KOZAK THOMAS LUCK
Chartered Accountants

PETER M. KOZAK DAPHNE J. THOMAS GREG D. LUCK
Practicing Through Professional Corporations

# TAX LETTER

August 2011

**CRA POLICY ON EMPLOYEE GIFTS AND AWARDS**
**CRA POLICY ON FREQUENT FLYER AND SIMILAR PROGRAMS**
**ALLOWABLE BUSINESS INVESTMENT LOSSES**
**DETAILS OF THE CHILDREN'S ARTS TAX CREDIT**
**THE "EQUIVALENT TO SPOUSE" CREDIT**
**TAX ALERT: CRA WARNS OF "PHISHING" SCHEMES AROUND THE COURTS**

## CRA POLICY ON EMPLOYEE GIFTS AND AWARDS

Technically, gifts and awards that you receive from your employer should be included in your income for tax purposes. However, due to practical concerns and for administrative convenience, the Canada Revenue Agency (CRA) allows certain gifts and awards to be received tax-free.

First, the CRA states that non-cash gifts and non-cash awards given to an arm's length employee are tax-free as long as the total value of such gifts and awards to the employee is $500 or less in the taxation year. Any amount over $500 is taxable.

Additionally, the CRA allows a separate non-cash long-service or anniversary award to be tax-free up to a value of $500. The value in excess of $500 is taxable. In order to qualify, the award must be for at least five years of service and at least five years must have passed since any previous long service award given to the employee.

In applying the $500 amounts described above, the two thresholds are considered separately. Thus, a shortfall in value under one threshold cannot be used to offset an excess value in the other threshold.

The CRA administrative positions do not apply to non-arm's length employees or persons related to non-arm's length employees.

Cash and near-cash gifts and awards (e.g. gifts certificates) are not covered by this policy, and they remain fully taxable.

Items of an immaterial or nominal value, such as coffee, tea, T-shirts with employer logos, mugs, plaques, and trophies, are not considered a taxable benefit to employees.

## CRA POLICY ON FREQUENT FLYER AND SIMILAR PROGRAMS

Before 2009, the CRA took the view that loyalty points such as frequent flyer points collected by employees when they charged their employment-related travel expenses on their personal credits cards (and that were then reimbursed by their employers) were taxable benefits. However, since 2009, the CRA has modified its administrative position, and generally allows such points to be earned tax-free.

In particular, the CRA's position is that frequent-flyer or similar loyalty points are not taxable if the points are collected using the employee's personal credit card. However, this applies only if the points are not converted to cash, the plan or arrangement is not indicative of an alternate form of remuneration and the plan or arrangement is not for tax avoidance purposes.

Furthermore, if the employer controls the points – for example, where a company credit card is used to charge the expenses and the employer allows the employee to redeem some of its points – the CRA states that a taxable benefit will continue to apply and the fair market value must be reported on the employee's T4 slip. The CRA provides the following example:

> **Example – Company credit card points as benefit to the employee**
>
> Jennifer's employer has a company credit card, under which loyalty points are earned. The employer is billed and pays the credit card charges. The employer allows Jennifer to redeem the points for her personal use. In such

…/2

CA
SUITE 204 (NORTH TOWER) 5811 COONEY ROAD, RICHMOND, B.C. V6X 3M1 • TEL: (604) 276-2636 • FAX: (604) 273-9304

circumstances, the fair market value of the goods or services received by Jennifer will represent a taxable employment benefit. In this case, the employer must include and report the value of the benefit on the employee's T4 slip.

## ALLOWABLE BUSINESS INVESTMENT LOSSES

As a general rule, capital losses can be used to offset capital gains and not other forms of income. More particularly, an allowable capital loss, being one-half of a capital loss, is deductible only against taxable capital gains, which are one-half of capital gains. Any excess allowable capital losses can be carried back three years or forward indefinitely and used in those years to offset taxable capital gains.

