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Tax Letter

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Monthly Newsletter | **November 2017**

EMPLOYEE DISCOUNTS

Historically, the administrative position of the Canada Revenue Agency ("CRA") in respect of employee discounts was as follows: Generally, if the employer sold its goods to its employees at a discount, but at a price that was at least equal to the employer's cost, there was no taxable benefit for the employees.

In an apparent about-face, a recent Income Tax Folio published by the CRA indicated that employee discounts would be taxable, unless the discount was available to the general public. Not surprisingly, this position caused an outcry and made front page news.

Soon afterward, Minister of National Revenue Diane Lebouthillier stated that the change in the Income Tax Folio was made without her consent, and she ordered the CRA to take it off its website. The Minister stated that the CRA was planning an internal review on wording changes to the Folio, which would be followed by a consultation on the issue with industry groups. Of course, this was not complete comfort, as the Minister did not specifically rule out the possibility that all discounts may become taxable.

However, on October 14, 2017, Prime Minister Trudeau got involved and tweeted: "Let me be blunt: we are not going to tax anyone's employee discounts. Minister @DiLebouthillier has asked the CRA to fix this".

We hope that this is true, and hopefully this will be the end of the story. We expect the CRA to fix the Folio accordingly in due course.

PERSONAL USE PROPERTY

GENERAL RULES

Personal use property ("PUP") is defined generally as property that you or a non-arm's length person uses primarily for personal purposes. PUP typically includes property such as your home, cottage, car, furniture, appliances, clothing, art work, bicycles, and so on.

If you sell a PUP at a gain, one-half of it is included in your income as a taxable capital gain. This is the same rule that applies to any capital property.

If you sell a PUP at a loss, the loss is normally denied. However, a loss may be claimed if the property is a "listed personal property", though only against gains from listed personal property.

Listed personal property is defined to mean the following types of property:

- A work of art;
- A rare book, folio or manuscript;
- Coins;
- Stamps; and
- Jewelry.

Losses from listed personal property can offset gains from listed personal property, but not other property. If your *gains* from listed personal property exceed your losses for a taxation year, one-half of the net amount is included in your income. If your *losses* exceed your gains for a taxation year, your net gain is nil. The excess losses can be carried forward 7 years or back 3 years to offset gains from listed personal property in those years.

Example

In 2017, you sell a piece of art (a listed personal property) at a gain of $10,000. In 2015, you sold a piece of art at a loss of $4,000, and you had no gains in that year from listed personal property.

In 2017, you can carry forward the $4,000 loss against the $10,000 gain, resulting in a $6,000 gain. Half of that, or $3,000, will be included in your 2017 income.

ONE THOUSAND DOLLAR THRESHOLD

All PUP, whether listed personal property or not, is subject to a *"de minimis"* threshold in terms of the cost and proceeds of disposition. Basically, where either the cost or the proceeds of disposition is less than $1,000, it is deemed to be $1,000. The threshold is meant to ignore PUP that is of relatively low value. (If you buy PUP for $100 and sell it for $900, both amounts are deemed to be $1,000 so there is no gain or loss for tax purposes.)

Example

In 2017, you sell a piece of art that cost you $800. You sell it for $5,000.

Your cost of the art will be deemed to be $1,000, so that you will have a $4,000 gain. Half of that will be included in your income.

You also sell a rare book that cost you $900. You sell it for $800.

Your cost and sales proceeds for the book will be deemed to be $1,000, so you will have no gain or loss from the book.

THE TAXATION OF PARTNERSHIPS

GENERAL RULES

There are three types of persons and taxpayers for income tax purposes: an individual, a corporation, and a trust.

A partnership is not considered a person or a taxpayer. It is a *relationship*, generally defined as two or more persons carrying on business with a view to profit.

Therefore, a partnership does not file a tax return and does not pay taxes. (However, as noted below, a partnership may have to file an information form.) Instead, the partners report their shares of the partnership income or loss on their tax returns, along with their other income or losses. The partnership is essentially treated as a "flow-through" entity or relationship rather than a person.

Although a partnership does not pay tax, the Income Tax Act requires a notional calculation of the partnership's income or loss as if the partnership were a person. The character of the income or loss (business income, property income, capital gains, etc.) is computed using the same rules that would apply to a taxpayer. In other words, most of the income inclusion and deduction rules (including items such as capital cost allowance) are notionally applied to the partnership.

The amount of the partnership income or loss is then divided among, or allocated to, each partner based on the partner's share of the partnership. Each partner's share is normally determined under the partnership agreement. The partner's share of the income or loss is reported on the partner's income tax return. This is done irrespective of whether the partnership has paid its income for the year out to the partners.

