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CAN AN EMPLOYMENT BENEFIT BE A TAXABLE BENEFIT IF THE TAXPAYER DOES NOT ENJOY IT?

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. Originally appeared in Tax Topics No. 1899 dated July 31, 2008.

Rachfalowski v. The Queen, 2008 DTC 3626 (Tax Court of Canada – Informal Procedure)

> The Court concluded that, objectively, the membership in the golf club was primarily for the benefit of the employer.

Rachfalowski, as then Chief Justice Bowman observed, is a relatively small case but one which addresses the difficult and important question of principle that affects the taxation of "benefits" that are part of an employment package and which are provided whether the employee wants them or not. In this case, the taxpayer was employed by Canada Life as Vice-President of the company's Investment Department. As part of his employment package, the taxpayer was offered a membership in a golf club of his choice, provided that the club offered year-round dining privileges. The taxpayer, however, was not a golfer. As such, he requested the cash equivalent of the membership fee or, alternatively, that the employer pay for his membership in a curling club. The employer declined these requests and the taxpayer eventually accepted the membership so as not to draw any attention to himself and look like he was "rebelling". During the taxation year at issue, the taxpayer used the club occasionally to entertain clients and on a couple of occasions played golf with clients, but later gave up the game because he was such a bad player. The taxpayer also took his wife for dinner at the club on a few occasions and paid for the dinners himself. The Minister assessed the taxpayer and included the amount of the golf membership fee in his income.

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The Court reviewed paragraph 6(1)(*a*) of the Act and noted that there must be a "benefit" and it must be received or enjoyed by the taxpayer. Despite the several dictionary definitions of the word "enjoy", the Court noted that the meaning of the word in section 6 has the meaning of "have the use or benefit of". However, the meaning of "receive" or "enjoy" is not the only part of the analysis. The Court noted that it is undoubtedly relevant whether something that is available but not used or taken advantage of is received or enjoyed. Further, the thing received or enjoyed must be a benefit in the first place. As such, there are three questions that must be answered: Is something a benefit? Is it received or enjoyed? What is its value? Bowman, C.J. stated:

> The three questions do not exist in hermetically sealed compartments. They merge into each other by imperceptible degrees so that in a sense they become different aspects of one question.

The Court reviewed many of the cases that considered paragraph 6(1)(*a*) of the Act, noting that the cases are not easily reconciled, and concluded:

> Instead of trying to find a consistent common thread in these and in the myriad of other employee benefit cases one may as well accept that philosophical differences do exist among judges and that although the expression "material acquisition conferring an economic benefit" used in many of the cases has a fine and impressive judicial ring to it, its reception is no substitute for asking "just what did the employee get out of the alleged benefit that ought to increase his or her income? ". This is a practical, common sense sort of question that calls for a practical common sense answer.

The Court accepted the appellant's assertion that he did not want the membership and was persuaded not to decline the membership outright because he would otherwise stand out and would not fit into the corporate culture. The Court concluded that, objectively, the membership in the golf club was primarily for the benefit of the employer. Bowman, C.J. went on to state that if he were wrong, the value of the benefit to the taxpayer of the golf club membership was minimal at most and would not constitute a taxable benefit under paragraph 6(1)(*a*) of the Act.

While *Rachfalowski* cannot be said to stand for the principle that a taxpayer must actually enjoy the benefit, that is, take delight or pleasure in receiving the benefit, for it to be taxable, the case does provide an interesting illustration of the factual considerations relevant to determining who is the primary beneficiary of the benefit – the taxpayer or the employer. Further, at least in respect of club memberships, it is the actual use of the benefit, as opposed to its availability, that should be considered.

– Matthew W. Turnell

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Hot News Items

Quebec Parental Insurance Premiums To Increase

On September 10, 2008 Quebec issued a Final Regulation to increase parental insurance premiums effective January 1, 2009.

The Regulation modifies the premium rates applicable to employees, employers and self-employed workers. The proposed amendments are chiefly attributable to a significant increase in the birth rate since the coming into force of the plan.

The majority of workers and employers will be affected by the proposed amendments which have financial implications. The amendments will entail an increase of 4.7¢ per $100 of payroll for employers, 3.4¢ per $100 of salary or wages for employees and 6¢ per $100 of income for self-employed workers.

