must obtain a **Social Security Number**, if they do not already have one.

Assuming these criteria are met, **no penalties or interest** will apply, and **any taxes payable** for the six years, up to the $25,000 maximum, will be **waived entirely**. The individual will also be **exempt** from the "covered expatriate" rules, which could otherwise impose additional tax and filing requirements. However, the IRS will process submissions by **non-eligible individuals** under the **ordinary rules**, potentially attracting **significant interest and/or penalty charges**.

ACTION ITEM: Often, children of U.S. parents are surprised to learn that they too are considered U.S. persons and subject to U.S. taxation. This program may assist them in correcting their affairs and obligations.