ADJUSTMENT TO COST OF PARTNERSHIP INTEREST

The income allocated to a partner for a taxation year is added to the partner's cost (adjusted cost base) of the partner's interest in the partnership. Any loss so allocated is deducted in computing the partner's cost of the interest.

Cash taken out of the partnership – the partner's "draw" – is not taxed again (as noted above, the income to the partner is taxed when it is allocated to the partner). Instead, the cash draw reduces the partner's cost of the interest.

The above rules ensure the appropriate amount of capital gain or loss if the partner sells the partnership interest.

Example

You are a partner in a partnership. Last year, you were allocated $100,000 of the partnership's income and included that amount in your income. However, you did not take any of that cash out of the partnership. Your previous cost of the interest was $50,000.

Your "adjusted cost base" of the partnership interest will now be $150,000 – reflecting your previous cost plus the $100,000 allocated income. This ensures that, if you sell your interest now, you will not be taxed again on the $100,000 amount that was included in your income.

On the other hand, if you take out the $100,000 amount as a cash draw, your cost of the interest will be reduced back to $50,000. This result is appropriate, since your withdrawal of the $100,000 would normally reduce the value and potential sale price of your interest by the same amount.

TAX CREDITS

Any tax credits are claimed by the partner rather than by the partnership.

Special rules may apply where the partnership pays an amount or otherwise undergoes a transaction that could trigger a tax credit.

For example, if the partnership makes a charitable donation, each partner will generally claim their *pro-rata* share of the charitable donation credit based on their share of the donation. Similarly, where the partnership makes a payment that qualifies for an investment tax credit, each partner will claim the credit based on the portion of the payment amount that can reasonably be considered to be the taxpayer's share.

LIMITED PARTNERS

Although most of the above rules also apply to a limited partner of a partnership, one main difference applies when the partnership has losses. Typically, the limited partner may deduct its share of partnership losses only to the extent of the limited partner's "at-risk amount" in respect of the interest.

In general terms, the at-risk amount is the partner's cost of the interest, reduced by certain amounts such as the partner's amount owing to the partnership, limited recourse debt used to acquire the interest, and any amounts or benefits to which the partner may be entitled that could serve to reduce the impact of any loss of the partnership allocated to the partner.

PARTNERSHIP INFORMATION RETURN

Although a partnership does not file an income tax return, in some cases it must file an *information return*, Form T5013. The information return and its schedules require information such as the identity and addresses of the partners, the type of business, a summary of the partnership income, information about the partnership agreement, the partners' shares of the partnership income, and various other items.

The information return is filed by Canadian partnerships and partnerships that carry on business in Canada. A Canadian partnership is one in which all the partners are resident in Canada.

However, the CRA provides that not all such partnerships are required to file the information return.

In particular, the CRA requires a partnership to file the return for a fiscal period only if:

- at the end of the fiscal period, the partnership has an absolute value of revenues plus an absolute value of expenses of more than $2 million, or has more than $5 million in assets; **or**
- at any time during the fiscal period:
  - the partnership was part of a "tiered partnership" (it has another partnership as a partner or is itself a partner in another partnership);
  - the partnership had a corporation or a trust as a partner;
  - the partnership invested in flow-through shares that incurred Canadian resource expenses and renounced those expenses to the partnership; **or**
  - the CRA requests that a return be filed.

The "absolute value" of a number is the value without regard to its positive or negative sign. Therefore, the $2 million revenue and expense threshold is determined by adding total worldwide expenses to total worldwide revenues.

If a partnership does not fall into one of the above categories, it is not required to file the return.

The CRA has also provided an administrative position that exempts farm partnerships from filing the return if they are made up of only individual partners. The exemption applied through the 2016 fiscal year. The CRA has not yet indicated whether the farm partnership exception will continue to apply for 2017, although we expect that it will.

If a partnership is required to file the T5013, each member is responsible for filing it. However, one member can file the return on behalf of all members; so only one return has to be filed for the partnership.

DEDUCTION OF CAR EXPENSES

DEDUCTION FOR BUSINESS

If you use your car in the course of carrying on your business, you can deduct most of your car expenses associated with the business travel. The deductible expenses include items such as:

- Gas;
- Insurance;
- Licenses;

- Repairs and maintenance;
- Leasing costs if you lease the car;
- Interest on car loan to buy the car;
- Capital cost allowance ("CCA"), which is depreciation claimed for tax purposes, if you own the car.

The last three items are subject to maximum dollar limits, as discussed in more detail below.

The amount you can deduct is pro-rated, based on your percentage of business use of the car in the year. For example, if your business use kilometres for the year are 40% of your total kilometres driven in the year, you can deduct 40% of the eligible expenses.

In this regard, the CRA allows you to use a "logbook" method under which the business use of the car can be calculated. Under this method, you must first complete one full year of a logbook of business travel to establish a "base year". Subsequently, you can use a three-month sample logbook in any year and use that sample to determine the whole year's business versus personal use, as long as the usage is within 10% of the results of the base year.