The 2009 rates are as follows:

- Employers – 0.677%
- Employees – 0.484%
- Self-employed persons – 0.860%

The new 2009 parental insurance premium rates have been incorporated into PAYSOURCE in the "Employer Taxes and Levies" tab division at ¶50,908.

2009 WCB Maximum Assessable Earnings

As of this update, we have received confirmation of the following 2009 WCB maximum assessable earnings figures.

- Alberta – 72,600;
- British Columbia – $68,500;
- Nova Scotia – $49,400;
- Ontario – $74,600;
- Quebec* – $62,000;
- Saskatchewan – $55,000;

* The Alberta and Quebec rates are 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.

Need To Know

CRA Announces Fourth Quarter Interest Rates

The fourth quarter interest rates were recently confirmed by the Canada Revenue Agency (CRA). Effective October 1, 2008 through December 31, 2008, the rates will be:

- 7% for interest on unremitted employee income tax source deductions, unremitted CPP and EI contributions, unpaid penalties, overdue personal income tax payments and insufficient income tax instalment payments;
- 5% for interest payable on income tax refunds and overpayments; and
- 3% for deemed interest when computing the taxable benefits on employee or shareholder loan provisions.

The fourth quarter interest rates have been incorporated into PAYSOURCE in the Employee Benefits section at ¶20,155 and ¶20,600, the Statutory Deductions – Employer Remittances section at ¶24,304, the Statutory Deductions – Tax section at ¶27,020, and the Year-End Reporting section at ¶65,686.

Employment Insurance Pilot Projects and Transitional Measures Extended

The Ministry of Human Resources and Social Development will be extending three Employment Insurance ("EI") pilot projects that were implemented in 2005, in order to better assess their effectiveness, and the transitional measures for two EI economic regions, namely, Madawaska–Charlotte in New Brunswick and Lower Saint Lawrence/North Shore in Quebec.

The purpose of an EI pilot project is to test, for a defined period, a new approach to employment insurance designed to assist unemployed persons. Three such projects, which were originally to run for three years and to come to a close in October or December 2008, will now be extended for longer periods. Moreover, the scopes of these pilot projects have been modified to be more responsive to current economic and labour market conditions. The three pilot projects are known as: Best 14 Weeks; New Entrant/Re-entrant (Decreased Hours of Insurable Employment); and Working While on Claim (Increased Allowable Earnings).

The **Best 14 Weeks** EI pilot project was to be a three-year project commencing October 30, 2005 and ending October 29, 2008. The aim of this project was, for EI regions with unemployment rates of 8 per cent or higher, to calculate EI benefit rates based on the highest 14 weeks of insurable earnings earned over the previous 52 weeks.

The regions originally included in the project were the following: Central Quebec; Northern British Columbia; Restigouche–Alberta; Chicoutimi–Jonquière; Northern Manitoba; St. John's; Eastern Nova Scotia; Northern Ontario; Southern Coastal British Columbia–excluding Greater Vancouver; Gaspésie–Îles-de-la-Madeleine; Northern Saskatchewan; Sudbury; Lower Saint Lawrence and North Shore; Northwest Territories; Trois-Rivières; Madawaska–Charlotte; Northwestern Quebec; Western Nova Scotia; Newfoundland and Labrador; Nunavut; Yukon; Northern Alberta; and Prince Edward Island.

New areas have now been added to the scope of the project, namely Huron, Niagara, Oshawa, and Windsor,

each of which have had unemployment rates of 8 per cent or higher for at least one month over the last six months, and the project will now run until October 23, 2010.

The **Working While on Claim** EI pilot project was to be a three-year project commencing December 11, 2005 and ending December 10, 2008. It was established to test whether increasing the amount of allowable earnings from employment during an EI claim would encourage more individuals to accept employment while on a claim. Currently, claimants can earn up to $50 a week or 25 per cent of their weekly benefit, whichever is higher, without deductions from their benefits.

