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PaySource®

November 2007
Number 149

DIRECTOR'S LIABILITY – DISSOLVED CORPORATION, LIMITATION PERIOD AND DUE DILIGENCE

This is a regular monthly feature examining recent cases of special interest, coordinated by **John C. Yuan** and **Christopher L.T. Falk** of **McCarthy Tétrault LLP**. The contributors to this feature are from McCarthy Tétrault LLP, Montreal, Toronto, Calgary, and Vancouver. Originally appeared in Tax Topics No. 1864 dated November 29, 2007.

– *Ron Choudhury*

Gabriel Leger v. The Queen, 2007 DTC 1121 (Tax Court of Canada)

The decision of the Tax Court of Canada in *Leger* illustrates the standard of care required of a sole director of a corporation in respect of unremitted tax deductions and the minimum threshold for a successful due diligence defence. The decision also shows that a corporate dissolution may not allow a director to avoid liability for unremitted source deductions if the corporation is subsequently revived.

The taxpayer in *Leger* was assessed under the ITA and the ETA in his capacity as director of a corporation, in respect of the corporation's failure to remit income tax, Employment Insurance premiums, Canada Pension Plan contributions, and Goods and Services Tax/Harmonized Sales Tax.

Inside

The taxpayer became a director of the relevant corporation soon after its incorporation and assumed sole directorship in January 1994. The corporation was dissolved on March 9, 1998 for failing to file annual returns but was revived on September 18, 1998. The taxpayer was a physician by profession. His involvement with the corporation was as an investor, at the behest of a fellow physician and a third investor. The corporation was managed on a day-to-day basis until March 1995 by the third investor, from March 1995 until March 1998 by an employee and from March 1998 until the cessation of its operations in December 1998, by another individual with no apparent connection to the corporation. The bookkeeping activities of the corporation were managed by different individuals during this period.

The evidence in the case indicates that the taxpayer was aware of the corporation's failure to remit payroll deductions and GST/HST. In 1995, in an effort to ensure that the corporation met its remittance obligations, the taxpayer instructed his personal accountant to examine the matter and liaise with the person then running the operations, and also instructed the management staff at the corporation to enrol in an accounting and management course. In addition, the taxpayer instructed the in-house bookkeeper at the corporation to prepare monthly income statements for the corporation.

Notwithstanding the taxpayer's efforts at ensuring that the corporation met its remittance obligations, the corporation failed to remit payroll deductions and GST/HST for most of 1997 and 1998. During this period, the taxpayer met with CRA representatives and instructed the manager of the corporation to ensure that remittances were timely made. The taxpayer indicated that he believed the manager's subsequent assurances that timely remittances were being made. The taxpayer also indicated that the corporation was revived after dissolution by the last individual in charge of running its operations, who signed the taxpayer's name on the articles of revival without informing him.

Upon appeal to the Tax Court, the taxpayer argued that he had ceased to be a director of the corporation due to its dissolution on March 9, 1998 and that he could not be assessed beyond the two-year period mandated by subsections 227.1(4) of the ITA and 323(5) of the ETA, both of which prohibit the commencement of an action or proceeding to recover any amount payable by a corporate director more than two years after cessation of directorship. The taxpayer argued, in the alternative, that the assessments against him were not statute-barred, and that he should be entitled to the benefit of the due diligence defence in subsections 227.1(3) of the ITA and 323(3) of the ETA.

The Tax Court allowed the taxpayer's appeal from the assessment under the ITA but dismissed his appeal from the assessment under the ETA. The Court commenced its analysis by examining whether the Minister was barred from assessing the taxpayer by virtue of the two-year limitation period in subsections 227.1(4) of the ITA and 323(5) of the ETA. The Court reviewed subsection 136(5) of the New Brunswick *Business Corporations Act*, which considers the rights and privileges of a revived corporation (which provisions governed the corporation), similar provisions in the *Canada Business Corporations Act* and the Ontario *Business Corporations Act* and the decision of the Ontario Superior Court of Justice in *Litemor Distributors (Ottawa) Ltd. v. W.C. Somers Electric Ltd.* ((2004) 73 OR (3d) 228), and held that the two-year limitation period for assessment had not expired. Mr. Justice Angers noted that the words of the relevant statute, analogous wording in parallel statutes, and case law on revival demonstrated that the revival of a corporation is retroactive to the date of its dissolution, such that the corporation is deemed to have never been dissolved. Accordingly, the taxpayer could not have ceased to be a director of the corporation due to its dissolution unless he had resigned from his position. His position was suspended during the period of dissolution and he was returned to the same position after revival. Since the tax-

