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DISCOUNTING TAXABLE BENEFITS

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. 1959 dated February 26, 2009.

Schutz et al. v. The Queen, 2009 DTC 1006, as amended (Tax Court of Canada)

In the *Schutz* case, the taxpayers were employees of Appleby College, a boarding school located in Oakville, Ontario. In order to fulfill their employment duties, the taxpayers were generally required to reside on campus in housing owned by the school. Accommodations included the headmaster's residence, dormitory residences, detached and semi-detached on-campus dwellings, and an off-campus duplex. While, with one exception, each of the taxpayers reported a housing benefit on his or her 1997 income tax return, the CRA took the position that the benefits reported by the taxpayers were understated and reassessed accordingly.

At trial, the taxpayers conceded that they received taxable benefits in the form of lodging under subsection 6(1) of the Act such that three issues were left to be determined: (1) the fair market rental value of the lodging received by each of the taxpayers; (2) whether the school derived ancillary advantage from the benefit attributed to the taxpayers and, if so, whether the amount of the benefit should be reduced accordingly; and (3) the discount, if any, to the fair market rental value that should be applied in view of the taxpayers' living circumstances (i.e., whether a discount should be granted due to (a) the loss of quiet enjoyment attributable to noise and disturbance, and (b) the loss of privacy).

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On the issue of fair market rental value, Justice Rossiter referred to the Supreme Court of Canada's decision in *Marcus* ([1970] S.C.R. 39) and set out the following principles for establishing the value of the taxable benefits: (1) the Court should appreciate all the factors that a "reasonably prudent and competent" person would take into consideration; (2) fair market rental value should be calculated "on the use of property basis"; (3) any comparable used should be similar if not under the exact same circumstances as the benefit being valued; (4) no consideration should be given to the individual circumstances of an employee receiving a taxable benefit; (5) the appellant taxpayer has the onus to establish, on a balance of probabilities, that the method used by the Minister or the result therefrom was either inaccurate or inappropriate or that another mechanism or formula is more reasonable; and (6) the Court is to make its own conclusion, making the best use of the information before it, including expert reports and submissions made by witnesses and counsel.

Both the Minister and the taxpayers presented expert evidence as to the fair market rental value of the housing. Justice Rossiter considered this evidence and, preferring the taxpayers' evidence, set out valuations based on the above-mentioned principles as well as factors including the following: (1) utility in terms of number of bedrooms and washrooms; (2) square footage; (3) property location; (4) nature of lot and lot size; (5) property amenities such as garage, air-conditioning, state of finish, and quality of construction; (6) property age; (7) property condition; and (8) nearby amenities.

Justice Rossiter next considered what discount, if any, ought to be made because of the employer/employee relationship and the ancillary advantage derived by the school from the benefits afforded to the taxpayers. On this issue, he held that the compensation received by the taxpayers for their duties, whether administrative, teaching or otherwise, offset the benefit received by the school such that no reduction was appropriate. In so holding, Justice Rossiter stated that case law under sections 9 and 15 of the Act did not apply, and agreed with the following statement made by the Minister:

> In virtually every instance where lodging is supplied to an employee, there will also be a direct or indirect consequential benefit to the employer. Indeed, it is difficult to imagine any scenario in which an employer would provide lodging to an employee without some reciprocal benefit. Nevertheless, in assessing value under para. 6(1)(*a*) the courts have repeatedly disregarded any benefit to the employer.