The pilot project originally applied in the same regions to which the Best 14 Weeks project, above, originally applied and allowed individuals to earn the greater of $75 or 40 per cent of benefits. The project tests whether this increased threshold will provide a greater incentive for individuals to accept all available work while receiving EI benefits.

The pilot project will now be expanded nationally and will run until December 10, 2010.

The **New Entrant/Re-entrant** EI pilot project was to be a three-year project commencing December 11, 2005 and ending December 10, 2008. It was established to test, in relation to entrants and re-entrants to the labour force, how decreasing the required number of hours of insurable employment in order to qualify for benefits would impact the labour market. New entrants and re-entrants who are not part of this project must work 910 hours in the preceding year in order to qualify for benefits. It was thought that lowering the entrance requirements for new entrants and re-entrants would increase an individual's access to employment programs that could provide him or her with the skills that employers are seeking.

The pilot project originally applied in the same regions to which the Best 14 Weeks project, above, originally applied.

The project will now expand to the new regions added to the Best 14 Weeks project, namely, Huron, Niagara, Oshawa, and Windsor, and will now run until December 10, 2010.

The current EI economic regions adopted in June 2000 had a greater-than-expected impact on the regions of **Madawaska–Charlotte** in New Brunswick and **Lower Saint Lawrence/North Shore** in Quebec.

These regions had difficulty adjusting to the number of hours needed to qualify for EI benefits. As a result, a three-year transitional period was put in place under the Employment Insurance Regulations, from September 2000 until October 2003, in order to assist these regions in the adjustment.

However, the period has been extended several times and was most recently set to end in October 2008. This period has now been extended again to April 10, 2010.

Recent Cases and Rulings

Oral offer of employment did not include probationary period

• • • **Ontario** • • • Rejdak was interviewed on August 3, 2005 at The Fight Network ("TFN") for the job of editor and creative director. TFN called him on August 5 to offer him the job, and Rejdak accepted. There was no indication given at that time that Rejdak's employment was subject to a probationary period. On August 8, Rejdak resigned his prior position, got a written employment agreement from TFN, and returned it signed the next day. The written employment agreement provided for a three-month probationary period. Rejdak was dismissed from his employment on October 26, and brought a wrongful dismissal claim.

The claim was allowed. Rejdak was offered a position by phone without a probationary period, but the written employment agreement which he signed a few days later included a three-month probationary period. There were no benefits in the signed employment agreement that would constitute additional consideration for the new probationary period term. In addition, the written employment agreement signed by Rejdak was a standard form used by all employees, and there was no suggestion that the terms were negotiable. Since Rejdak had relied on the oral agreement entered into with TFN over the phone to resign from his prior employment, he had no realistic choice but to sign the agreement. Therefore, the written agreement did not supersede the oral agreement, and it was of no force and effect. He was awarded four months' reasonable notice.

Rejdak v. The Fight Network Inc., (Ont. S.C.J.), 2008 CLLC ¶210-033.

No bad faith dismissal where just cause unproven but reasonably believed by employer

• • • **Ontario** • • • Mulvihill worked for the City of Ottawa, and was given permission to work from home in order to help her son, who had been diagnosed with attention deficit disorder. Then, as a result of budget cuts, Mulvihill was informed that she would be required to work the original hours of employment she had agreed to. However, there would be some flexibility for work at home days as necessary. Around the same time, her supervisors were dissatisfied with Mulvihill's performance as an employee, as she had failed to complete work, be with co-workers, and attend at the workplace. After a particular incident where Mulvihill asked for information from a co-worker and was sent an e-mail in return that criticized her attitude and performance, Mulvihill sent a complaint to her supervisor alleging that she was the victim of harassment. After an investigation, during which Mulvihill did not work because of medical reasons, the City determined that there had been no harassment. Mulvihill complained in an e-mail that she was not satisfied with the results of the investigation, but she did not utilize the provision in the City's harassment policy which provided for the review of a complaint dismissed at the initial stage. The City terminated Mulvihill for insubordination. In an action for wrongful dismissal, the City withdrew its just cause defence and paid her the equivalent of three months' salary, which it believed was the amount set out in the severance provisions of the employment contract. The trial judge awarded her four and a half months' compensation, as well as bad faith damages of five and a half months' salary. The City appealed the award of bad faith damages.

