

TAX LETTER

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HST QUIZ — IS YOUR BUSINESS CHARGING IT PROPERLY?

Whether or not you're in a Harmonized Sales Tax province, if you carry on business you need to know the rules for when to charge HST. You might be surprised!

The GST/HST rates are:

- 13% HST in Ontario, New Brunswick and Newfoundland & Labrador
- 12% HST in British Columbia
- 15% HST in Nova Scotia

- 5% GST in all other provinces and the territories. (There is also a provincial retail sales tax in Saskatchewan, Manitoba and PEI, and a GST-like Quebec Sales Tax in Quebec. Alberta and the territories have only the 5% GST.)

Try this quiz and see how you do. Answers are on page 6.

1. You're in Calgary and you sell widgets. A customer in Halifax orders a widget and you ship it to her in Halifax. What rate of tax do you charge?



2. You're in Calgary and you sell widgets. A customer in Halifax orders a widget and you "deliver" it at your warehouse in Calgary. In order to get the widget to her, you also arrange (as your customer's agent) for a courier company to deliver the widget to her. What rate of tax do you charge?
3. You're in Calgary and you sell widgets. A customer in Halifax orders a widget and you deliver it at your warehouse in Calgary. In order to get the widget, your customer calls a courier company to have the widget picked up at your warehouse. What rate of tax do you charge?
4. You're an engineer based in Vancouver. A client in Winnipeg thinks he's invented a new device, and want you to review his design plans to tell him if they will work. You stay at your office in Vancouver, review the plans, write a report and bill the client. What rate of tax do you charge?
5. You're an engineer based in Vancouver. A client in Winnipeg thinks he's invented a new device, and want you to review his design plans to tell him if they will work. You travel to Winnipeg, review the plans, write a report and bill the client. What rate of tax do you charge?
6. You're an engineer based in Vancouver. A client in Winnipeg thinks he's invented a new device, but is being sued by a competitor in Ontario who says your client stole the plans. They're in litigation in the Ontario courts. You stay at your office in Vancouver, review the plans, write an expert report for your client to use in the litigation and bill the client. What rate of tax do you charge?
7. Following #6, you travel to Toronto to testify as an expert witness in the trial, on behalf of your Winnipeg client. What rate of tax do you charge?
8. You're a hair stylist, based in Toronto. You style the hair of a client from Edmonton who's visiting Toronto. What rate of tax do you charge?
9. You're a plastic surgeon, based in Toronto doing facelifts (which are taxable when done solely for cosmetic reasons). You treat a patient from Edmonton who's visiting Toronto. What rate of tax do you charge?
10. You're a computer expert based in New Brunswick. A customer from a nearby town in Quebec sends you a computer to repair. You repair it and return it. What rate of tax do you charge?

(See page 6 for the answers.)

TAX-FREE EMPLOYMENT BENEFITS

If you are an employee, then as a general rule you must pay tax on both your **salary** and any **employee benefits**. Except for benefits that are specifically identified as non-taxable, all benefits are taxable.

Some examples of common **taxable** employee benefits include (though there are some exceptions to these):

- a car provided to you by your employer (the benefit is generally calculated using a standard "standby charge", plus an amount for GST or HST, plus an additional amount for operating expenses where the employer pays any of your personal expenses)
- employer-paid parking
- board, lodging, and rent-free or low-rent housing (with an exception as discussed below for remote or temporary work sites)

- employer-paid life insurance
- holiday trips, prizes and incentive awards (with an exception for certain non-cash gifts or awards, discussed below)
- fitness, gym or health club memberships
- interest-free or low-interest loans from your employer (the benefit is generally the amount of interest that you are not paying, but not exceeding the prescribed rate under the Income Tax Act)
- stock options (complex rules apply to determine the value and timing of the benefit)
- income tax return preparation and financial counselling.

The following are some benefits that are **non-taxable**, either because they are listed as such in the Income Tax Act, or because of CRA administrative policy:

1. Your employer's contributions to your **registered pension plan**. (The pension is taxable when you receive it, typically after you retire.)
2. Your employer's contributions to a **group sickness, accident insurance or disability insurance plan** (including critical-illness insurance). However, if your employer pays such contributions, then any benefits you receive from the plan (e.g., if you become disabled) are taxable to you, minus a deduction for any premiums you paid to the plan yourself over the years.
3. Your employer's contributions to a "**private health services plan**". This includes a drug plan and a group surgical/medical plan that covers drugs, medical expenses and hospital charges not covered by public health

insurance. It also includes a **dental insurance plan**. In addition, benefits you receive from these plans are **not** taxable. This is therefore one of the best possible employee benefits.