However, if the capital loss qualifies as a "business investment loss", then half of the loss is an allowable business investment loss (ABIL), which can be deducted against all forms of income in a taxation year (e.g. employment, business, or investment income). Furthermore, excess ABILs in a year can be carried back three years and forward ten years to offset all sources of income in those years (seven years forward in the case of losses arising in taxation years ending before March 23, 2004). After the tenth carry-forward year, any unused ABILS revert to regular net capital losses, which can be carried forward indefinitely but deducted only against taxable capital gains.

### Specific requirements for ABIL treatment

As noted above, an ABIL is one-half of a business investment loss ("BIL"). A BIL is a loss that arises on the disposition of a share in a corporation that was, at the time of the disposition or within the twelve-month period prior to the disposition, a "small business corporation".

In general terms, a small business corporation is a Canadian-controlled private corporation, (CCPC) all or substantially all of whose assets are used principally in an active business carried on primarily in Canada. A CCPC is a private Canadian corporation that is not controlled by non-residents, public corporations, or any combination thereof.

There are two types of dispositions that can generate the BIL. First, the loss can be realized on an actual disposition (e.g. sale or other transfer) of the share to an arm's length person.

Second, the loss can occur on a deemed disposition of the share. A deemed disposition of the share will occur at the end of a taxation year if 1) the corporation has become bankrupt during the year; or 2) the corporation is insolvent and subject to a winding-up order made in the year; or 3) the corporation is insolvent, no longer carrying on a business, the fair market value of the share is nil, and it is reasonable to expect that the corporation will be dissolved or wound up and will no longer carry on a business.

In order to have a deemed disposition, you must make an election in your income tax return for the year. The deemed disposition will occur for proceeds of $0, meaning that your loss and BIL will equal your adjusted cost base of the share.

**Example**

Joan owns shares in a small business corporation with an adjusted cost base of $50,000. During 2011, the corporation went bankrupt. Joan had $125,000 of business income in the 2011 year and no other sources of income.

Joan makes an election to have the deemed disposition for $0 apply at the end of 2011. She has a $50,000 BIL and therefore a $25,000 ABIL. The $25,000 ABIL is deductible from Joan's business income for 2011, such that she will report net income of $100,000.

Similar rules apply to an actual or deemed disposition of a debt owing by a small business corporation. In the case of a deemed disposition, the debt must be a "bad debt", which generally means that it is uncollectible.

### ABIL reduced by capital gains exemption previously claimed

The amount of BIL, and therefore your ABIL, is reduced by the total of the capital gains exemption claimed in previous years. The capital gains exemption applies to gains on dispositions of qualified small business corporation shares or qualified farm or fishing property.

For example, if Joan in the above scenario claimed a $10,000 capital gains deduction in 2010 in respect of a $10,000 taxable capital gain – that is, one-half of a $20,000 capital gain – the BIL in 2011 would be reduced by $20,000 from $50,000 to $30,000, and the ABIL would be reduced by $10,000 from $25,000 to $15,000. Therefore, only $15,000 would be available to offset her business income.

However, the $10,000 would revert to a regular allowable capital loss, which could not be used in 2011 (because she has no taxable capital gains in 2011), but could be carried forward or back and deducted against taxable capital gains of other years.

## DETAILS OF THE CHILDREN'S ARTS TAX CREDIT

As we noted in last month's Tax Letter, the recent Federal budget introduced a new children's arts tax credit. The credit is available starting this year. Although draft legislation to implement the credit had not yet been released as of mid-July 2011, the budget documents and a recent CRA notice have provided some details. The details of the credit are as follows.

The credit is 15% of up to $500 of eligible expenses incurred in the year for each child who is enrolled in a program of artistic, cultural, recreational or developmental activity ("eligible program"), and who is:

- under 16 years at the beginning of the year in which the expenses are paid; or
- under 18 years at the beginning of the year in which the expenses are paid if the child is eligible for the disability tax credit.