Finally, Justice Rossiter considered the extent of discounting that ought to be permitted due to the loss of quiet enjoyment and loss of privacy experienced by certain of the taxpayers. While the Minister's expert had allowed some discounting for the loss of quiet enjoyment, the expert did not make any significant allowance for the loss of privacy. Furthermore, the Minister argued that the disturbance or inconvenience of being on call 24/7 was part of the taxpayers' employment for which they were sufficiently compensated through their salaries, "additional responsibility allowances", or reduced teaching loads. Finding that there was no evidence that the staff members received additional remuneration to live on campus or that they were paid supplementary amounts due to disturbances or loss of privacy, Justice Rossiter held that a discount on both bases was appropriate and rejected the methodology used by the Minister's expert for determining the appropriate quantum. Instead, Justice Rossiter applied a 65% reduction to the benefit attributable to the headmaster's house, an 80% reduction to the benefit attributable to the dormitory residences, and a 25% reduction to the benefit attributable to the remaining detached and semi-detached on-campus dwellings. No discount was applied to the off-campus duplex. Justice Rossiter also applied these discounts to the utilities paid by the school for the benefit of the taxpayers.

While it may not be surprising that a discount was found to be appropriate, the extent of the discounts asso-

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ciated with the headmaster's house and the dormitory residences is noteworthy.

– Stefanie Morand

Hot News Items

Prince Edward Island Amends Date for Islander Day

Last December Prince Edward Island established a new statutory holiday effective for 2009. The new statutory holiday, known as Islander Day, took place on the second Monday in February. The first Islander Day was observed on February 9, 2009.

Prince Edward Island recently introduced legislation to move the date of Islander Day to the third Monday of February in every year. This move was prompted by the fact that various other provinces celebrate a statutory holiday on the third and not the second Monday in February (i.e. Family Day in Alberta, Ontario and Saskatchewan and Louis Reil Day in Manitoba).

Islander Day is considered a public holiday under both the *Employment Standards Act* and the *Retail Business Holidays Act*, so employers should be aware that the rules applying to holiday pay and retail business openings under those Acts apply to Islander Day.

The date change for Islander Day is found in Bill 72, *An Act to Amend the Islander Day Act*, which received first reading April 22, 2009, second reading May 13, 2009, and third reading and Royal Assent May 15, 2009.

Yukon Reservists' Leave Now Law

The Yukon recently introduced legislation to provide for reservists' leave.

The new reservists' leave is provided for in Bill 67, the *Act to Amend the Employment Standards Act* which was previously summarized in the March issue of PAYSOURCE, No. 165. Bill 67 received third reading May 4, 2009 and Royal Assent May 14, 2009.

The new Reservists' leave has been incorporated into the "Employment Standards" section of PAYSOURCE at ¶6925.

Need To Know

2009 Budget Season

Budget season is upon us once again. To date, the federal government, Alberta, British Columbia, Manitoba, New Brunswick, Newfoundland and Labrador, Nova Scotia, Ontario, Prince Edward Island, Quebec, Saskatchewan, the Northwest Territories, and the Yukon have issued their 2009 Budgets. Highlights of the Budgets relating to payroll are reproduced below. The only Budget still to come is that of Nunavut, which is scheduled for June 4, 2009. The Nunavut Budget will be added to the list at that time.

Federal

The 2009 federal Budget was presented January 27, 2009, and is reproduced in the "Budgets & New Developments" section at ¶180,166.

Alberta

The 2009 Alberta Budget was presented April 7, 2009, and is reproduced in the "Budgets & New Developments" section at ¶180,168.

British Columbia

The 2009 British Columbia Budget was presented February 17, 2009 and is reproduced in the "Budgets & New Developments" section at ¶180,168.

Manitoba

The 2009 Manitoba Budget was presented March 25, 2009, and is reproduced in the "Budgets & New Developments" section at ¶180,168.

New Brunswick

The 2009 New Brunswick Budget was presented March 17, 2009, and is reproduced in the "Budgets & New Developments" section at ¶180,168.

Newfoundland and Labrador

The 2009 Newfoundland and Labrador Budget was presented March 26, 2009, and is reproduced in the "Budgets & New Developments" section at ¶180,168.

Nova Scotia

The 2009 Nova Scotia Budget of May 4, 2009, presented by Finance Minister Jamie Muir contained the following changes affecting payroll.

The Province of Nova Scotia is maintaining personal income, corporate income and sales tax rates for Nova Scotians in 2009 and 2010.

