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2010 FEDERAL BUDGET

The 2010 federal Budget of March 4, 2010, presented by Finance Minister James M. Flaherty, contained the following measures related to payroll.

Personal Income Tax Measures: Rates and Credits

Budget 2009 included significant personal income tax relief by:

- increasing the first and second personal income tax brackets,
- increasing the basic personal amount, the spousal and common-law partner amount, and the eligible dependant amount, and
- increasing the age amount

Budget 2010 contained no new taxes, no tax increases and no tax reductions. As well, in the section of the Budget relating to *Plan to Return to Budget Balance and Fiscal Outlook*, the following statement was made: "The Government will not raise taxes. The Government will not cut major transfers to persons and other levels of government."

See Commentary at ¶180,166.

Scholarship Exemption and Education Tax Credit

The Budget provides that, where the scholarship exemption applies to a student in a part-time program, the exemption will apply only to an award to the extent it covers tuition fees and costs incurred for program-related materials. The budget papers indicate that this limit will not apply to students entitled to the disability tax credit or students who cannot enroll full-time owing to a mental or physical impairment.

Inside

Currently, scholarships, bursaries and fellowships ("awards") are excluded from income if received by students in respect of programs at post-secondary institutions, or in respect of programs at other institutions that are certified by the Minister of Human Resources and Skills Development as being institutions that furnish a person with skills for, or improve a person's skills in, an occupation. The Budget proposes that a post-secondary program that consists principally of research will not be a "qualifying education program", and therefore not eligible for the scholarship exemption or the education tax credit, unless the program leads to a diploma from college or CEGEP, or a bachelor, masters or doctoral degree (or an equivalent degree). According to the budget papers, this means that post-doctoral fellowships will not be subject to the exemption and therefore will be taxable.

These proposals apply for the 2010 and subsequent taxation years.

See Commentary at ¶22,110.

Employee Stock Options

Budget 2010 proposes the following measures associated with the tax treatment of employee stock options.

See Commentary at ¶22,200.

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Stock Option Cash Outs

If an employee acquires a security of his or her employer under a stock option agreement in the course of his or her employment, the difference between the fair market value of the security at the time the option is exercised and the amount paid by the employee to acquire the security is treated as a taxable employment benefit. If certain conditions are met, the employee is entitled to a deduction equal to one-half of the employment benefit (the stock option deduction).

The stock option deduction results in the taxation of stock option benefits at capital gains tax rates, and as such provides Canadian businesses with a valuable tool to attract and retain highly skilled workers. In 2007, about 78,000 employees took advantage of the deduction, claiming an average amount of $53,000; three-quarters of the aggregate value of the deduction was claimed by individuals earning more than $500,000.

Given the considerable tax benefits provided by the stock option deduction, particularly to high-income individuals, it is important to ensure that it is used in a manner consistent with its intended policy objectives.

The tax rules currently ensure that, when an employee acquires securities under a stock option agreement, only one deduction (at the employee level) is provided. This is because employers are, in this context, prevented from claiming a tax deduction for the issuance of a security.

It is possible, however, to structure employee stock option agreements so that, if employees dispose of ("cash out") their stock option rights for a cash payment from the employer (or other in-kind benefit), the employment benefit is eligible for the stock option deduction while the cash payment is fully deductible by the employer.

Budget 2010 proposes to prevent both the stock option deduction and a deduction by the employer from being claimed for the same employment benefit. To this effect, the stock option deduction will generally be available to employees only in situations where they exercise their options by acquiring securities of their employer. An employer may continue to allow employees to cash out their stock option rights to the corporation without affecting their eligibility for the stock option deduction provided the employer makes an election to forgo the deduction for the cash payment. This will ensure a comparable tax rate with that available on other compensation, when considered on a total employer–employee basis.

The proposed measure will also help preserve symmetry in the tax treatment of stock-based compensation: that is, where preferential tax treatment is provided to the employee on stock-based benefits, the employer is generally not allowed a tax deduction for the cost of such benefits.

Budget 2010 also proposes to amend the income tax rules to clarify that the disposition of rights under a stock option agreement to a non-arm's length person results in an employment benefit at the time of disposition (including cash out). Although the government considers that these benefits are taxable in these circumstances under existing tax rules, the government also believes that clarification of these rules is warranted.

These measures will apply to dispositions of employee stock options that occur after 4:00 p.m. Eastern Standard Time on March 4, 2010.

Tax Deferral Election and Remittance Requirement

The benefit arising when an employee acquires securities under a stock option agreement is treated as employment income for tax purposes. Any subsequent change in the value of the optioned securities is treated separately as a capital gain or loss upon disposition of securities. This treatment recognizes that once employees acquire securities through a stock option they are in a position similar to that of other individuals who acquire securities directly in the market.