PAYSOURCE

Published monthly as the newsletter complement to PaySource, by CCH Canadian Limited. For subscription information, see your CCH Account Manager or call 1-800-268-4522 or (416) 224-2248 (Toronto).

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payer had not resigned from his director's position at any point, he remained a director of the corporation after its revival.

The Court subsequently focused on the availability of the due diligence defence. Mr. Justice Angers reviewed the Federal Court of Appeal decision in *Soper v. R.* (97 DTC 5407), which analyzed director's liability for inside and outside directors, and noted the existence of a higher standard of due diligence typically required of inside directors and of sole directors. Mr. Justice Angers also discussed the Tax Court's decision in *Sziklai v. R.* (2006 DTC 2798), where the Court prescribed reasonableness as the applicable standard of care for directors, and held that the standard of care applicable in determining what a reasonably prudent person should do depends, among other things, on the person's background and his participation in, and knowledge of, the affairs of the corporation. The Court stated that: "The question is always . . . whether the director, by virtue of his position and involvement, was in a position to detect the potential problem and deal with it."

Turning to the facts of the case, the Court noted that the taxpayer had taken steps in early 1995 to ensure that the corporation remitted its payroll deductions, and that the taxpayer could not have detected the corporation's failure to remit payroll deductions in light of his efforts. The Court concluded that even though the taxpayer was subject to a higher standard as a sole director, rather than one of several directors, his reliance on key employees to make payroll remittances was permissible in the circumstances of the case.

However, the Court also found that the steps taken by the taxpayer were not adequate to prevent a reoccurrence. The taxpayer had knowledge of the fact that the corporation had failed to remit taxes in September 1997; therefore, the taxpayer was obliged to do more than rely on affirmative answers from a manager or instruct key employees to make remittances. Monthly income and loss statements could not inform the taxpayer of remittances. There was no evidence of what the taxpayer's accountant actually did, or of any other mechanism, to ensure that the corporation met its remittance obligations. The Court held that the taxpayer could not be absolved of liability for the reoccurrence of the corporation's failure to remit after 1995. Accordingly, the taxpayer was held liable in the amount of $912.81 for 1997, $11,093.90 for 1998 and for NSF cheques returned in and after November 1996.

The decision of the Tax Court in *Leger* demonstrates the Court's willingness to hold a director liable for unremitted tax deductions of a corporation even though the director may have demonstrated some level of diligence. The taxpayer in this case apparently was also charged in a separate matter for another corporation's failure to remit tax deductions from January 1, 2000 to January 30, 2001 (*R v. Léger* ([2004] 4 CTC 320). The New Brunswick Provincial Court acquitted the taxpayer in that case on the basis that there was no direct evidence that the taxpayer had directed, participated in, assented to, authorized or acquiesced in the commission of an offence (which was a full *mens rea* offence) as director or agent of the corporation.

Hot News Items

2008 CPP/QPP Contributions

In October, Revenu Québec announced that the maximum pensionable earnings under the Quebec Pension Plan (QPP) for 2008 will be $44,900 – up from $43,700 in 2007.

In November, the Canada Revenue Agency confirmed that the 2008 CPP figures will be the same as under the Quebec Pension Plan (QPP).

Contributors who earn more than $44,900 in 2008 are not required or permitted to make additional contributions to the CPP/QPP.

The basic exemption amount for 2008 remains $3,500. Therefore, maximum contributory earnings are $41,400. Individuals who earn less than that amount do not need to contribute to the CPP/QPP.

The employee and employer contribution rates for 2008 will remain unchanged at 4.95%, and the self-employed contribution rate will remain unchanged at 9.9%.

The maximum employer and employee contribution to the plan for 2008 will be $2,049.30 and the maximum self-employed contribution will be $4,098.60. The maximums in 2007 were $1,989.90 and $3,979.80.