Tax relief from changes to the Basic Personal Amount and other non-refundable personal tax credits will proceed in 2009 and 2010 as planned. Previously announced reductions in the large corporations tax will also continue as legislated.

Previously Announced Tax Measures

The government remains committed to legislated reductions in the tax burden on individuals and businesses. These measures were previously legislated and will take effect in the 2009 or 2010 taxation years.

Basic Personal Amount and Other Non-Refundable Credits

As announced in the 2006-07 Budget, the province is increasing the basic personal amount exempted from personal income taxes by $250 per year over a four-year period. This represents an increase of $1,000 or 13.83 per cent. The province's other non-refundable credits will also grow by 13.83 per cent over this period. The basic personal amount will increase from $7,731 to $7,981 effective January 1, 2009, and to $8,231 in January 2010. Other non-refundable tax credit amounts will grow by 3.23 per cent in 2009 and 3.13 per cent in 2010.

Relative to tax credit amounts in 2006, Nova Scotians will pay more than $50 million less in personal income taxes in 2009-10. Increases in credit amounts in 2009 and 2010 will save Nova Scotians $19.1 million relative to 2008 amounts this budget year.

Volunteer Firefighters Tax Credit

For the 2009 tax year, the Volunteer Firefighters and Ground Search and Rescue Tax Credits will increase from $375 to $500 as announced in the 2007-08 Budget. Increasing this refundable tax credit will provide an additional $900,000 to volunteers who keep Nova Scotia communities safe.

Large Corporations Tax

As announced in the 2006-07 Budget, the province's Large Corporations Tax on capital of non-financial institutions will decline from 0.2 per cent to 0.15 per cent on July 1, 2009. That tax rate will continue to decline on an annual basis until its elimination in 2012.

The tax reduction from 0.2 per cent to 0.15 per cent on July 1, 2009, will save large Nova Scotia companies an estimated $9.1 million in taxes.

New Tax Measures

Small Business Tax Rate

Nova Scotia's small and medium-size businesses are important sources of job creation. Over three years starting in 2011, the government will cut the small business tax rate in half. The rate will remain at five per cent in 2009 and 2010, drop to four per cent in 2011, three per cent in 2012 and 2.5 per cent in 2013. In 2007, the small business rate of five per cent saved Nova Scotia's smaller and medium sized companies $119 million in taxes relative to the general corporate rate of 16 per cent.

On full implementation, this measure is expected to save small and medium-sized businesses an additional $25 million to $30 million per year. About 12,000 companies are expected to benefit from this tax reduction, overwhelmingly among companies based entirely in the province.

Healthy Living Tax Credit

The 2008-09 Budget announced the extension of the Healthy Living Tax Credit to all Nova Scotians effective January 1, 2009. The extension of this credit to adult recreation expenses has been temporarily deferred. Extension of the Healthy Living Tax Credit to adults will be revisited at a later date. This credit enhancement would have cost $5.3 million in 2009-10.

For the 2009 and subsequent taxation years, up to $500 in expenses for children's sport and recreation registration fees are still eligible for a tax credit.

Transit Tax Credit

The 2008-09 Budget announced a new Transit Tax Credit starting in 2009. The implementation of this credit has been temporarily deferred and will be revisited at a

later date. This tax credit would have cost $1.5 million in 2009-10.

Ontario

The 2009 Ontario Budget was presented March 26, 2009, and is reproduced in the "Budgets & New Developments" section at ¶180,168.

Prince Edward Island

The 2009 Prince Edward Island Budget was presented April 16, 2009, and is reproduced in the "Budgets & New Developments" section at ¶180,168.

Quebec

The 2009 Quebec Budget was presented March 19, 2009, and is reproduced in the "Budgets & New Developments" section at ¶180,168.

Saskatchewan

The 2009 Saskatchewan Budget was presented March 18, 2009, and is reproduced in the "Budgets & New Developments" section at ¶180,168.