Furthermore, if at least $100 in eligible expenses has been paid for a child eligible for the disability tax credit, an

additional amount of 15% of $500 can be claimed for that child. Either parent may claim the credit, or it may be shared between parents.

**Eligible program**

An "eligible program" is either a program of at least 8 consecutive weeks in which a minimum of 90% of all the activities are "eligible activities", or a program (e.g. a camp) of at least 5 consecutive days in which more than 50% of the daily activities are eligible activities.

In terms of memberships, the full cost of a child's membership in a club, association or similar organization will be eligible for the credit if more than 50% of the activities offered to children by the organization include a significant amount of eligible activities. The CRA notes that the membership must be at least 8 weeks in duration.

A program that is part of a school curriculum is **not** an eligible program.

**Eligible activity**

For the above purposes, an "eligible activity" includes an activity that:

- contributes to the development of creative skills or expertise in artistic or cultural activities; or
- provides a substantial focus on wilderness and the natural environment; or
- helps children develop and use particular intellectual skills; or
- includes structured interaction among children where supervisors teach or help children develop interpersonal skills; or
- provides enrichment or tutoring in academic subjects.

For disabled children, the budget documents state that eligible activities will include similar activities that have been adapted to accommodate the needs and abilities of a child who is eligible for the disability tax credit.

**Eligible expenses**

Eligible expenses include fees paid for the cost of registration or membership, which may include the program's costs of administration, instruction, the rental of facilities or equipment used in common, and incidental supplies.

The following are **not** eligible expenses:

- Fees paid for the purchase or rental of equipment for the child's exclusive personal use (e.g. musical instruments);
- Fees for travel, meals and accommodation;
- Expenses that qualify for the purposes of the child care expense deduction or the children's fitness tax credit.

The organization offering the program will determine the amount of the fee that is eligible for the credit. The CRA states that parents should keep the receipts issued by the organization for verification purposes, although the receipts do not have to be filed with their tax returns.

## THE "EQUIVALENT TO SPOUSE" CREDIT

As most readers are likely aware, you are entitled to the spousal credit if you have a spouse or common-law partner with no or little income. The federal credit is 15% of $10,527 for 2011 and is indexed annually for inflation. The credit is reduced if your spouse has any income and disappears completely once their income reaches the $10,527 threshold. Provinces have similar credits with different amounts and rates.

If, at any time in a taxation year, you are single, or married or in a common-law relationship but not living with or supporting your spouse and not being supported by them, you may be eligible for the wholly dependent person credit, also known as the "equivalent to spouse" credit. The credit is known as such because it is equal in amount to the spousal credit and is similarly reduced and phased out when the person you are supporting ("dependant", described below) has income up to the $10,527 threshold (for 2011).

In addition to the above criteria, you must support the dependant in a home that you "maintain" (this can be a rented or owned property). The dependant must be

- related to you (e.g. children, grandchildren, siblings, parents);
- wholly dependent on you for support; and
- except in the case of a parent or grandparent, either under 18 years of age or dependent upon you by reason of mental or physical infirmity.

Similar to the spousal credit, you may claim the equivalent to spouse credit for only one person in a taxation year. Similarly, only one person per household may claim the credit.

**Interaction with other dependant credits**

You cannot claim the spousal credit and the equivalent to spouse credit in the same year.

You cannot claim the equivalent to spouse credit for a person who is married or in a common-law relationship and is being claimed under the spousal credit by someone else.

You can claim the regular child credit (for children under 18) and the equivalent to spouse credit for the same person.

If you are eligible to claim the equivalent to spouse credit for a person, you cannot claim the caregiver or infirm dependent credit for the same person (although a "top-up" credit may be allowed if the caregiver credit would otherwise exceed the equivalent to spouse credit).