4. 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 or five years since the last such award. Any excess over these amounts is taxable. These rules do not apply to non-arm's length employees, such as shareholders of closely-held corporations and their family members.
5. The cost of an **attendant** to assist you at work if you are sufficiently disabled that you qualify for the disability tax credit. This can be paid directly by the employer, or paid to you as a reasonable allowance.
6. **Child care** that is provided at the workplace, managed directly by the employer.
7. **Computers** provided by the employer, if provided to enhance employees' quality of life and computer literacy, under the CRA's guidelines for employment-related training.
8. **Legal fees** paid by an employer, if they relate to an employee act during the normal course of employment duties.
9. Reimbursement of certain **moving expenses** if you relocate because of your employment.
10. 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.

11. **Transportation to the job for certain employees**, if provided directly by the employer. A reimbursement or allowance for transportation is generally taxable.
12. **Tuition fees** for you to take courses that primarily benefit the employer, if you agree to continue employment for a reasonable time after the training.
13. **Uniforms, special clothing or safety footwear** that you need for your job. If the employer pays for the dry cleaning or laundering of such clothes, that is also non-taxable.
14. **Work permit and visa fees** paid by an employer so that a foreign employee can work in Canada. However, permanent resident authorization fees are considered to be a taxable benefit if paid by the employer.

BUY NEW COMPUTERS BEFORE JANUARY OR FEBRUARY!

The 2009 federal Budget introduced a special incentive for buying general-purpose computers, such as a laptop or desktop computer.

Such computers (and systems software for them), purchased from January 28, 2009 through January 31, 2011, qualify for a **100% capital cost allowance** (CCA) writeoff in the year of purchase. They are also not subject to the usual rule that limits CCA on new goods to one-half of the amount otherwise allowed.

If you need a new computer for your business and your year-end is December 31, then if you buy the computer by December 31 you can deduct the entire cost against your 2010 income, as though it were a current expense.

Beginning February 1, the CCA rate goes back down to 55%, and the “half-year rule” applies,

so that for the year of purchase you can deduct only 27.5% of the cost of the computer.

DIRECTORS’ LIABILITY — A CAUTIONARY TALE

The recent Tax Court of Canada decision in *Ustel* provides some good lessons about the dangers that can befall directors of small companies.

Ustel was a director of a company that ran a retail store selling art and framing. He founded the company with two other individuals, but left its active management in 2002 when he ceased to be President of the company. Unfortunately for him, when the company sent an update to the (Ontario) provincial government corporate registry to record that he had left, it showed him as resigning as President but did not show him as ceasing to be a director.

The company eventually went out of business without paying its GST and income tax debts, and the CRA assessed Ustel in 2008 in two ways.

First, Ustel was assessed as a director of the company for the GST it had collected but not remitted to the CRA. Directors can be assessed for a company’s unremitted GST or HST.

Second, Ustel was assessed some \$17,000 in respect of the company’s income tax debt. Directors can be assessed for a company’s unremitted payroll deductions (employee source deductions), but not for its regular corporate income tax. So how did this happen?

The CRA assessed Ustel under *Income Tax Act* section 160, for having received **dividends** from the company during a year in which it owed money to the CRA. Section 160 allows the CRA to pursue any related person who has received money or property from a “tax debtor” without paying full value. Dividends fall under this rule.

Ustel appealed to the Tax Court of Canada. He argued that he had delivered the company a letter resigning as director in 2002, so that the two-year limitation period had run before he was assessed. He also argued that he had never received dividends from the company, but only employment income.

The Tax Court dismissed the GST appeal, but allowed the income tax appeal to the extent possible.

On the GST side, the Court accepted Ustel's evidence that he had resigned in 2002. Various events, including Ustel ceasing to be a signing officer of the company, and the company's Chartered Accounting firm having had a copy of his resignation letter in its files, suggested that the letter had indeed been delivered.

However, that was not the end of the matter. The Court ruled that Ustel had continued to act as a *de facto* director by signing the corporation's income tax returns in 2003 and 2004 as a director.

The judge then went on to find that, because Ustel had held himself out as a director in 2003 and 2004, he had an "onus" to take action to let the CRA know that he was not a director. Because the CRA had reasonable grounds to believe he was still a director, he "should have taken steps to disabuse the CRA of that belief". Thus, in 2008 he was still a *de facto* director!

On the income tax side, the Court ruled that there was insufficient evidence that Ustel had received dividends from the corporation. The corporate records were somewhat confused, and it appeared from the evidence that its accountant had made mistakes in how income was reported.

The Tax Court thus allowed Ustel's income tax appeal. However, since Ustel had appealed under the Court's Informal Procedure, the income tax adjustment was limited to \$12,000 (plus interest), as provided by the *Tax Court of*

Canada Act. (The Court did not discuss the fact that the \$12,000 limit is normally considered to apply to each taxation year. Ustel's income tax assessment was for both 2003 and 2004. Arguably, Ustel should have been allowed \$12,000 for each year.)