The new CPP/QPP rates have been incorporated into PAYSOURCE in the "CPP/QPP" tab division at ¶30,355 *et seq.*

2008 WCB Maximum Assessable Earnings

As of this update, we have received confirmation of the following 2008 WCB maximum assessable earnings figures.

- Alberta – $68,500;
- British Columbia – $66,500;

- Manitoba – $77,000;
- New Brunswick – $54,200;
- Newfoundland/Labrador – $49,295;
- Nova Scotia – $48,400;
- Ontario – $73,300;
- Prince Edward Island – $45,400;
- Quebec* – $60,500;
- Saskatchewan – $55,000; and
- N.W.T./Nun. – $70,600.

*The Quebec rate is preliminary and may be subject to change.

The new maximum assessable earnings figures have been incorporated into PAYSOURCE in the "Workers' Compensation" tab division at ¶80,005.

Yukon

Bereavement Leave Changes Introduced

Bill 38, the *Act to amend the Employment Standards Act*, has received first reading in the Yukon Legislature. The Act, if passed, will repeal the current definition of "immediate family" for the purposes of entitlement to bereavement leave, and replace it with a definition of "family member", which includes some new classes of relatives.

As it stands, the definition of "immediate family" in subsection 60(1) of the Yukon's *Employment Standards Act*includes:

> . . . a spouse, parent, child, including a child to whom the employee stands in the place of parent, brother, sister, father of a spouse, mother of a spouse, stepmother, step-father, grandparent, grandchild, son-in-law, daughter-in-law, and any relative permanently residing in the employee's household or with whom the employee resides . . .

The new definition of "family member" for the purposes of entitlement to bereavement leave would encompass, in addition to a spouse or common-law partner, children, or grandparents, those persons who are members of a class of persons prescribed in the compassionate care benefit sections (specifically subsection 41.11(1)) of the federal Employment Insurance Regulations. Such persons include:

- stepsiblings or siblings-in-law;
- stepgrandparents, or grandparents-in-law;
- aunts, uncles, nieces, or nephews of the employee or the employee's spouse or common-law partner; and
- a current or former foster parent, foster child, ward, or guardian of the employee or the employee's spouse or common-law partner.

Bill 38 received first reading on October 29, 2007. The progress of the Bill will be noted in future Reports.

Need To Know

2008 EI Premium Rates Confirmed

In the October issue of *PaySource*, No. 148, we reported on the preliminary EI figures as per the Chief Actuaries Report. With this issue, we are confirming that the 2008 EI rates set by the EI Commission are the same as the preliminary figures.

The following are the 2008 EI rates:

- 1.73% (compared to 1.80% for 2007) for residents of provinces without a provincial plan (all of Canada except Quebec); and
- 1.39% (compared to 1.46% for 2007) for residents of provinces with a provincial plan (Quebec) (calculated as 1.73% minus the premium reduction of 0.34% (reduction rate identical to 2007) granted for provincial plans).

2008 Maximum Insurable Earnings

In 2007, and for the first time since 1996, the annual maximum insurable earnings exceeded the threshold of $39,000 established by the Act. In accordance with the indexation formula of section 4 of the Act, which is based on the average weekly earnings, the annual maximum insurable earnings for **2008 shall therefore be set at $41,100**, compared to $40,000 for 2007.

Therefore, based on the 2008 premium rate and the 2008 maximum insurable earnings, the general 2008 annual maximum contributions are as follows:

- employee contributions – $711.03, and
- employer contributions – $995.44.

For Quebec, using the 2008 premium rate and the 2008 maximum insurable earnings, the 2008 annual maximum contributions are as follows:

- employee contributions – $571.29, and
- employer contributions – $799.81.

Because EI benefits replace 55 per cent of a claimant's average weekly insurable earnings, up to the Maximum Insurable Earnings, the maximum amount of EI benefits payable also increases to $435 per week from $423 in 2007.

The 2008 EI rates are located into the "EI" section of PAYSOURCE at ¶35,400 *et seq*.

Federal Fall Economic Statement – Personal Income Tax Rates and GST

On October 30, the Honourable Jim Flaherty, Minister of Finance, presented the government's 2007 Economic Statement, which proposes broad-based tax relief for all Canadians, including a further reduction of the goods and services tax (GST).