## TAX ALERT: CRA WARNS OF "PHISHING" SCHEMES

The CRA recently published a tax alert advising taxpayers to beware of telephone calls, mail, or email that claim to be from

the CRA, but in fact are not. According to the CRA, these are "phishing" scams that could result in identity thefts:

> "Canadians should especially beware of phishing scams asking for their personal information, such as a social insurance, credit card, bank account, and passport numbers. Some of these scams ask for this personal information directly, and others refer the taxpayer to a Web site resembling the CRA's where the person is asked to verify their identity by entering personal information."

The CRA identified one particular scheme involving emails that are sent to taxpayers claiming that a complaint containing evidence of involvement in tax evasion has been filed against them using the "Informant Leads Program". The CRA states that this email is not from the CRA and that taxpayers should not respond to it. For more information about this scheme, the CRA directs taxpayers to its Informant Leads Program Web page (http://www.cra-arc.gc.ca/ntcs/frdlntmls-eng.html).

## AROUND THE COURTS

### Legal expenses deductible for defending against former employer's attempt to recover salary

Paragraph 8(1)(b) of the Income Tax Act allows you to deduct legal expenses incurred to collect or establish a right to salary or wages owed to you by your employer or former employer. In the recent *Chagnon* case, the issue was whether the provision extends to the situation where a taxpayer incurs legal expenses to defend a lawsuit in which the former employer attempts to reclaim salary already paid to the taxpayer.

The taxpayer was the president of a corporation and was given employee stock options. After the corporation was taken over by another company, the taxpayer was allowed to give up his stock options in consideration for a lump sum amount of extra salary. As a result, he received an extra $23,237,627 in salary for the stock options. The corporation later instituted legal proceedings against the taxpayer for the recovery of the amount, alleging that he had been in breach of his duty of loyalty to the corporation in respect of the takeover. The taxpayer was successful in defending the lawsuit, and attempted to deduct the legal fees. The CRA denied the deduction on the grounds that they were not incurred to collect or establish a right to salary.

On appeal, the Tax Court of Canada allowed the taxpayer's deduction. The Court found that the taxpayer, in defending his right to retain the salary already paid, was effectively establishing his right to the salary. Therefore, the legal fees were deductible.

### More on the tuition credit for online courses offered by foreign universities

As discussed in last month's Tax Letter, in the *Cammidge* case, the taxpayer was allowed to claim the tuition tax credit for an online MBA program offered by the University of Phoenix. The Tax Court ruled that the university was "in Canada" because it had two campuses in Canada. Furthermore, since the taxpayer was "enrolled" in the university, she had met the main statutory requirements for the credit for universities in Canada.

On the other hand, if the University of Phoenix had been found to be "outside Canada", the result would have been different. Under the existing provisions of the Act, the tuition credit in such case is available only if the student is in "in full-time attendance" and the courses are at least "13 consecutive weeks duration". None of the taxpayer's courses in *Cammidge* were 13 consecutive weeks. Furthermore, it is not clear whether she was in "attendance" at the university since the courses were all online.

In this regard, in the more recent decision in the *Faint* case, the University of Phoenix was found to be outside Canada. The taxpayer in this case also took online courses from the University, but in a different program. In contrast to the *Cammidge* decision, the Tax Court in this case held that the University of Phoenix did not qualify as a university "in Canada" because its campus in Canada had no connection to the taxpayer's courses – none of the courses were offered there and the taxpayer received no instructions or technical support from the campus. (Whether the taxpayer in *Cammidge* had such a connection to the Canadian campus is unclear from the facts.) Since the taxpayer's courses were all less than 13 consecutive weeks in duration, the tuition credit in this case was denied.

Both cases dealt with taxation years before 2011. It appears that this year's federal budget will rectify the issue. The budget proposes to reduce the 13 consecutive week requirement for foreign universities to a 3 consecutive week requirement, starting with courses taken in 2011. Accordingly, many students actually attending at foreign universities will benefit from the change and qualify for the tuition credit.

* * *

This letter summarizes recent tax developments and tax planning opportunities; however, we recommend that you consult with an expert before embarking on any of the suggestions contained in this letter, which are appropriate to your own specific requirements.