More particularly, the CRA requires the following under the logbook method:

- You previously filled out and retained a logbook covering a full 12-month period that was typical for the business (the "base year"). The 12-month period is not required to be a calendar year;
- A logbook for a sample period of at least one continuous three-month period in each subsequent year has been maintained (the "sample year period");
- The distances travelled and the business use of the car during the three-month sample period is within 10 percentage points of the corresponding figures for the same three-month period in the base year (the "base year period"); and
- The calculated annual business use of the car in a subsequent year does not go up or down by more than 10 percentage points in comparison to the base year.

The business use of the car in the subsequent year is then calculated by multiplying the business use from the base year by the ratio of the sample period and base year period. The CRA sets out the formula for this calculation as follows:

(Sample year period % ÷ Base year period %) × Base year annual % = Calculated annual business use

LIMIT FOR LEASING, INTEREST AND CCA

The amount you can deduct for these costs is limited to certain maximums. The maximum amounts below are reviewed by the Department of Finance every year and an announcement is made each December for the next year, but they have been unchanged since 2001 (for cars acquired or leases entered into since that year).

For lease payments, your eligible deduction is generally limited to $800 (plus applicable provincial retail sales tax, or GST/HST if you are not eligible to claim GST/HST input tax credits) per 30-day period in the year. The deductible amount may be ground down further if the manufacturer's list price of the car exceeds $35,294 (plus the provincial retail sales tax or GST/HST where not refundable).

For interest on a car loan, the maximum amount that may be deducted is $300 per 30-day period in the year in which the loan is outstanding.

For CCA, the maximum cost that can be used as a base for claiming depreciation for tax purposes is $30,000 (plus provincial retail sales tax and GST/HST where applicable).

In each case, the deductible amount is pro-rated, again based on your business use kilometres relative to your total kilometres for the year.

DEDUCTION FOR EMPLOYEE

The same expenses as discussed above may be allowed to an employee who uses his or her car in the performance of employment duties.

However, the following conditions must be met:

- You must ordinarily be required to carry on the duties of the employment **away from the employer's place of business**;
- You are required under your contract of employment to pay the car expenses;
- You did **not** receive a tax-free car allowance from your employer;
- Your expenses were **not** reimbursed by your employer; and
- Your employer must certify in Form T2200 that you met the conditions required for the deduction. Although the Income Tax Act

specifies that you must file the form with your tax return for the year, the CRA waives this requirement, stating on the form that you only need to keep it in your records in case CRA asks for it.

As with a business, your deduction must be pro-rated based on your employment use kilometres in the year relative to your total kilometres for the year.

ELECTRONIC DISTRIBUTION OF T4 INFORMATION SLIPS

Until recently, your employer was required to mail your T4 slips (reporting your employment income, taxes withheld, etc.). Your employer could provide them by electronic means, but only if you had previously consented.

Effective for the 2017 taxation year – for which T4 slips must be issued by the end of February 2018 – an employer can issue the slips electronically to current employees without their consent, but only through a secure system, not by general Internet email. The employer will not be able to issue a T4 electronically if the employee specifically requests paper copies, or if the employee "cannot reasonably be expected to have access to the information return in electronic format". These changes were first announced in the 2017 Federal Budget.

AROUND THE COURTS

LAWYER NOT ALLOWED TO DEDUCT LOSSES FROM LAW PRACTICE

If you carry on a business and incur a net business loss in a taxation year, the loss can be used to offset other sources of income for the year. However, if your activities do not constitute a business so that you do not have a "source of income", your loss will not be deductible.

Normally, if your activities are clearly commercial in nature and there is no personal element to them, you will have a source of income and any losses will be deductible as noted above.

An unusual recent case held that a lawyer practising law on a part-time basis did not have a business, so her losses from the practice were disallowed. Normally, one would think that a law practice has little or no personal element and that losses would be allowed.

The case was *Renaud v. The Queen*. The taxpayer was employed at the Canadian Transportation Agency. However, in the years in question, she also had a part-time law practice, which took up 5 to 10 hours a week. She also taught part time at a law school. The issue in the case was whether the part-time practice constituted a source of income, so that she could deduct the losses she incurred in those years.

As noted, her losses were not allowed. The Tax Court of Canada Judge held that in this "rather exceptional situation", the taxpayer did not demonstrate that her activities were undertaken in the pursuit of profit.

Based on her low hours, billings, and choice of clients, the Judge stated that "what the appellant seeks in her private practice is to try to help people with modest incomes while working professionally and trying to somewhat reduce what it is costing her to carry out this activity. That is commendable, very, very commendable, but I fail to see how that can be clearly commercial." As a result, she had no source of income and therefore no deductible losses.

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