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TAX LETTER

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WOULD YOU LIKE SOME TAX-FREE INCOME?

Here are some of the kinds of income that are not taxed, based on the provisions of the *Income Tax Act*, CRA interpretations, or court decisions:

- Bequests and other inheritances from a deceased person
- Capital gains on your home, subject to rules that ensure that your family has only one "principal residence" at a time. However, if you build a home with an intention or secondary intention to sell, this does not apply. Even if you move in and live in the home for a while, the exemption will not be available because your gain will be business profit, not capital gain, and the principal-residence exemption applies only to capital gains. Also, since 2016 you must report the gain to claim the exemption. (*Income Tax Act*, 40(2)(b) and 54 "principal residence")
- Compensation for damage to business operations in some circumstances. (Federal Court of Appeal, *Toronto Refiners & Smelters* case (2002); Tax Court of Canada, *Frank Beban Logging* case (1998) and Henco case (2014))
- Compensation for mental or emotional damage at the workplace, such as harassment of an employee, or for human rights violations. (Several Tax Court of Canada cases, such as *Dunphy* (2009) and *Abenaim* (2017), and numerous CRA interpretation letters)
- Compensation to parents for the cost of transporting students to school when a school board discontinued bus service. (CRA interpretation letter, 2004)

- Damages for breach of an employment contract before it began. (Supreme Court of Canada, 1996 decision in *Schwartz v. The Queen*)
- Damages or compensation for personal injury, including structured settlements and awards from a provincial Criminal Injuries Compensation Board, and including Indian residential-school settlements. (Interpretation Bulletin IT-365R2, and CRA interpretation letters)
- Disaster relief payments, including from an employer (if the purpose is philanthropic, not based on employment, and the employer does not deduct the payment). (CRA interpretation letters)
- Foster care and similar in-home care that you provide, provided it does not cross the line into being a "business" for you. (*Income Tax Act*, paragraph 81(1)(h))
- Gifts, provided they are not disguised employment income or business income
- Grants under most government programs, unless the program has been prescribed in the *Income Tax Regulations* as taxable, or it relates to your business (Tax Court of Canada, *Layton* case, 1995). Note that the Canada Emergency Response Benefit, paid during the COVID-19 pandemic, is taxable under a provision (56(1)(r)) covering "income replacement benefits" that are similar to EI. However, the special COVID-related grants to seniors and to persons with disabilities are non-taxable.
- Income of a "status Indian" earned on a reserve. If you aren't a status Indian, this exemption can't help you!
- Lottery or other gambling winnings, unless you are so organized and active in your gambling that it constitutes a "business" from which you could deduct losses if you lost money. (Interpretation Bulletin IT-213R, and several court decisions)
- Reimbursements of expenses to volunteers. (CRA interpretation letter, 2005)
- Strike pay from a union. (Supreme Court of Canada, 1990 decision in *Fries v. The Queen*). A union's cash gift to a member is also usually tax-free.
- Television game show prizes, even where the taxpayer trained to develop expertise in the subject matter (Tax Court of Canada, *Turcotte* case, 1998))
- Welfare and similar social assistance payments. These must be reported as income, but an offsetting deduction is available when calculating taxable income. (*Income Tax Act*, 56(1)(u) and 110(1)(f))
- Workers' compensation benefits. These must be reported as income, but an offsetting deduction is available when calculating taxable income. (*Income Tax Act*, 56(1)(v) and 110(1)(f)(ii))
- Certain employment benefits (see CRA guide T4130).

  A few examples are:

  – Your employer's contributions to your registered pension plan, or a private health services plan.

  – Your employer can give you up to $500 in non-cash gifts and awards per year, such as for a birthday or Christmas. As well, a separate non-cash "long service" or "anniversary" award of up to $500 can be non-taxable; it must be for at least five years of service and at least five years since the last such award.

  – Board and lodging at, and transportation to, a "special work site" where you work temporarily, or a "remote work site" that is remote from any established community.

  – Transportation to the job, if provided directly by the employer.