Northwest Territories

The 2009 Northwest Territories Budget was presented February 4, 2009, and is reproduced in the "Budgets & New Developments" section at ¶180,168.

Yukon

The 2009 Yukon Budget was presented March 19, 2009, and is reproduced in the "Budgets & New Developments" section at ¶180,168.

Ontario Organ Donor Leave Progresses

Ontario has introduced legislation to provide unpaid job-protected leave for employees who donate certain organs to another individual.

The new leave builds on the $4 million announced in 2007 to implement an Organ Donation Strategy. The strategy includes the establishment of the Program for Reimbursing Expenses of Living Organ Donors, a fund that will reimburse living organ donors for reasonable, out-of-pocket expenses and lost income associated with their organ donation. Living donation has many advantages such as reduced wait times and patient suffering, increased transplant success, and reduced health costs.

Organ donor leave will be available to employees who are donating all or part of the following organs: kidney, liver, lung, pancreas and small bowel. Other organ and tissue donations may be added by regulation.

In order to qualify for the leave, an employee must be employed by his or her employer for at least 13 weeks. All employees covered by the *Employment Standards Act, 2000* are eligible for the leave, regardless of the size of their employer. Employees must give their employer at least two weeks' written notice before starting the leave or, if such notice is not possible in the circumstances, provide notice as soon as possible. Where an employer so requests, an employee must provide a medical certificate confirming that the employee has undergone or will undergo surgery for the purpose of organ donation.

Organ donor leave begins on the day that the surgery to donate the organ takes place. If needed, a donor may begin the leave at an earlier time as specified in a medical certificate. (The length of the leave to which a donor would be entitled would remain the same regardless of when it began.) The employee would be entitled to extend the leave for an additional period of up to 13 weeks (i.e., the total length of leave could be up to 26 weeks) if a medical certificate confirmed that the employee is not yet able to perform his or her duties.

The employee may end his or her organ donor leave early by giving the employer at least two weeks' written notice.

An employee's seniority and length of service credits continue to accumulate during the leave and the employer must continue to make its contributions to any applicable benefit plans unless the employee gives the employer written notice that he or she does not intend to pay his or her contributions, if any.

At the end of the organ donor leave, the employer is required to reinstate the employee in the position he or she occupied when the leave started, or to provide alternative work of a comparable nature at not less than the earnings and other benefits that had accrued to the employee when the leave started.

The new organ donor leave is provided for in Bill 154, the *Employment Standards Amendment Act (Organ Donor Leave), 2009*, which was previously summarized in the March issue of PAYSOURCE, No. 165. Bill 154 received third reading May 25 2009.

The new Organ Donor leave has been incorporated into the "Employment Standards" section of PAYSOURCE at ¶6829.

Ontario Temporary Help Agency Workers Protection Legislation Progresses

The Ontario government has introduced legislation that would ensure that temporary help agency employees are being treated fairly. This legislation would amend the *Employment Standards Act, 2000* (ESA) to change a number of provisions affecting temporary help agency employees.

The new temporary help agency workers protection is provided for in Bill 139, the *Employment Standards Amendment Act (Temporary Help Agencies), 2009*, which was previously summarized in the March issue of PAYSOURCE, No. 165.

Bill 139 received third reading May 4, 2009 and Royal Assent May 6, 2009. The new provisions become law six months after receiving Royal Assent and will therefore become law November 6, 2009.

Minimum Wage Changes Reminders for Newfoundland/Labrador and Prince Edward Island

The new minimum wage rates are located in the "Employment Standards" section of PAYSOURCE at ¶5710, ¶5771, and ¶5801.

Newfoundland and Labrador

On July 1, 2009, the minimum wage will increase to $9.00 per hour, up from the current level of $8.50 per hour.

Prince Edward Island

Effective June 1, 2009, the hourly minimum wage will increase by 20 cents to $8.20 per hour, up from the current minimum wage of $8.00 per hour.