Goods and Services Tax (GST) Rate – Taxable Benefits

This Economic Statement proposes to reduce the GST rate by one percentage point, from 6 to 5 per cent, effective January 1, 2008. This Economic Statement also proposes to maintain the GST credit at current levels for low- and modest-income Canadians and to retain the existing GST rebate rates for new housing and purchases made by public service bodies.

The determination of the GST remittable on certain taxable benefits for employees and shareholders is calculated based on amounts determined for income tax purposes. The GST is calculated by multiplying the amount determined for income tax purposes by a factor specified in the *Excise Tax Act* or a rate prescribed in related regulations. These factors and rates will be adjusted to reflect the January 1, 2008 GST rate reduction. In particular, the prescribed rate for calculating the GST on the automobile operating expense benefit, which is currently 4 per cent, will be 3 per cent for the 2008 and subsequent taxation years, and for calculating the HST, the prescribed rate, which is currently 10 per cent, will be 9 per cent for the 2008 and subsequent taxation years. Also, the factor, which currently uses 5 per cent, that is applicable to taxable benefits other than automobile operating expenses, will use 4 per cent for the 2008 and subsequent taxation years and for calculating the HST, the factor, which currently uses 13 per cent, will use 12 per cent for the 2008 and subsequent taxation years.

Personal Income Tax Measures

The government is also proposing additional personal tax relief as follows:

- Increasing the basic personal amount to $9,600 retroactive to January 1, 2007. The basic personal amount will remain at $9,600 for 2008 and will be increased to $10,100 on January 1, 2009. Amounts in 2010 and following years will be indexed.
- Reducing the lowest personal income tax rate to 15 per cent from 15.5 per cent retroactive to January 1, 2007.

NOTE: These retroactive measures to personal income tax rates will be implemented through the personal income tax (T1) process when tax filers prepare and file their 2007 Income Tax Returns and NOT through changes to deductions at source. Changes to payroll systems/source deductions to reflect the new rates will be implemented effective January 1, 2008.

Business Income Tax Measures

For Canadian businesses, the government will be:

- Reducing the general corporate income tax rate to 15 per cent by 2012, starting with a 1-percentage-point reduction in the rate in 2008 beyond the already scheduled reductions.
- Reducing the small business income tax rate to 11 per cent in 2008, one year earlier than scheduled.

With these reductions, Canada's general federal corporate income tax rate will fall by one-third between 2007 and 2012, and Canada's corporate tax rate will become the lowest among the major industrialized economies.

Manitoba

Louis Riel Day Becomes Law

Bill 16, *The Statutory Holidays Act*, received third reading on October 29, 2007 and Royal Assent November 8, 2007.

Bill 16, which was previously reported in PAYSOURCE, No. 148 dated October 2007, introduces "Louis Riel Day" as a new statutory holiday in Manitoba. The new holiday will be celebrated on the third Monday in February. Alberta, Ontario, and Saskatchewan all celebrate the third Monday in February as a provincially paid holiday, but under the name "Family Day".

The new statutory holiday is located in the Employment Standards section of PAYSOURCE at ¶5402.

Permissible Deductions from Wages

Manitoba Regulation 6/2007 amends the Employment Standards Regulation, by adding a new item to the list of permissible deductions with respect to an employee's wages. The Regulation allows an employer, with the employee's authorization, to deduct amounts payable by the employee for a traffic offence under an image capturing enforcement system.

The new permissible deduction from wages will be incorporated into the commentary with the next Report.

Throne Speech

On November 20, 2007, the Throne Speech, delivered by Lieutenant-Governor John Harvard, opened the second session of the 39th Manitoba Legislature. Amongst the many items contained in the Throne Speech, the following are of interest to payroll practitioners:

- Tax Reductions: A commitment to implement Budget 2007 tax reductions, subject to the requirements of balanced budget legislation, including: middle income bracket tax rate reduction to 12.75 per cent from 13 per cent, effective Jan. 1, 2008 and basic personal amount increase of $200 effective Jan. 1, 2008 (Note: see minimum wage below);
- An increase in the minimum wage based on previous public consultations; and
- Introduction of amendments to the *Employment Services Act* to protect workers who are not covered by existing labour law protections.