There are five lessons to be learned from this case.

First, a director who has resigned needs to ensure that the provincial corporate registry is updated to show the resignation, to start the two-year clock running. Once two years have run after the resignation is clearly documented, a former director cannot be assessed.

Second, a director who has resigned needs to be extremely careful not to take any action in which he or she purports to act as director. Otherwise he or she may be assessed as a *de facto* director.

Third, even though directors are not liable for unpaid corporate income tax, the CRA can often get to the same result by proceeding under section 160, so shareholders have to be very cautious about taking dividends from a corporation. Taking employment or consulting income is much safer, because it normally constitutes payment for services rendered.

Fourth, as noted above, a corporation that pays dividends while insolvent runs the risk of having such dividends held to be void, so that the shareholders would have to pay much higher tax on the payments.

Fifth, where an Informal Procedure income tax appeal has more than \$12,000 at stake, consider whether separate appeals filed for each taxation year would allow the Court to circumvent the \$12,000 rule so as to allow a higher adjustment than \$12,000 plus interest.

All in all, an interesting case and a cautionary tale!

RRSP DEDUCTION LIMIT FOR 2011

If you haven't yet made your RRSP contribution for 2010 and are under 71, you can make it any time up to and including March 1, 2011 (60 days after year-end).

The maximum contribution for 2010 is **\$22,000**, or 18% of your 2009 "earned income" if that "earned income" was less than \$122,222. Earned income is generally your income from:

- employment
- carrying on business (but not through a corporation unless the corporation pays you a salary; dividends or shareholder benefits are not "earned income")
- net rental income (after expenses) from real estate
- CPP disability pension
- research grants
- taxable spousal support payments.

Your RRSP contribution room is reduced by your "pension adjustment" if you are a member of a registered pension plan.

If you have the cash available, it is a good idea to make your 2011 contribution early in 2011. Then any income earned on those funds will grow tax-free in the RRSP. You can make your contribution any time from January 1, 2011 to February 29, 2012.

HST QUIZ — THE ANSWERS

Here are the answers to the quiz on page 1.

1. You charge 15%, the rate for Nova Scotia. Goods sold and shipped anywhere in Canada bear GST or HST based on the rate of tax in the destination province.
2. You still charge 15%, the rate for Nova Scotia. As long as you're arranging the shipping, even as the customer's agent, the same rule applies as in #1: the GST or HST applies at the rate in the destination province to which you've shipped the goods.
3. You charge only 5% GST, the rate for Alberta. You've completed delivery at your Calgary warehouse, and the customer has made her own arrangements to pick up the goods.
4. You charge only 5% GST. Services are normally taxed based on the customer's address (subject to various exceptions).
5. Again you charge only 5% GST. It doesn't matter where you perform the work. Services are normally taxed based on the customer's address (subject to various exceptions).
6. You charge 13% HST, the rate for Ontario. A service "rendered in connection with litigation" in a province's courts is taxed at the rate for that province. The litigation is in an Ontario court. This rule is often thought to apply only to lawyers' services, but is actually much broader!
7. Again you charge 13% HST, the rate for Ontario, because this is a service in connection with litigation in an Ontario court. It doesn't matter where you perform the service.
8. You charge 13% HST, the rate for Ontario. Even though services are normally taxed based on the customer's address, there is an exception for "personal services", which are taxed based on where they are performed.

Since you perform the service in Ontario, the Ontario rate applies.

9. You charge only 5% GST, the rate for Alberta. The exception for “personal services” in #8 above doesn’t apply to an “advisory, professional or consulting service”. Instead, such a service is subject to the normal rule for services, based on the customer’s address. (A physician’s service is a “professional” service.)

10. You charge only 5% GST, the rate for Quebec. There is a special rule for goods that are sent for repair, alteration, cleaning or a similar physical service. The tax applies based on the address to which the goods are returned after being repaired, altered, cleaned, etc.

AROUND THE COURTS

Taxpayer loses because of what he wrote on Facebook

In the recent case of *Shonn’s Makeovers & Spa*, an individual worked at a small Ottawa hair salon as a colouring artist. He claimed Employment Insurance benefits as an employee. The CRA ruled that he was an employee, but the owner of the hair salon appealed, arguing that he had hired the worker as an independent contractor. The worker claimed that the pay he received was supposed to be after employee withholdings, while the owner claimed he was simply paying gross amounts to an independent contractor.

In the end, the Court judge decided the case based on the worker’s Facebook page, where he described himself as a “self-employed hair colour specialist”. The worker claimed that he had lied on Facebook, but he admitted that the rest of his Facebook page was true: “his age, his likes and preferences, his hometown, his education, activities and groups”. The Court therefore concluded that he was self-employed.

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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.