Recent Cases and Rulings

Negative comment about employer's integrity was fundamental breach of job obligation

• • • **Manitoba** • • • Canelas was employed by People First of Canada as a community inclusion project facilitator, which was a part-time position. He was required to work six days every two weeks, which included some out-of-province travel. When Canelas successfully completed his three-month probationary period, he asked for payment for the overtime hours that he had worked during his probationary period. People First of Canada usually gave employees time off in lieu of overtime but it did pay Canelas for some of his overtime hours worked. Canelas was then asked to go on an unpaid leave of absence because of their limited budget. Just before his scheduled return to work, Canelas was terminated, and was paid two weeks' pay in lieu of notice. Canelas brought a claim for wrongful dismissal.

The action was dismissed. There was no fixed-term contract in place between the parties. Therefore, if he was found to have been wrongfully dismissed then Canelas would be entitled to reasonable notice of six weeks. People First of Canada dealt with people with intellectual disabilities, which required employees to maintain standards of sensitivity, confidentiality, integrity and trustworthiness. Canelas breached a fundamental obligation of his job by making an unwarranted negative comment about the integrity of his employer to a person with intellectual disabilities who dealt with People First of Canada. Canelas disclosed confidential information, which caused unnecessary anxiety to a vulnerable board member, which amounted to serious misconduct and was sufficient cause for his termination. Canelas was dismissed for just cause, and was not entitled to reasonable notice.

Canelas v. People First of Canada/Des Personnes D'abord du Canada, (Man. Q.B.), 2009 CLLC ¶210-022.

Allowances for employment at special work site or remote location not taxable

During 2002 and 2003, the taxpayer was employed by a contractor, Yukon, to work on a contract project as a Concrete Forming Foreman. Yukon paid the taxpayer various allowances totalling $72,000 for 2002 and $77,154 for 2003. The taxpayer did not report these allowances as income, on the assumption that they represented non-taxable reimbursements for costs he incurred for the benefit of Yukon. The Minister included the $72,000 and $77,154 in the taxpayer's income for 2002 and 2003,

respectively, and imposed penalties for gross negligence. The taxpayer appealed to the Tax Court of Canada.

The taxpayer's appeal was allowed in part. An annual travel allowance for trade shows of $7,800 paid to the taxpayer during 2002 and 2003 by Yukon was required to be included in his income for those years (with the exception of one $1,755 amount), since most of the trips taken by the taxpayer using this allowance were for pleasure rather than for business purposes. An annual board and lodging allowance of $39,000 paid by Yukon during 2002 and 2003 to the taxpayer fell within the remote location provisions of s. 6(6)(*a*) of the Act, and thus was not required to be included in his income for those years. An annual transportation allowance of $13,000 paid by Yukon to the taxpayer during 2002 and 2003 fell within the special work site rules in s. 6(6)(*b*) of the Act, and thus was not required to be included in his income for those years. The balance of the travel allowances paid by Yukon to the taxpayer ($12,200 for 2002 and $17,354 for 2003) did not constitute reasonable allowances for negotiating contracts under s. 6(1)(*b*)(v) of the Act and, hence, were not exempt from inclusion in his income for tax purposes. In light of the foregoing findings, the $72,000 and $77,154 included in the taxpayer's incomes for 2002 and 2003 should be reduced to $18,245 for 2002 and $25,154 for 2003. The penalties were deleted, since the income inclusions assessed by the Minister were reduced by some 70%. The Minister was ordered to reassess accordingly.

Agostini, (Tax Court of Canada), 2009 DTC 1088./cite>

Move to start new work at same location was "eligible relocation"

In 2006, the taxpayer moved from her residence in Woodville, Ontario to Whitby, Ontario, which brought her more than 40 kilometres closer to her place of employment at a hospital in Oshawa, Ontario (the "Hospital"). In reassessing the taxpayer for 2006, the Minister denied the deduction of $18,823.44 in moving expenses claimed in respect of her move. The Minister's position was that the taxpayer's move was not to enable her to work at the Hospital, because she was already working there, albeit part-time. On her appeal to the Tax Court of Canada, the taxpayer's argument was that, after her move, she became employed at the Hospital full-time, which made her move an "eligible relocation" within the meaning of s. 248(1) of the Act.