Subscribers will be notified when the above items are introduced as legislation.

Minimum Wage Increases

Manitoba's minimum wage will increase by 50 cents to $8.50 an hour effective April 1, 2008.

New Brunswick's minimum wage will increase from $7.25 to $7.75 per hour on March 31, 2008, 2007.

The new minimum wage rates are located in the Employment Standards section of PAYSOURCE at ¶5505; ¶5526 and ¶5528.

Prince Edward Island Adds Canadian Forces Reservists Leave

Bill 6, *An Act to Amend the Employment Standards Act* received Royal Assent on November 2, 2007.

Bill 6, which was previously reported in PAYSOURCE, No. 148 dated October 2007, amends the *Employment Standards Act* to provide job protection for members of the reserve force of the Canadian Forces. The amendment establishes the right of employees who have worked for an employer for at least six months and who are in the reserve force to take unpaid leave to participate in military training or active service. Employees are required to give reasonable notice of their intention to take this leave. Finally, the amendment provides for the reinstatement of the employee on his or her return from military service or training and clarifies that an employer is not obliged to pay pension benefits in respect of such leave.

With this amendment, Prince Edward Island joins Manitoba, Nova Scotia and Saskatchewan in providing Canadian Forces Reservists Leave.

The new Canadian Forces Reservists Leave has been added to the Employment Standards section of PAYSOURCE at ¶5936.

Recent Cases and Rulings

Employee deliberately misled employer regarding affair with subordinate

• • • **British Columbia** • • • Carroll, a branch manager at Emco, carried on a three-year affair with a subordinate employee in the branch. During that time, he conducted performance reviews, gave salary raises, carried out disciplinary proceedings, and promoted the employee in question. He denied having an affair both when confronted by a co-worker and by his immediate supervisor. When the affair ended, the personal and working relationship between Carroll and the employee deteriorated. This created a tense atmosphere for other employees, and disrupted their work. Carroll continued to deny the affair, until it was obvious and unavoidable. Emco decided to terminate Carroll as branch manager and transfer him, as well as the two female employees involved. Carroll was offered the same salary and benefits in the new position, but no supervisory responsibility. Carroll refused, and sued for wrongful dismissal.

The action was dismissed. As set out by the Supreme Court of Canada in *McKinley v. BC Tel* (2001 CLLC ¶210-027), the issue was "whether the impugned behaviour was sufficiently egregious to violate or undermine the obligations and faith inherent to the employment relationship". In this case, the Court confirmed the trial judge's finding that Carroll was deliberately misleading the employer. Despite the fact that Carroll was a valued employee, the dismissal without notice resulted from the sexual affair and its effects on the performance of Carroll at work, the working conditions at the branch generally, and on the business of the branch. The Court also noted that it was Carroll's employment as branch manager that Emco terminated, and the fact that they offered him a job in a different capacity without such responsibilities was irrelevant.

Carroll v. Emco Corporation, (British Columbia Court of Appeal), (2007 CLLC ¶210-042).

Employee's refusal to acknowledge mistake in writing was just cause for dismissal

• • • **British Columbia** • • • McGachie worked for the Victoria Immigrant & Refugee Centre Society (the "Centre") as an employment counsellor. Her probationary period was extended more than once, and her supervisor warned McGachie that her performance was unsatisfactory. On more than one occasion, McGachie's supervisor recommended that she be dismissed for incompetence. Finally, McGachie sent a document called a "Return to Work Action Plan" to the government agency which funded the Centre, even though she knew that she was not allowed to send the document without her supervisor's approval. When the government funding agency received the document, it realized the Centre was providing services to clients who were ineligible for funding, resulting in a clarification of the funding policy. This meant that a number of clients of the Centre were no longer eligible for service. When McGachie was confronted about her actions, she was asked to acknowledge her mistake in writing. Instead, she characterized this requirement as a new term of employment equivalent to a probationary period. At that point she was fired, and sued for wrongful dismissal.