Under certain conditions, an employee of a publicly traded company may elect to defer the recognition of the employment benefit for tax purposes until the disposition of the optioned securities. This election is available for benefits in respect of up to $100,000 of an employee's qualifying stock options vesting in a particular year. Gains or losses realized on the optioned securities continue to be treated separately from the employment benefit as capital income.

If an employee elects to defer recognition of the employment benefit and the value of the optioned securities subsequently decreases, the employee may not have sufficient proceeds from the disposition of the securities to satisfy his or her tax obligation on the employment benefit, which can create financial difficulties for some individuals.

Budget 2010 proposes to repeal the tax deferral election and to clarify existing withholding requirements to ensure that an amount in respect of tax on the value of the employment benefit associated with the issuance of a security is required to be remitted to the government by the employer. The bonus method of taxation is to be used to determine the amount that must be remitted. This amount will be added to the employer's remittances of tax withheld at source in respect of all employee salary and benefits, including other in-kind benefits, for the period that includes the date on which the security was issued or sold. These measures will prevent situations in which an employee is unable to meet his or her tax obligation as a result of a decrease in the value of these securities.

The repeal of the tax deferral election will apply to employee stock options exercised after 4:00 p.m. Eastern Standard Time on March 4, 2010.

The clarifications to remittance requirements will apply to benefits arising on the issuance of securities after 2010, to provide time for businesses to adjust their compensation arrangements and payroll systems.

See Commentary at ¶22,220.

Employment Insurance (EI)

EI Rates 2010

The government is maintaining the freeze of the EI premium rate at $1.73 per $100 of insurable earnings to the end of 2010 – the lowest rate since 1982. In Budget 2009, this action was estimated to leave more than $1.6 billion in the hands of employers and employees in 2010-11.

EI Rates for 2011 and Beyond

When the temporary freeze of EI premiums is lifted in 2011, premium rates will be set by an independent arm's length Crown corporation, the Canada Employment Insurance Financing Board (CEIFB). Under the EI financing regime announced in Budget 2008, the CEIFB will set EI premium rates in order to balance the EI program over time, subject to a 15-cent limit on annual changes. Consistent with the government's commitment in Budget 2009, the CEIFB will not be mandated to recover any EI deficits resulting from the benefit and training enhancements announced in Budget 2009.

See Commentary at ¶35,415.

EI Work-Sharing Agreements Extended

Work-sharing avoids layoffs by offering EI income benefits to qualifying workers willing to work a reduced work week while their employer recovers. The 2009 federal Budget (the Economic Action Plan) extended work-sharing agreements by 14 weeks, to a maximum of 52 weeks, and increased access to work-sharing agreements by providing greater flexibility in the qualifying criteria and streamlining processes for employers. More than 160,000 workers are currently participating in nearly 6,000 work-sharing agreements.

Budget 2010 extends this measure. Existing or recently terminated work-sharing agreements will be extended by an additional 26 weeks, to a maximum of 78 weeks. Greater flexibility in the qualifying criteria for new work-sharing agreements will also continue to be provided. Both of these enhancements will be in place until March 31, 2011.

Other Measures

Online Notices (Electronic Delivery of CRA Notices)

In 2000 the *Personal Information Protection and Electronic Documents Act* introduced a legislative framework by which requirements in federal statutes and regulations, which contemplate the use of paper or do not expressly permit the use of electronic technology, may be administered or complied with in the electronic environment.

This gave the Canada Revenue Agency general legislative authority to provide information electronically in most circumstances. However, the provisions of some of the various statutes dealing with notices issued by the Canada Revenue Agency were enacted at a time when electronic alternatives were not contemplated. As a result of the specific language of these provisions, some notices cannot be provided in electronic format even with the general permission accorded by the *Personal Information Protection and Electronic Documents Act*. As such, taxpayers can receive notices, such as notices of assessment under the *Income Tax Act*, from the Canada Revenue Agency only through the mail system or personally.

Budget 2010 proposes that the *Income Tax Act*, *Excise Tax Act*, *Excise Act, 2001*, *Air Travellers Security Charge Act*, *Canada Pension Plan* and *Employment Insurance Act* be amended to allow for the electronic issuance of those notices that can currently be sent by ordinary mail. However, notices that are specifically required to be served personally or by registered or certified mail will not be eligible to be transmitted electronically.