The appeal was allowed. The fact that cause for dismissal was alleged, but not ultimately proven, did not automatically mean that bad faith damages should be awarded. As long as an employer has a reasonable basis to believe it can dismiss an employee for cause, the employer has the right to take that position without fear that failure to succeed will automatically expose it to a finding of bad faith. In this case, the City acted on an honest and reasonably held belief that the employee's insubordination gave rise to just cause for termination, namely that she had persistently alleged bias and incompetence against co-workers without any proof, and her refusal to return to work without a transfer. There was nothing in the dismissal letter that was untruthful, misleading or insensitive, and the City was honest and forthright about why it was dismissing Mulvihill. Thus, the dismissal for cause was not a basis for a finding the City acted in bad faith or unfairly. In addition, the fact that Mulvihill was on sick leave when she was terminated did not necessarily mean that the dismissal was conducted in an unfair or bad faith manner.

Mulvihill v. Corporation of the City of Ottawa, (Ont. C.A.), 2008 CLLC ¶210-035.

Termination clause, added to last of series of contracts over 12 years, upheld

• • • **Alberta** • • • Pennock was employed by his employer under a series of employment contracts for 12 years. The most recent contract was for a three-year term, dated November 1998, and specified that either party could terminate the agreement with 30 days' notice. Pennock met with his supervisor on June 20, 2001, at which time he was told that his employer intended to end the relationship once a suitable replacement agent was found. The next day, Pennock sent a fax in which he acknowledged that he had been terminated, and that he would be leaving the company at the end of the month. The employer accepted this as Pennock's resignation. Pennock sued for wrongful dismissal, claiming a breach of his employment agreement. The trial judge found that Pennock was a dependent contractor and that the employment agreement was enforceable except for the termination clause, which was so unreasonable as to be void. The employer appealed.

The appeal was allowed. The terms of the contract were not ambiguous, and any prospect that the parties might agree to extend the term beyond the limit of the contract was not a promise that the term would be extended, and it did not create ambiguity. This was not changed by the fact that in this situation there were successive renewals of the employment contract. The language of the contract was clear, and it was to remain in force for three years unless terminated on 30 days' notice by either party. While courts may imply a term of reasonable notice of termination in situations where the agreement does not contain express terms governing the required length of notice required, such a term may not be implied if there is a clear and express provision in the contract. Here, there was no allegation of unconscionability or oppression, so the express terms of the contract dealing with termination cannot be replaced with a reasonable notice provision. Therefore, Pennock was only entitled to recover damages for the 30-day notice period provided in the contract.

Pennock v. United Farmers of Alberta Co-Operative Limited, (Alta. C.A.), 2008 CLLC ¶210-036.

Taxpayer received taxable benefits from wholly owned corporation

The taxpayer was an employee and the sole shareholder of a corporation ("U Inc."). The taxpayer had driven U Inc.'s vehicles at U Inc.'s expense and had stored them at his residence. The taxpayer also benefited from living and working on a property owned by U Inc., the rent of which was subsidized by U Inc. Repair and maintenance of the property was also paid by U Inc. The taxpayer had made improvements to specialized machines owned by U Inc., increasing U Inc.'s income-generating capacity. The taxpayer subsequently made an election under subsection 85(1) of the Act and transferred his know-how in the machines to U Inc., assigning a consideration of $1 for the machines and $1 for his intellectual property. In reassessing the taxpayer for 1997 and 1998, the Minister included in his income automobile, repair and maintenance, and rental benefits on the basis that the expenses were personal in nature and unrelated to U Inc.'s business. The Minister also assessed business income in respect of the transfer, on the basis that the taxpayer had transferred ownership of the machines to U Inc. and had received a taxable benefit in return. The Minister also contended that subsection 85(1) did not apply to the transfer. The taxpayer appealed to the Tax Court of Canada.

The taxpayer's appeal was allowed in part. The taxpayer was liable for part of the automobile benefits assessed, as well as for rental benefits, but not for repair and maintenance benefits. In addition, the taxpayer had transferred his know-how to U Inc. (as opposed to the machinery), and the transfer was executed on a tax-free basis following an election under subsection 85(1). The matter was referred back to the Minister for reconsideration and reassessment.

