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IN THIS ISSUE

AUTO ALLOWANCES: Fixed Payments for Small Trips Can be Costly!

In a March 28, 2013 Technical Interpretation, Canada Revenue Agency (CRA) notes that:

1. An allowance received for the use of a motor vehicle is deemed not to be reasonable (and therefore taxable to the employee) unless based solely on the number of kilometres travelled.
2. In this case, the employee was provided $4.60 per trip of less than 10 kilometres. CRA concluded that this payment would be taxable to the employee, however, certain expenses may be deductible by the employee.

Because it is a taxable allowance, the employer will not be entitled to the GST/HST Input Tax Credit. However, the employee, in addition to deducting employment expenses, may be entitled to a GST/HST rebate.

Action Item: Motor vehicle allowances are a common target of CRA review because many detailed rules apply. Give us a call if you want to review the tax implications of your motor vehicle allowances.

EMPLOYMENT INSURANCE: Which Working Hours Count?

The number of hours or weeks one needs to qualify for EI are based on where the person lives and the unemployment rate in that economic region at the time the claim is filed. In an April 12, 2013 Tax Court of Canada case, at issue was how many of a teacher's hours worked were insurable hours under the Employment Insurance Act (EIA).

Taxpayer wins

The government originally did not include hours spent attending meetings assigned by a principal, preparation and planning of courses, marking student work, and recording student achievements in determining eligible employment hours.

The Court noted that:

The EIA defines hours of insurable employment and notes that where a person's earnings are not paid on an hourly basis but the employer provides evidence of the number of hours that the person actually worked in the period of employment and for which the person was remunerated, the person is deemed to have worked that number of hours in insurable employment.

The Court increased the number of hours from 509 (as conceded by CRA) to 547 hours for this extra time.

Action Item: Although this case refers to a teaching scenario, consider whether it also applies to you or your employees.

BUSINESS EXPENSES: Prove It!

In a June 20, 2013 Tax Court of Canada case, at issue was whether the taxpayer, Mr. L, operated a business activity providing consulting services, whether the expenses he claimed were deductible, and whether gross negligence penalties should be applied.

In his 2007 Tax Return, $2,000 in professional gross revenue and $17,154 in expenses for a loss of $15,154 were reported. In 2008, no gross income and $12,190 of business expenses were claimed.

Taxpayer loses

The Appeal was denied and the costly gross negligence penalty left in place. The Judge noted, "There was no credible explanation that would indicate that any of the amounts that Mr. L reported on his tax returns in respect of his purported consulting business were incurred for the purpose of gaining or producing income. At best, I believe that Mr. L was indifferent as to whether the expenses that he claimed on his tax return were accurate or not. More likely, I believe that Mr. L knew the expenses he claimed on his returns were false and claimed them anyway."

Action Item: Ensure that you are maintaining the necessary support in an efficient manner before the Tax Man comes to call! We can assist with a review of your recordkeeping system if needed.

3RD PARTY DISCLOSURE OF UNREPORTED INCOME

In an April 10, 2013 Tax Court of Canada case, CRA reassessed a taxpayer to include approximately $28,000 of income. CRA based this income inclusion on the results of the audit of a different company which listed the taxpayer as a Subcontractor.

Taxpayer wins

The Court indicated that, "It is simply insufficient to tax a person solely because another person under audit points to them and provides their name and address. Names and addresses are readily available publicly and the companies could just as easily have given CRA almost any Canadian's name, this would include mine." In allowing the appeal, the Court indicated "it is unfortunately entirely possible that the taxpayer did work for, and got paid by, these companies. However, the evidence of that, such as it is, falls very short of allowing me to conclude that, on a balance of probabilities, he did."

Action Item: CRA's assessments can be challenged – make sure you contact us to review any surprises from CRA. While the win is positive, it bears noting that the taxes were only reversed because the taxpayer went to court.

OLD TAX RETURNS: They can be reopened!

In a May 31, 2013 Tax Court of Canada case, at issue was whether shareholder withdrawals of $28,791, $32,173 and $23,351 for the 2004, 2005 and 2006 taxation years, respectively, could be added as personal income.