These measures will provide the Canada Revenue Agency with the legislative authority to issue electronic notices, if authorized by a taxpayer, which will be made available on the Canada Revenue Agency's existing secure online platforms (My Account and My Business Account). The Canada Revenue Agency will inform taxpayers that provide such authorization that a new electronic document is available in their secure online account by sending the taxpayer an e-mail to that effect. The Canada Revenue Agency intends to provide this service in respect of notices of assessment and reassessment of tax under Part I of the *Income Tax Act*, and notices of determination and redetermination in respect of the Goods and Services Tax/Harmonized Sales Tax (GST/HST) credit and the Canada Child Tax Benefit. Legislative authority will also be provided to the Canada Revenue Agency to issue electronic notices for GST/HST, excise tax and duty (other than the duty on beer), and the Air Travellers Security Charge.

The necessary legislative amendments will be effective as of the date of Royal Assent of the implementing legislation. However, the application of these measures will commence at such time as will be announced by the Minister of National Revenue

Interest on Overpaid Taxes

The government pays interest in respect of overpayments of most taxes and other levies. The applicable interest rate for a quarter is equal to the average yield of three-month Government of Canada Treasury Bills sold in the first month of the preceding quarter, rounded up to the nearest percentage point, plus 2 percentage points.

The Auditor General raised concerns in her Spring 2009 report about interest paid on tax overpayments by corporations:

> If the [Canada Revenue] Agency unnecessarily holds large amounts on deposit, with an obligation to pay interest when making a refund, the federal government effectively is borrowing those funds at a higher interest rate than necessary. Instead of borrowing at Treasury bill rates, it will pay a rate that is at least two percentage points higher.

Budget 2010 proposes that, effective July 1, 2010, the interest rate payable by the Minister of National Revenue to corporations will be set at the average yield of three-month Government of Canada Treasury Bills sold in the first month of the preceding quarter, rounded up to the nearest percentage point. This new rate for corporations will apply in respect of income tax, GST/HST, EI premiums, CPP contributions, excise tax and duty (except in respect of excise duty on beer), the Air Travellers Security Charge and the softwood lumber products export charge.

The interest rate calculations in respect of non-corporate taxpayers will not change.

Red Tape Reduction Commission

Reducing red tape for businesses is an ongoing challenge that requires continued attention. The Canadian Federation of Independent Business (CFIB) estimates that businesses in Canada currently spend over $30 billion each year complying with regulations. A number of provincial governments have previously undertaken work to reduce red tape. For example, British Columbia has eliminated more than 150,000 regulations since 2001, and has committed to maintaining a zero net increase in regulations through to 2012.

The Government of Canada will establish a new federal Red Tape Reduction Commission involving both Parliamentarians and private sector representatives to review federal regulations in areas where reform is most needed to reduce the compliance burden, especially on small businesses, while safeguarding the health and safety of Canadians. The Commission will be asked to provide specific recommendations on how to reduce unnecessary regulations and make the regulatory system more effective, so that small businesses can focus on investing and creating jobs. This approach will provide the strong leadership necessary to produce comprehensive and effective results.

Previously Announced Measures

Budget 2010 confirms the government's intention to proceed with the following previously announced tax measure: Draft amendments released on February 26, 2010 relating to Tax Proposals to Accommodate Employee Life and Health Trusts. The Department of Finance Release No. 2010-016 is reproduced below along with the accompanying Backgrounder, which describe the proposed income tax amendments

Tax Proposals to Accommodate Employee Life and Health Trusts

The Honourable Jim Flaherty, Minister of Finance, today announced his intention to propose amendments to the *Income Tax Act* to accommodate employee life and health trusts.

"These proposed amendments will ensure that a fair and neutral tax regime applies to employee life and health trusts," said Minister Flaherty. "The Government of Canada remains committed to a fair and competitive tax system."

The proposed amendments would:

- create a new type of taxable trust in the *Income Tax Act*, an employee life and health trust;
- provide rules regarding the timing of deductions of any pre-funding of such a trust by an employer;
- allow the trust to deduct in computing its income all amounts paid from the trust to employees or retirees in respect of benefits, even if employees receive those amounts tax-free;
- provide rules governing the carryback and carryforward of any losses arising after the deduction of employee benefit payments by the trust;
- preserve the same tax treatment for employee benefits received from the trust as if they had been received directly from the employer (many types of health and welfare employment benefits are tax-exempt for employees under the existing income tax rules); and
- provide special rules applicable to employee life and health trusts whose beneficiaries include employee shareholders, highly compensated employees or related persons to ensure that the trusts do not offer unfair advantages to these individuals.

The proposed amendments would apply to trusts established after 2009. A more detailed overview of the proposed amendments can be found in the accompanying backgrounder.

Draft legislative amendments to implement these proposals, together with explanatory notes, also accompany this release. Amendments to regulations regarding withholding and reporting in relation to employee benefits paid by employee life and health trusts will be brought forward when the legislation is introduced.