  – Uniforms, special clothing or safety footwear that you need for your job.

Examples of how to save tax by planning for tax-free income

1. Suppose you are fired from your job in circumstances where you suffer emotional trauma.

   If you sue for "wrongful dismissal" and reach a settlement with your employer, the settlement will be taxable.

   If instead you sue not only for "wrongful dismissal", but also for emotional injury and/or violation of your human rights, you may be able to have at least part of the settlement classified as compensation for your personal (emotional) injuries or human rights violations. This portion of the settlement will be non-taxable.

2. Suppose you have a choice of employment benefits from your employer. You can choose between the use of a company car, or a health care plan (drug and dental). The two packages cost the same to your employer, so the employer does not care which one you choose.

   If you choose the company car, that is a taxable benefit. You will be required to report, as employment income on your tax return, an annual "standby charge" of 24% of the original cost of the car, or 2/3 of the leasing cost, plus an amount for operating costs if the employer pays those.

   If you opt for the health care plan, you will not have a taxable benefit, either when the employer pays the premiums for the plan or when you receive health care benefits such as reimbursement for drugs or dental care. Thus, you will have a lower income tax bill. Note in the province of Quebec, employer paid premiums are taxable to the employee.

3. Long-term planning: You can choose between buying a home to live in, or continuing to rent a home and investing your money.

   If you invest in securities, the return on your investment will normally be taxable, whether fully taxed as interest income, taxed somewhat lower as dividend income, or half-taxed as capital gains. The rent you pay to rent a home is not deductible (except to the extent you have a home-based business).

   If you "invest" in your own home to live in, and sell it for a gain, then the capital gain will be tax-free.

   Of course, it can be hard to predict whether residential home values will increase at the same rate as the return you can obtain by investing. But of course it's also hard to predict what those stocks and mutual funds will do for you in the same time frame!

SOME GST AND HST QUIRKS YOU MIGHT NEED TO KNOW

Here are a baker's dozen of unusual GST and HST rules from the *Excise Tax Act* (ETA) – some less well-known than others – that might affect your business. Note that while the GST and HST are administered by the CRA across Canada, they are administered in Quebec by Revenu Québec (RQ).

1. **Medical and other health clinics**. When revenues are shared between a doctor (or other health care provider) and a clinic, it is often unclear whether the *clinic is paying the doctor* for health care services (exempt), or the *doctor is paying the clinic* for the use of the clinic's facilities (taxable). This determination depends on both the contractual arrangements and the facts. (See CRA Policy P-238.) These arrangements need to be carefully reviewed by a GST expert to ensure that the right taxes are being remitted by the right parties. Otherwise there can be a nasty (and expensive) surprise when the CRA or RQ audits either business!

2. **Cosmetic-related health care services**. Cosmetic surgery (e.g. facelift, teeth whitening, laser spots removal) is taxable unless it is needed for medical or reconstructive purposes. This rule actually applies to *all* health care services "in respect of" a cosmetic service. Thus, for example, a **nursing service or dental hygienist service** relating to a cosmetic treatment may be taxable, even though such services are normally exempt.

3. **Charges between related companies** can often be free of GST by filing a special election (ETA section 156, Form RC4616) with the CRA or RQ, but only if the effect is merely to eliminate cash flow. This election cannot save tax. If one of the companies is making exempt supplies such as residential rents or health care services (so that it cannot claim full input tax credits), the companies cannot make the election. Also, if the election was made before 2015 on old Form GST25, it is now invalid and the companies are at risk of being assessed for not collecting and remitting GST/HST.

   (A different election on Form GST27 (ETA section 150) is available to eliminate tax in certain cases, but only if one of the companies is a "financial institution" as that term is defined.)

4. Not all **health care services** are exempt. Those that are not regulated by at least 5 provinces, or covered by public health insurance in at least 2 provinces, are not on the "exempt" list. For example, the services of **massage therapists, kinesiologists and homeopaths** are taxable, even if they are regulated by the province! (There is an exception for a "small supplier", with no more than $30,000 per year of annual taxable supplies, who chooses not to register for GST/HST.)