The taxpayer's appeal was allowed. The taxpayer's move was work related. It involved an "eligible relocation", because the taxpayer's new job involved new full-time work under new circumstances on a different floor in the Hospital. The words "new work location" in the definition of "eligible relocation" should be read to mean "new work", and not necessarily "new location". The taxpayer was therefore entitled to the moving expense deduction claimed.

Gelinas, (Tax Court of Canada), 2009 DTC 1091.

Amount Paid to the Employee's Estate

The CRA was asked whether an amount paid to a former employee's estate after his death was a death benefit or a retiring allowance. The employee had been on long-term disability and was receiving health benefits when he died. In addition, the employee had the right to receive a lump sum as a retiring allowance upon retirement at age 65 in 2013, but such retiring allowance had crystallized since the specific operation where he was employed was permanently closed in 2005. The lump sum was now payable to the employee's estate.

The CRA was of the view that because the employee was on long term disability and was receiving benefits from the employer-funded health plan, he may still have been considered an employee of the employer. Interpretation Bulletin IT-508R, Death Benefits states "if an employee ceased employment and was entitled to receive a retiring allowance but dies before the payment is made, the subsequent payment of the amount to a beneficiary of the deceased is included in the recipient's income under s. 56(1)(*a*)(ii) as a retiring allowance". However, Interpretation Bulletin IT-337R4, Retiring Allowances (Consolidated) provides that if an employee dies while still employed and the employee was entitled to a retiring allowance upon retirement, the severance pay received by a beneficiary after the death qualifies as the gross amount of a death benefit.

In this case, because the employee remained on long term disability and had the right to receive a retiring allowance at age 65 but died before reaching that age, the CRA is of the view that the amount received by the estate would be a death benefit. As a consequence, the amount could not be transferred into the beneficiary's RRSP (this would only be a possibility if the amount were considered a retiring allowance).

Income Tax Rulings Directorate, March 24, 2009, Document No. 2008-0304261E5.

Flexible Health Care Spending Accounts

The CRA was asked whether the non-taxable status of a private health services plan ("PHSP") provided through a health care spending account ("HCSA") is affected where

employees can select benefits after the plan year has commenced and in addition, whether such a plan can provide for the carryforward of unused credits and medical expenses.

Generally, a PHSP, as defined in s. 248(1), is non-taxable by virtue of s. 6(1)(*a*)(i). A HCSA may qualify as a PHSP provided it meets the requirements of a PHSP, and if it does not, the benefits derived under the HCSA will be taxable pursuant to s. 6(1)(*a*). These requirements are discussed in Interpretation Bulletin IT-529, Flexible Employee Benefit Programs.

IT-529 provides that the employee's annual allocation of flex credits to the HCSA must ordinarily be irrevocably made on or before the beginning of the flex plan year. Therefore, once the employee's benefit selection has been made for a particular plan year it cannot be changed without affecting the income tax status of the plan, subject to two exceptions. The first exception is where the employee experiences a "life event" such as the birth or death of a dependant, a change in marital status, or the loss of insurance coverage under a spouse's employer's plan. The second exception is where there is a change in a employee's employment status which affects the participation in the flex plan (such as a change from full-time to part-time).

With respect to the second question about carrying forward unused credits and medical expenses, the CRA also referred to IT-529 which provides that a carryforward of unused credits or eligible medical expenses (but not both) for a period not exceeding a year will not in and of itself disqualify the HCSA from being a PHSP. However, the employee will not be able to use amounts that were not allocated to a specific component of the HCSA in a previous year to be carried forward.

Income Tax Rulings Directorate, March 17, 2009, Document No. 2008-0304591E5