The Government intends to introduce legislation in respect of these proposals at an early opportunity. Consequently, any comments on the attached draft proposals are requested by April 30, 2010. Comments may be submitted to the Tax Legislation Division of the Department of Finance.

Backgrounder

In general terms, the proposed amendments would allow amounts paid to employees and retirees from an "employee life and health trust" to be deducted in computing the trust's income. At the same time, the benefits would receive the same tax treatment (generally tax-free) in the hands of employees as if they had been paid directly by the employer. If the trust's costs (including payments to employees) exceed its revenue for a particular year, the excess will be treated as a business loss for the trust, subject to a special three-year carryback and carryforward mechanism.

More details are provided below. Other aspects of the proposed tax treatment are in most respects similar to the existing income tax law and policy that currently applies in the area of health and welfare trusts for employees.

Definitions

Under the proposals, an "employee life and health trust" is generally defined in the *Income Tax Act* (the "Act") as a trust, established by one or more employers, that meets a number of conditions. "Designated employee benefits" are defined to mean any combination of group sickness or accident benefits, private health services plan benefits or group term life insurance benefits for employees or former employees of an employer provided through a plan of insurance (including a self-funded plan of insurance). In general terms, the trust would have to meet the following conditions throughout any taxation year that it wished to benefit from employee life and health trust status:

- its objects must be limited to the provision of designated employee benefits, and paying out any remaining surplus on wind-up;
- it must be a Canadian resident trust;
- all beneficiaries must be employees or former employees of an employer, dependants of those employees, or another employee life and health trust;
- the trust must be maintained primarily for the benefit of ordinary employees (and not "key employees" – a new defined term under the rules);
- Key employees must generally be treated the same as other employees under the trust;
- employers generally may not have any rights to distributions from the trust; and
- employer representatives may not constitute a majority of the trustees of the trust.

Employer contributions

Under the proposals, no deduction would be permitted in a taxation year for the portion of an employer contribution to the trust made in the taxation year which related to anything other than designated employee benefits being provided in that year. Instead, the portion of the pre-funding, if any, that relates to designated employee benefit payments in a given future taxation year could be deducted in that future year. As a result of these rules, employer contributions to the trust in excess of the amount that is actuarially determined to be necessary to fund the contemplated benefits being provided over the life of the trust would not be deductible in any year.

To the extent that an obligation to the trust is satisfied with the issuance and contribution to the trust of a promissory note (or similar evidence of indebtedness) of the employer or a related party, payments in respect of any portion of the principal amount evidenced by the promissory note, or interest thereon, shall be deemed to be payments in satisfaction of the employer's liability to the trust, and not payments of principal or interest. From the employer's perspective these payments will, provided they are made in order to fund the payment of designated employee benefits and subject to normal tax rules, generally be deductible in the later of the year to which the portion relates and the year in which the payment to the trust is made.

Employee contributions

Employee contributions would be permitted but not required, and would not be deductible by employees, but could qualify for the medical expense tax credit, to the extent that they are contributions to a private health services plan. Similarly, employee contributions to a wage loss replacement plan that is administered by the employee life and health trust would reduce the taxable portion of any wage loss replacement received from the trust.

Unevenness of trust revenues and expenses

Trust distributions to beneficiaries in a year that exceed the trust's income for that year normally are treated as distributions of trust capital with no other income tax impact. However, an employee life and health trust would be permitted to treat employee benefit payments as expenses. If the trust's expenses exceed its revenue for a particular year, the excess would be treated as a type of loss of the trust, with special rules allowing it to be deductible against income in any of the three preceding or three following taxation years, provided that the trust retained its status as an employee life and health trust for the year.

Treatment of benefits in the hands of employees

Of the "designated employee benefits" described above, some are currently taxable in the hands of employees on receipt (i.e., benefits under a wage loss replacement plan or coverage under a group term life insurance policy), while others are generally tax-exempt when received by employees. Either taxable or tax-exempt benefits, or a combination of the two, could be provided through an employee life and health trust, but their tax treatment in the hands of employees would not change due to the existence of the trust.

For example, private health services benefits would generally be tax-exempt in the hands of the employees, while disability insurance payments would generally be taxable. No benefit would be considered to be received or enjoyed by an employee because of an employer contribution to the trust, except to the extent that the trust provides group term life insurance coverage. The value of group term life insurance coverage is currently a taxable employment benefit during each year of coverage, while life insurance proceeds received on death are generally tax-exempt. This tax treatment would be preserved when similar benefits are provided through the trust.

Payments made on the wind-up of the trust, otherwise than for the provision of designated employee benefits, would be taxable to the recipient.