5. **Services** are generally taxed based on the **customer's address**. Thus, in general, if a consultant in Ontario bills an Alberta client, only 5% GST applies, but if a consultant in Alberta bills an Ontario client, the Ontario 13% HST rate applies. However, there are many exceptions to this rule. One exception is for **"personal" services** (e.g., haircuts), which are taxed based on where they are performed ... but this rule excludes a **"professional" service** (e.g. a lawyer or accountant), which normally follows the general rule! This rule may have surprising effects. For example, a hotel with a spa that provides massage therapy should likely be charging GST or HST based on the customer's home province, if massage therapy is a "professional" service.

6. A **vendor selling real property** that has GST or HST buried in the price (where the vendor wasn't able to claim an input tax credit on purchasing the property, for any of various reasons) can often recover that GST or HST, by way of a special input tax credit or rebate. These obscure rules, in ETA sections 193 and 257, are often overlooked by lawyers and accountants advising vendors.

7. If you acquire a **service or intangible property** (e.g. a consulting service or downloaded software) **from outside Canada**, and you are not charged GST/HST, you generally have a legal obligation to self-assess and pay the GST or HST to the Canada Revenue Agency, unless the purchase is for a business that can claim full input tax credits anyway. This is called an **"imported taxable supply"**. The CRA does not in practice assess consumers for this, though legally it could. But if you acquire an imported taxable supply for your business, and you are not able to claim input tax credits (e.g. because your sales are exempt), the CRA or RQ may find this on auditing your business and assess you.

8. If a GST-registered **agent sells goods for a principal who is not required to collect tax**, the agent is considered to have bought and sold the property from the principal, and must collect GST or HST on the full price charged to the customer. For example, suppose you have a used boat (which you used for your own pleasure) that you want to sell. You leave it with a boat dealer, who sells it for you and takes a commission. The dealer must collect and remit GST or HST on the full sale price (not just the commission), even though you would not have to do so if you sold the boat yourself.
9. If your business collects a "**deposit**" from a customer, no GST or HST applies until you apply it as "consideration" for the purchase. However, based on a Tax Court case (*Tendances et Concepts Inc.*, 2011), what you think is a "deposit" might actually be a "payment on account", in which case the GST or HST applies as soon as you have collected the deposit. As well, once you have **invoiced** an amount, the entire GST or HST on that amount is normally "payable" and must be remitted for that reporting period.
10. If you are **selling commercial real property** to a GST-registered purchaser, the purchaser normally accounts for the GST or HST and usually claims an offsetting input tax credit, so that the purchaser doesn't actually pay any amount in tax. However, the sale is still "taxable" for GST/HST purposes. As a result, if your purchase and sale agreement says that any GST or HST is "included" in the sale price, you will only get 100/105ths, 100/113ths or 100/115ths of the sale price (depending on the province) when the deal closes. Be careful about how the agreement is worded!
11. The sale of **vacant land** is often exempt when sold by an individual, but there are many exceptions. For example, if you have previously severed the land into more than two parts, it will be taxable. If you have been renting out the land, it may be taxable. A sale by a corporation is always taxable. If a farm has a farmhouse on it, the farmhouse portion (plus one-half hectare of land) is usually exempt. Again there are lots of special rules and exceptions, and you should get professional advice to make sure you're getting it right.
12. If your business **sues another person for breach of contract**, and the original contract bore GST or HST, any amount you receive as damages or in a settlement will normally be considered to be GST- or HST-included, so that you must remit tax out of the total and the defendant may be able to claim an input tax credit. Make sure to "gross up" for the GST or HST in any claim or settlement in such cases. But you may have already recognized and remitted GST/HST when you first billed the client. To the extent you have to write off some of the amount originally owing, you can likely use the "bad debt" or "credit note" rules in the legislation (ETA sections 231 and 232) to recover from the CRA or RQ the GST/HST that you weren't able to collect.
13. An employed **musician** who is also GST-registered can often claim input tax credits for tax paid on buying musical instruments used in employment, under a special rule in ETA subsection 199(5).