Jarjoura, (Tax court of Canada), 2008 DTC 4435.

Meals Consumed by Self-Employed Fishers

The CRA was asked to comment on the deductibility of meals consumed by a self-employed fisher who works on a fishing vessel for an extended period and shares in the net profit of the vessel on a "share-of-the-catch" basis. The cost of the meals consumed on the vessel is deducted in determining net profit.

It is the CRA's view that, subject to the 50% limitation in subsection 67.1(1), the cost of the meals would be a deductible travel expense under paragraph 18(1)(*h*). However, in the situation they were asked to comment on, it appeared that the cost of the food consumed on the vessel had been deducted in determining the person's share of net profit. Consequently, the individual would be required to add 50% of the cost of his or her share of the meals to income. If the net income allocated to the individual did not include the cost of the food consumed on the vessels, 50% of the cost of the meals would be deductible.

Technical Interpretation, Business and Partnerships Division, July 9, 2008, Document No. 2008-0269021E5.

Travel Expenses – Principal Place of Business

The situation considered by the CRA involved sea pilots who were members of a partnership carrying on a sea transport piloting business. The business premises were only used by the administrative personnel, not by the pilots, who received their assignments by phone at their residences. All the preparatory work to execute their navigation activities was executed at their residences and involved the following: preparation of a transit plan; update of navigation notices, depth measurement reports, and nautical charts; and verification of the tides and water levels compared to the draught of the ship. The CRA was asked if the travel expenses incurred by the pilots between their residences and their port of shipment would be deductible in calculating their income.

The CRA confirmed that the expenses would be considered to be incurred for the purpose of traveling between the pilots' homes and their place of business, and treated as personal and living expenses not deductible under paragraph 18(1)(*h*) of the Act (see paragraph 24 of IT-521R). They would only be allowed to deduct those expenses if they could demonstrate that their homes were their principal place of business or base of business operations. Based on the facts of this particular situation, the CRA could not conclude that their homes was their principal place of business. The case law describes the principal place of business as the place where secretarial activities are exercised, where financial statements and tax returns are prepared, where communications with clients, suppliers, lawyers, accountants, and government take place, and where business mail is received. As indicated in paragraph 2 of IT-514, a room in a contractor's home could be considered to be his principal place of business if used for receiving work orders, bookkeeping, purchasing, and preparing payrolls, even if other business activities, including the performance of the contracts, was carried out at the customer's location.

Technical Interpretation, Business and Partnerships Division, July 11, 2008, Document No. 2008-0271941E5.

Employee Benefit Plan Established for Employees of Limited Partnership

The CRA issued favourable rulings regarding an employee benefit plan established for the employees of a limited partnership. A trust will be established by the employer, to which employees will make contributions to acquire notional units at a fixed price. The employer will also make a contribution to the plan to acquire one notional unit for each participant. The trust will use the capital contributions to acquire limited partnership units. When an employee terminates participation in the plan, the notional units in his or her account may be redeemed at a fixed redemption price.

Cash distributions by the limited partnership will be used by the trust to fund redemptions, liabilities, expenses, and any provision for reserves. Any excess will be allocated proportionately to the participants, based on the number of notional units held, and distributed in the calendar year. To the extent the trust deducts the payment to the participant, the amount will be designated as a distribution of income. Amounts that are distributed by the trust and not designated as a distribution of income may be designated as a distribution of capital.

The CRA ruled that the plan was an employee benefit plan as defined in subsection 248(1) and not a salary deferral arrangement. Consistent with this, contributions to the plan by the employer will be deductible under section 32.1 and income distributions to the participants will be included in income under paragraph 6(1)(*g*). Participation in the plan will not result in an income inclusion under subsection 5(1) or paragraph 6(1)(*a*). Administrative expenses incurred by the trust that are not deducted by the employer will be deductible by the trust.

With regard to the redemption of a participant's notional units at a fixed redemption price, the CRA noted that the value of the units was a question of fact and that they had not made a determination in this regard.

Tax Ruling, Financial Sector and Exempt Entities Division, July 16, 2008, Document No. 2006-0206461R3.

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