To the extent that a particular benefit is taxable to the employee, the benefit paid from the trust would be required to be reported as an employment benefit and not as a trust distribution.

Part XIII Tax

Part XIII of the *Income Tax Act* imposes certain taxes on the income of a non-resident from Canadian sources. Distributions that are payments of designated employee benefits from an employee life and health trust to non-resident employees or former employees will generally not be subject to tax under Part XIII.

These proposals will apply to trusts established after 2009.

Hot News Items

2010 Provincial Budgets

Budget season is upon us once again. To date, the following provinces/territories have presented their 2010 Budgets. Highlights of budget measures that relate to payroll are reproduced below. As other provinces/territories issue their Budgets, they will be added to the list.

Alberta

The 2010 Alberta Budget was presented February 9, 2010, and is reproduced in the "Budgets & New Developments" section at ¶180,174.

British Columbia

The 2010 British Columbia Budget of March 2, 2010, presented by Finance and Enterprise Minister Colin Hansen contained the following measure related to payroll.

Medical Services Plan Premiums To Increase

Effective January 1, 2011 Medical Services Plan premiums will increase by $3.50 a month for individuals and by $7.00 a month for families. Therefore, effective January 1, 2011, the premiums will be $60.50 for singles, $109 for a family of one and $121 for a family of three or more.

See Commentary at ¶70,059.

Manitoba

The 2010 Manitoba Budget of March 23, 2010, presented by Finance Minister Rosann Wowchuk contained contained no new taxes or tax increases affecting payroll.

Changes Pursuant to Tax Collection Agreements

Manitoba will parallel the changes announced in the 2010 federal Budget. Changes to the tax treatment of stock options will be made to eliminate double deductions, limit deferrals and ensure that tax does not exceed the proceeds of disposition in cases where the value of the securities granted declines before they are taxed.

New Brunswick

The 2010 New Brunswick Budget was presented December 1, 2009 and is reproduced in the "Budgets & New Developments" section at ¶180,174.

Newfoundland and Labrador

The 2010 Newfoundland and Labrador Budget of March 29, 2010, presented by Finance Minister Tom Marshall contained the following measures affecting payroll.

Personal Tax Rates and Credits

Effective July 1, 2010, the provincial personal income tax rate for individuals will be reduced as follows:

- from 12.8% to 12.5% on the second income bracket (income between $31,278 and $62,556), and
- from 15.5% to 13.3% on the third income bracket (income starting at $62,556).

Effective for the 2010 tax year, changes will be made to the Age Amount, a non-refundable tax credit for taxpayers who are 65 or older by December 31 of the tax year. The Age Amount will increase from $3,681 to $5,000. As a result of the increase in the non-refundable tax credit amount, the income at which taxpayers will be eligible to receive a benefit from the credit will increase from $51,940 to $60,733. Eligible seniors that claim the Age Amount will receive a benefit of up to $102 through a reduction in their provincial tax payable.

See Commentary at ¶25,190.

Ontario

The 2010 Ontario Budget of March 25, 2010, presented by Finance Minister Dwight Duncan contained no new taxes or tax increases affecting payroll.

Changes Pursuant to Tax Collection Agreements

Ontario will parallel the changes announced in the 2010 federal Budget. Changes to the tax treatment of stock options will be made to eliminate double deductions, limit deferrals and ensure that tax does not exceed the proceeds of disposition in cases where the value of the securities granted declines before they are taxed.

Saskatchewan

The 2010 Saskatchewan Budget of March 24, 2010, presented by Finance Minister Rod Gantefoer contained no new taxes or tax increases affecting payroll.

Northwest Territories

The 2010 Northwest Territories Budget was presented January 28, 2010, and is reproduced in the "Budgets & New Developments" section at ¶180,174.

Nunavut

The 2010 Nunavut Budget of March 8, 2010, presented by Finance Minister Keith Peterson contained no new taxes or tax increases.

Yukon

The 2010 Yukon Budget of March 25, 2010, presented by Finance Minister Dennis Fentie contained no new taxes or tax increases.

Need To Know

CRA's Contract Payment Reporting System

The CRA released a Fact Sheet describing the contract payment reporting system, which was introduced in February 1998. The Fact Sheet notes that the CRA has modified the reporting system to minimize the administrative costs of complying with the system. Individuals, partnerships, and corporations whose primary business activity is construction must report payments to subcontractors for construction services. As well as the amount of the payment, the information to be filed includes the subcontractor's name, address, and identification number. The Fact Sheet notes that in January 2010, the CRA gave all contractors new identifying numbers, with an RZ extension. The information may be reported on either a calendar year or fiscal year basis and is due within six months from the end of the elected reported period. The payment need not be reported if the total amount paid to a subcontractor is less than $500 for the year. Currently, the payment information may be reported on the T5018 Information Return. Beginning in January 2011, it will be mandatory to use the T5018 return.