CRA generally has three years from the date of their initial assessment to revise its assessment of an individual or Canadian-controlled private

corporation's income tax return. At the time of reassessment, the 2004 and 2005 years were past this deadline. Any misrepresentation that is attributable to neglect, carelessness or willful default is subject to reassessment, even if the usual deadline has passed.

Taxpayer loses

The Judge noted that, meaningful books do not exist for the Company or the Appellant, and if they do, they were not produced at the Hearing nor were any source documents regarding actual receipts, vouchers or invoices relevant to specific business expenses. As the reconciliation of the shareholder's loan account was rendered impossible by the absence of an ascertainable flow of funds, the Court did not allow for a reduction in personal benefits received other than for a minor amount.

The Judge found that CRA discharged its onus of proof thereby allowing the reassessment of these years past the usual deadline on the basis that the returns were signed with such imprecise expenses, shareholder advances and benefits that a misrepresentation was presented due to carelessness.

Taxpayer "wins"

The Court, however, did not find that the errors were the result of dishonesty or deceit and, therefore, did not fall within the threshold for the imposition of gross negligence penalties of 50% of the underlying taxes.

Action Item: While the taxpayer lost his case, he also "won" because the removal of the gross negligence penalties reduced his tax cost by a third of what CRA had assessed – it can be worthwhile challenging CRA's assessments.

RENTAL PROPERTY: Receipt Retention Issue – more than 6 years!

On August 31, 2010, CRA had advised the taxpayer that his income tax return for the 2007 year was under review and that he was required to provide information and documents concerning a rental property sold in 2007.

The taxpayer had disposed of the rental property for $285,000. CRA included this amount on the 2007 Personal Tax Return but reduced the Adjusted Cost Base (ACB) claimed by the taxpayer by the estimated $52,810 of renovation expenses which the taxpayer had added.

The dispute was settled in a July 3, 2013 Tax Court of Canada case. The taxpayer could not provide any corroborating evidence of the renovation costs, therefore, the Court did not accept this as part of the ACB.

The taxpayer referred to the expiration of six years as being the time for which he had to keep receipts.

CRA successfully argued that this six years commences after the year to which the costs relate. Therefore, costs which become part of the ACB of the property must be maintained for six years after the property is disposed, not six years after the costs are incurred.

Related to the above, in a June 14, 2013 Technical Interpretation, CRA noted that permanent documents must be kept for a period ending two years following the dissolution of the corporation and the general documents must be kept for a period ending six years following the last year for which they relate, unless the corporation is dissolved, in which case the period ends two years following the dissolution of the corporation.

It should be noted that, at the Tax Court, the onus is on the taxpayer to prove CRA is wrong, not the other way around. "Innocent until proven guilty" is

a principal of criminal law, and most tax disputes are not criminal in nature.

Action Item: Don't throw out the receipts for improvements to property! Keep them separate from regular expense receipts.

U.S. SNOWBIRD: Watch Out for the new U.S. Visa!

U.S. immigration reform legislation proposing to allow Canadians aged 55 and older to spend 240 days in the country without a Visa is still on track to become law.

It is, however, noted that provincial healthcare limits on time spent out of the country ranging from 6 to 7 months could reduce the amount of time that an individual could spend regardless of the U.S. Visa changes.

Although immigration reform is being proposed, taxation law is not likely to significantly change. This means that individuals staying in the U.S. more than, say, 121 days in a year (based on complicated calculations) may still be deemed resident and find themselves exposed to additional U.S. filings, tax, and an assortment of other taxation issues. Individuals may be able to obtain some relief if they stay up to 183 days, if they are considered to have a closer connection with Canada and they complete the appropriate form.

Action Item: The IRS can be quite aggressive in pursuing filings. Please let us know if you are, or will be, spending a significant amount of time in the U.S. Our firm does not advise on U.S. tax matters or prepare U.S. tax filings, but we can provide you a referral to a U.S. Tax Accountant.