The claim was dismissed. Given that substantial time had passed since the earlier warnings to McGachie, the current situation could only constitute grounds for summary dismissal if it constituted serious misconduct on its own. Her mistake was prejudicial to her employer's business, as it precluded the employer from servicing some clients, and it had the potential to preclude the employer from meeting the terms of its contract with the governmental funding agency. However, there was no evidence that McGachie understood the potential consequences of breaching the policy, or that she breached the policy because she disagreed with it. The Court did not believe the mistake was serious enough to warrant summary dismissal, but it was serious enough to warrant discipline. The discipline imposed was an acknowledgement in writing by McGachie of her mistake, which she did not do. The discipline was reasonable in the circumstances, and her refusal to do so constituted insubordination, which was sufficient grounds for summary dismissal.

McGachie v. Victoria Immigrant & Refugee Centre Society, (British Columbia Supreme Court), 2007 CLLC ¶210-044.

Amounts paid to sick or injured employees were advances not subject to taxation

The Minister included in the taxpayer's income all source deductions of amounts paid to injured or sick employees during their absence from the workplace for 2000 to 2002, on the grounds that the amounts constituted remuneration subject to taxation under the *Income Tax Act*. The taxpayer challenged the Minister's assessments made under the provisions of the *Income Tax Act* and the *Employment Insurance Act*in an appeal before the Tax Court of Canada, on the basis that the amounts at issue were advances, and not remuneration, and accordingly were not subject to taxation.

The appeal was allowed. The Tax Court of Canada had jurisdiction to address all of the issues raised on appeal given the Court's general jurisdiction to review the correctness of assessments made under the *Income Tax Act*. The payments made to employees on leave due to sickness or injury were advances, constituting an economic support measure, and not remuneration subject to taxation under the *Income Tax Act*. Therefore, the taxpayer was entitled to keep the source deductions without incurring tax liability under the *Income Tax Act*, or, alternatively, exercise the right to receive a reimbursement of any remittances made to the Receiver General of Canada. Also, the reimbursements received by the taxpayer for advances paid to sick or injured employees was in line with Quebec legislation governing compensation rendered for workplace accidents and sickness, as well as the terms of the workplace collective agreement, and did not constitute amounts subject to taxation. The Minister was ordered to vacate the assessments for 2000 to 2002.

Ville de Québec, (Tax Court of Canada), 2007 DTC 1289.

Employee Benefits – Gift Certificates Received as Lottery Prizes

The situation the CRA was asked to consider involved an employer remitting $25 gift certificates to its employees in the course of a lottery reserved for its employees. The CRA was asked if the value of the certificates would be treated as employment income and be included in the employee's income, or be treated as a non-taxable amount received from a lottery. The CRA was also asked if the amount would have to be reported on the employee's T4. The CRA relied on paragraph 1 of IT-213R and the Technical Interpretation No. 2004-0097171E5 (see ¶8229) to confirm that an employee receiving a prize (including a gift certificate) from a lottery organized by the employer and open only to employees should include the value of the prize in his employment income in accordance with subsection 5(1) of the Act. The CRA has an administrative policy allowing an employer to give annually to an employee two non-cash gifts or rewards with no tax implications, but the policy would not be applicable in this case. The policy does not apply to near-cash gifts which would clearly include gift certificates. The value of those gift certificates would therefore have to be included in the employees' employment income and be reported in Boxes 14 and 40 (Other information) of their annual T4. Note that the value of the lottery prizes would not be included in the employees' income if the lottery was open to everyone because, in this case, the prizes could not be considered as employment income.

Technical Interpretation, Business and Partnerships Division, July 24, 2007, Document No. 2007-0227261E5.

Fitness Club and Fitness Training Program

Generally, it is the CRA's view that an employee's membership in a fitness club or participation in a fitness training program that is paid for by an employer results in a taxable benefit. The CRA does not consider the employer to be the primary beneficiary of an employee's membership in a fitness club or participation in a fitness training program where the employee becomes healthier and is generally better able to perform his or her job through reduced sick time. An exception to this is where the conditions of employment require the employee to meet stringent fitness standards and "it can be demonstrated that a particular fitness training course or fitness club membership fulfills this specific employment requirement".

Technical Interpretation, Business and Partnerships Division, August 20, 2007, Document No. 2006-0216251E5.

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