CRA Announces Second Quarter Interest Rates

The second quarter interest rates were recently confirmed by the Canada Revenue Agency (CRA). Effective April 1, 2010 through June 30, 2010, the rates will be:

- 5% 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;
- 3% for interest payable on income tax refunds and overpayments; and
- 1% for deemed interest when computing the taxable benefits on employee or shareholder loan provisions.

The second quarter interest rates have been incorporated into PAYSOURCE in the "Employee Benefits" section at ¶20,155, ¶20,600, and ¶20,605, 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.

Minimum Wage Reminders

The new minimum wage rates are located in the "Employment Standards" section of PAYSOURCE at ¶5710, ¶5761, ¶5781, ¶5791, ¶5831 and ¶5851.

New Brunswick

Effective April 1, 2010 the minimum wage will increase to $8.50 per hour, up from the current minimum wage of $8.25.

Nova Scotia

Effective April 1, 2010, the hourly minimum wage will increase to $9.20 per hour, up from the current level of $8.60 per hour.

Ontario

Effective March 31, 2010, the hourly minimum wage will increase to $10.25 per hour, up from the current level of $9.50 per hour.

Northwest Territories

Effective April 1, 2010, the minimum wage will increase to $9 an hour, up from the current minimum wage of $8.25.

Yukon

Each April 1, the minimum wage is adjusted based on the previous calendar year's Consumer Price Index (Whitehorse).

As of April 1, 2010, the Yukon minimum wage will be $8.93.

Recent Cases and Rulings

"Dependent Contractor" is Somewhere Between Employee and Independent Contractor

• • • **Ontario** • • • McKee and Reid, the owner of Reid Heritage Homes ("RHH"), entered into an agreement for RHH to supply 69 homes in Guelph for McKee to advertise and sell, for a fee. The agreement included a termination provision, allowing either party to terminate the agreement with 30 days' notice. Once these homes had been sold, RHH continued to provide homes to McKee to sell, but hired someone else to handle the advertising aspect of the sales. McKee was given the title of Sales Manager, and eventually hired her own subagents, with whom she split commissions. Over 18 years later, RHH decided to change the relationship, and told McKee that she and her subagents would have to work for RHH as direct employees. McKee was offered a standard form contract with a 14-day notice period, and first pick of one phase of any project in Guelph. McKee refused, and brought an action for wrongful dismissal. The trial judge found McKee was an employee, not an independent contractor, and awarded her 18 months' reasonable notice. RHH appealed.

The appeal was dismissed. Between employee and independent contractor, an intermediate category exists of non-employment work relationships that exhibit a certain minimum economic dependency demonstrated by complete or near complete exclusivity, known as "dependent contractors". Such workers are owed reasonable notice on termination. In this situation, the trial judge determined that McKee was an employee of RHH when she was terminated. This decision was defensible under the legal principles defining work relationships, and the category of an employee. Specifically, McKee worked exclusively for RHH pursuant to their implied agreement; McKee was subject to the control of RHH with respect to her sales, including where to sell, what promotional materials to use, what to sell, and how much to sell it for; RHH provided stationery and forms for McKee, and she performed her sales in model homes provided by the company; McKee was financially dependent on RHH; and, McKee and her sales force were a crucial element of RHH's business organization.

McKee and Bribet Holdings Inc. v. Reid's Heritage Homes Ltd., (Ont. C.A.), 2010 CLLC ¶210-011.

Whether Employee Received Earnings Before Work Start Date Not Matter for Tax Court

• • • **Canada** • • • The original record of employment by the employer showed that McLaughlin started work with Graphite after October 29, 2005. An amended record of employment was submitted by the employer on August 3, 2006, after McLaughlin was terminated, showing that he had been paid $680 per week for work done between September 12, and October 29, 2005. Graphite explained that they did not show earnings in the original record of employment for those weeks to accommodate McLaughlin, who was in receipt of Employment Insurance benefits at that time. McLaughlin said he was not working for Graphite during the relevant weeks, and claimed Graphite amended the record of employment as retaliation for McLaughlin making a health and safety complaint to the Ministry of Labour. The Commission reallocated undeclared earnings to the weeks between September 12 and October 29, 2005, resulting in an overpayment of benefits. McLaughlin had a penalty imposed on him for making false and misleading statements. The Board allowed the appeal, and the Umpire allowed a further appeal, finding the only issue before the Board was whether part of the post-October 29, 2005 earnings should be reallocated to the weeks prior to October 29, when it was claimed the service was rendered. The Umpire also found the Commission lacked jurisdiction to determine when McLaughlin started work. McLaughlin brought an application for judicial review.