TAX BREAKS FOR PERSONS WITH DISABILITIES

The *Income Tax Act* provides many potential benefits, credits and tax breaks to persons with disabilities.

In most but not all cases, the test to qualify for these benefits is based on qualifying for the "Disability Tax Credit", which requires having a physician complete a Form T2201 (for some

disabilities, other health-care providers also qualify), certifying that the person has a "severe and prolonged impairment" that affects the person's "activities of daily living" in a particular way. The Act and Form T2201 have detailed requirements that must be met to qualify.

Once a person qualifies for the Disability Tax Credit (which is worth $1,286 as a federal credit in 2020, plus a provincial credit), here are some other benefits that are available:

- $600 non-taxable federal government payment to help with the effects of COVID-19, to be paid this fall
- certain disability-related employment benefits (transportation, parking and an attendant) are non-taxable
- deductions are allowed for a wide range of "disability supports" required to enable the person to work, study or carry on grant-funded research
- medical expense credit for nursing home care, attendant, group home care or certain therapy
- 15% Home Accessibility Tax Credit, for qualifying expenditures
- $750 Disability Home Purchase Credit
- higher Canada Workers Benefit (formerly called the Working Income Tax Benefit)
- eligibility for a Registered Disability Savings Plan, along with the government-provided Canada Disability Savings Grant and Canada Disability Savings Bond
- enhanced entitlement to a Registered Education Savings Plan
- enhanced Home Buyer's Plan (using RRSP to help fund a home purchase)
- limited exclusions from the Tax on Split Income (which taxes family members at a high rate, typically where income-splitting is done through a corporation)
- reduced withholdings if using the Lifelong Learning Plan (using RRSP to help fund education)
- a "qualified disability trust" for the person can be taxed at low marginal rates not available to other trusts
- a trust for the person can make a "preferred-beneficiary election" to allocate income to the person for tax purposes without paying it out
- refund of 1.5¢ per litre of gasoline purchased, under the Federal Excise Gasoline Tax Refund Program (CRA Form XE8), for anyone with "an impairment of mobility to such a degree that using public transportation would be hazardous".

Where the taxpayer's **child** has such a disability, the following are some of the available benefits, in additional to those above where they can apply to a child (e.g., medical expenses):

- the Disability Tax Credit can be claimed by the taxpayer for the child
- higher Canada Child Benefit payments (formerly called the Child Tax Benefit)
- higher child-care expense deduction limits

AROUND THE COURTS

Construction contractors beware! The CRA has ways to find you

The Federal Court of Appeal has continued to allow the CRA to find construction contractors who are not reporting all their income. (Residential contractors are notorious for doing renovations for cash and not reporting all their income and GST/HST.)

In *Roofmart Ontario Inc. v. Canada*, 2020 FCA 85, the CRA issued a Requirement for Information to Roofmart, a major Canadian

supplier of roofing and building materials, to disclose details of all its customers who spent at least $20,000 per year at Roofmart from 2015-2017, or $10,000 in the first six months of 2018. Unlike consumers, contractors normally have accounts at building-supply stores that allow them to buy materials at a discount. This means that the stores keep records identifying these customers and their purchases, even if they pay cash.

The CRA brought this application in Federal Court and Roofmart resisted it. The Federal Court granted the application in 2019. Roofmart argued that the CRA must be currently engaged in an audit of the target group, but the Court disagreed. The request was legitimately made for audit purposes.

Roofmart appealed further, to the Federal Court of Appeal. The Court of Appeal has now confirmed that the order issued was appropriate, and there was no requirement for the CRA to have an existing audit underway or pending. As well, the customers whose names were sought were an "ascertainable group". Therefore, Roofmart must comply.

Contractors who use Roofmart may wish to consider using the CRA's Voluntary Disclosure Program to disclose unreported sales and GST/HST, so as to eliminate most penalties and the possibility of criminal charges. Once the CRA starts an audit, it will be too late for a voluntary disclosure.

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.

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