The application for judicial review was allowed. The Umpire erred in law. The Commission may request an officer of the Canada Revenue Agency to rule on the duration of an insurable employment, including the date on which it began. If such a question arises in the course of a claim for benefits, it shall be determined by an officer of the Canada Revenue Agency. In this situation, the question of whether McLaughlin was in receipt of earnings from Graphite in respect of services rendered before October 29 was relevant to whether he had ceased to be entitled to Employment Insurance benefits because he was in receipt of earnings from employment. Therefore, it was a matter for the Board and the Umpire, not the Tax Court.

McLaughlin v. Attorney General of Canada, (F.C.A.), 2010 CLLC ¶240-003.

Portion of Payment Was Not Retiring Allowance

The taxpayer filed a complaint with the Human Rights Commission (the "Commission") against his employer, a school board (the "Board"), for alleged gender discrimination. He was later discharged from his employment for alleged misconduct, but not because he had filed the complaint with the Commission. He then appealed his discharge by the Board to the Minister of Education. A settlement was subsequently reached, and he received $68,276 from the Board, $23,276 of which was a long-service payment that was rolled into an RRSP. On reassessment, the Minister included $45,000 (i.e., $68,276 less $23,276) in the taxpayer's income for 2006 as a retiring allowance. The taxpayer appealed to the Tax Court of Canada.

The taxpayer's appeal was allowed in part. The documentary evidence clearly indicated that the $45,000 was paid by the Board to the taxpayer to settle two matters, i.e., his discharge from his employment, and his agreement to withdraw his complaint with the Commission. The complaint filed with the Commission related to a claim that was totally separate from the one relating to the taxpayer's discharge from his employment, and both the taxpayer and the Board understood this. As a result, not all of the $45,000 constituted a "retiring allowance". Although the taxpayer had arbitrarily ascribed $17,277 of the $45,000 to the matter of his complaint to the Commission, this amount should be reduced to $11,139. The Minister was therefore ordered to reassess on the basis that $11,139 of the $45,000 was not a "retiring allowance" to be included in the taxpayer's income for 2006.

Dunphy, (Tax Court of Canada), 2010 DTC 1028.

Pension Benefits – Taxation of Lump-Sum Payments Received for Cost of Living Adjustment

The transaction the CRA was asked to rule on involved a corporation exempted from Part I Tax by virtue of paragraph 149(1)(*c*) of the Act and having implemented a defined benefit registered pension plan ("RPP") for the benefit of its employees. Because the RPP does not provide for the cost of living indexation of the annuities, resulting in a significant erosion of the retirees' pension income for the recent years, the corporation would like to compensate them for that non-indexation of their annuities. Since the current wording of the RPP does not allow for the payment of amounts other than annuities to retirees and the corporation does not want to include an indexation clause in the plan or provide for an indexation lump-sum payment, the corporation would sign a side agreement under which the employer would renounce a portion of the future actuarial gains of the RPP in favor of the corporation. This portion of the gains would then be used to finance the payment by the corporation of an indexation lump-sum payments to each eligible retiree or eligible surviving spouse of an eligible retiree. The gains renounced by the employer in favour of the corporation to finance the lump-sum payments would bear an interest rate from the date of payment of the lump-sum payments until full reimbursement. The purpose of this transaction is to compensate retirees and surviving spouses for the non-indexation of their annuities without affecting their rights to the Guaranteed Income Supplement ("GIS"). The CRA was asked to rule if the lump-sum payments received by the retirees or surviving spouses would be considered as superannuation or pension benefits, and would be taxable under subparagraph 56(1)(*a*)(i) of the Act. The CRA ruled that those payments would be taxable in the year received under subparagraph 56(1)(*a*)(i) of the Act.

Tax Ruling, Financial Sector and Exempt Entities Division, December 17, 2009, Document No. 2009-0337641R3.

Deduction of Motor Vehicle Expenses (No. 1)

The CRA was asked (i) whether a per kilometre motor vehicle allowance paid by an employer would qualify as a reasonable allowance for the purpose of paragraph 6(1)(*b*), (ii) whether a particular location was a regular place of employment ("RPE") of a taxpayer, and (iii) whether expenses for travel between the employee's home and the particular location would be deductible to the employee.

The CRA stated that the reasonableness of any motor vehicle allowance is always a question of fact. A reasonable motor vehicle allowance is excluded from an employee's taxable income under paragraph 6(1)(*b*) (i.e., for use of a vehicle for travelling in the performance of the duties of the office or employment).

Whether a particular location is an RPE is always a question of fact. Travel from an employee's home to an RPE is considered personal. However, where an employee travels to or from home to a place other than an RPE, such travel is employment-related.

Motor vehicle expenses incurred by an employee in the course of employment are deductible under paragraph 8(1)(*h*.1). Where an employee receives a motor vehicle allowance under paragraph 6(1)(*b*), no amount may be deducted under paragraph 8(1)(*h*.1). However, where the employee includes the amount of the allowance in his/her income, the CRA will permit the deduction under paragraph 8(1)(*h*.1) if the requirements are otherwise met.

See also CRA Document 2009-0339891E5 "Deduction of Motor Vehicle Expenses" (21 January 2010) below for another recent technical interpretation on the issue.

Income Tax Rulings Directorate, Business and Partnerships Division, January 20, 2010, Document No. 2009-0335451E5.

Deduction of Motor Vehicle Expenses (No. 2)

The CRA was asked whether certain motor vehicle expenses incurred for travel between an employee's home and his employer's various retail store locations would be deductible to the employee.

The employee was a corporate trainer and provided such training at the employer's various retail store locations. The employee also performed certain administrative duties at his home and/or at the retail store locations. Generally, the taxpayer did not report for work at the employer's regional office.

The CRA stated that its long-standing position is that travel between an employee's home and regular place of employment ("RPE") is personal travel and thus any motor vehicle expenses for such travel would not be deductible. However, where an employee proceeds directly from home to a point of call other than the RPE or returns home from such a point such travel is considered employment related. A particular work location is an RPE if it is a location at or from which the employee regularly reports for work or performs the duties of employment. An employee may have more than one RPE, and an RPE may change from time to time. It is a question of fact as to whether a particular location is an RPE of the employee.

For employment-related travel, an employee's motor vehicle expenses are deductible under paragraph 8(1)(*h*.1) of the Act, but no deduction may be claimed where the employee has received motor vehicle allowance that was not taxable under paragraph 6(1)(*b*). However, where the employee includes the allowance in his/her income, the CRA will generally allow the employee to claim motor vehicle expenses under paragraph 8(1)(*h*.1) if the requirements are otherwise met.

See also CRA Document 2009-0320531E5 "Reasonable allowances" (18 December 2009) (reported in the February issue of *PaySource*, No. 176) and CRA Document 2009-0335451E5 "Motor Vehicle Allowances" (20 January 2010) above, for further discussion of reasonable motor vehicle allowances.

Income Tax Rulings Directorate, Business and Partnerships Division, January 21, 2010, Document No. 2009-0339891E5.

Directors' Fees Paid to Non-Residents

Director's fees paid to a non-resident director are only subject to withholding pursuant to paragraph 152(1)(*a*) of the Act if work is performed by the non-resident director in Canada. Such fees are subject to Canadian tax under paragraph 115(1)(*a*), which imposes Canadian tax on non-residents in respect of income from an office or employment performed in Canada. The definition of "office" in subsection 248(1) specifically includes the remuneration of a corporate director. Additionally, the amount of Canadian tax payable may be effected by an applicable tax treaty. For example, although there is no provision in the Canada–United States Tax Convention (1980) (the "Treaty") that specifically contemplates non-resident director's fees, Article XV of the Treaty states that employment income is exempt from Canadian tax if one of the following two conditions are met: (i) the remuneration does not exceed C$10,000; or (ii) the recipient was not in Canada for a period exceeding 183 days in any 12-month period and the remuneration is not paid by, or on behalf of, a person who is a resident of Canada and is not borne by a permanent establishment in Canada. Therefore, should a U.S. resident director meet one of the above-noted exemptions, there may be no Canadian tax on the remuneration paid in respect of work performed by the non-resident director in Canada. It should be noted that prior to the enactment of the Fifth Protocol to the Treaty, the 183-day time period was measured within a calendar year rather than any 12-month period.

Furthermore, where the non-resident director does not attend any meeting or perform any other related functions in Canada, Regulation 104(2) provides that his/her remuneration is not subject to withholding or deduction. However, if the services are partly performed in Canada, the employer is responsible for apportioning that part of the director's fee paid to the non-resident director for the services performed in Canada.

We note that the CRA is currently studying whether remuneration paid to non-resident directors who participate in meetings via telephone or other communication facilities is subject to withholding (see, for example CRA Document 2009-0308041E5). We would find it puzzling if the CRA concludes that a non-resident director who participates in director's meetings via certain telecommunication devices is performing work "in Canada".

Insolvency and Administrative Law Section, Income Tax Rulings Directorate, January 25, 2010, Document No. 2009-0345151E5.

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