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Tax Notes

September 2009
Number 560

Spousal Trusts

The following article is based on materials to appear in the upcoming third edition of Tax and Family Business Succession Planning, by David Louis, Michael Goldberg, and Samantha Prasad (Minden Gross LLP), to be published this fall by CCH Canadian Limited. It is a portion of ¶812, which deals with Spouse Trusts in Chapter 8, Wills & Will Substitutes.

A spouse trust can be a very effective succession and estate planning vehicle. It combines the tax-deferral advantages of leaving assets to a spouse, with the ability to protect family interests. Where a successful business is involved, it is more usual to use a spouse trust rather than leaving the shares and other assets outright to the surviving spouse, in order to preclude the possibility of the surviving spouse changing the terms of his or her will, e.g., in the event of a remarriage.[1] In addition, the appointment of suitable trustees may protect against mismanagement of the business or distributions which could jeopardize financially the viability of the ongoing business. Specifically, this could provide protection from the surviving spouse exercising retraction rights attaching to freeze shares, e.g., where an elderly surviving spouse has remarried and is under the influence of a spendthrift spouse.

Spouse trusts may be used for *inter vivos* (lifetime) gifts or testamentary bequests. In order to qualify for rollover treatment, the trust must provide that:

- The spouse is entitled to receive all of the income of the trust that arises before the spouse's death;[2] and
- No person except the spouse may, before the spouse's death, receive or otherwise obtain the use of any of the income or capital of the trust.[3]

Note: to obtain a rollover on a outright disposition to a spouse, both the decedent and the beneficiary must be Canadian residents; for a spouse trust, the decedent and the spouse trust must both be Canadian residents.[4]

Several comments can be made in respect of these requirements:

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1 As noted above, the spouse must be entitled to obtain all of the income of the trust during his or her lifetime. This means that there can be no provisions disentitling the spouse to an interest in a spouse trust, e.g., if the spouse remarries. However, if the trust holds shares of a corporation, subject to fiduciary-type considerations, it is possible to effectively control the amount of income received by the trust and, consequently, the amount to which the spouse is entitled. Specifically, where a corporation is held by a trust, the dividends paid on the shares may be regulated by the directors of the corporation. (In such circumstances, it may be prudent to ensure that control of the corporation is not held by the trustees themselves; otherwise, the spouse might assert that distributions should have been made by the corporation as a consequence of the duties of the trustees.)

2 The requirement that no other person can receive or obtain the use of capital does not mean that the spouse is entitled to receive the capital. In other words, as long as no one else may receive or obtain the use of the capital, the trust will not be disqualified as a spouse trust.

3 In respect of the use of capital requirement, careful drafting is required in order to ensure that this requirement is not violated. For example, a loan to a relative might be interpreted as allowing someone other than the spouse to obtain the use of capital. Provisions in a trust that allow this could throw the trust offside.[5] Although CRA Document No. 9627345, November 14, 1996, and paragraph 16 of IT-305R4 indicate that a loan to a non-spouse on commercial terms (e.g., commercial interest rates)[6] would not taint a spouse trust, Document No. 2003-0019235, July 17, 2003, indicates that where the trust permits funds to be loaned (or any other form of assistance to be provided) to anyone other than the spouse for inadequate consideration, this would disqualify the trust, whether or not such a loan was actually made. The latter document appears to indicate that the will in question authorized the trustee to lend funds or provide any other financial assistance to any beneficiary with or without consideration.

A recent Technical Interpretation (Document No. 2006-0185551C6, September 11, 2006) also raised the question of whether the rollover to a spouse trust would be available if the trustee is required to pay life insurance premiums. The CRA's negative answer was based on the argument that a duty to fund a life insurance policy out of trust capital or income would be one under which another person may obtain the use of the trust capital or income. The CRA indicated that "the mere possibility of a person other than the survivor receiving or obtaining, before the survivor's death, use of the trust capital or income is sufficient to disqualify the property transfer from the rollover."

It appears that the concept of being able to "obtain the use" is potentially very broad.[7] (Notwithstanding the CRA's administrative policy as stated above, even if a loan is on commercial terms, query whether the debtor is nevertheless obtaining the use of the capital.) As the "no use" requirement must presumably be met under the terms of the trust, appropriate language should be inserted in the document. It therefore appears to be advisable to examine closely the powers given to trustees in a spouse trust in order to make sure (for example) that the "boilerplate" does not trip over the "no use" requirement, e.g., by providing for a power to lend on any terms they see fit. If there are changes to the CRA policy in respect to spouse trusts from time to time, it would necessitate an amendment to the document – if possible. Another approach would be to provide that trustees must adhere to the policies of the CRA in respect of the "no use" and other requirements in respect of qualifying spouse trust status, as delineated from time to time.

4 The meaning of "income" and "capital" as mentioned above pertains to trust/estate law. As mentioned previously, in a typical succession plan, freeze shares will be an important (perhaps the primary) asset in a spouse trust. While dividends on the freeze shares are treated as income, and therefore must be distributed to the spouse, a redemp-

TAX NOTES

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

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RETURN UNDELIVERABLE CANADIAN ADDRESSES TO
CIRCULATION DEPT.
330–123 MAIN ST
TORONTO ON M5W 1A1
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tion is treated as a return of capital, even though the redemption may trigger a deemed dividend. Therefore, it is not a requirement of a spouse trust that the proceeds of a redemption be distributed to the spouse. It should also be noted that, per subsection 108(3), capital dividends from private corporations are excluded from income for these purposes (as are capital gains dividends from mutual fund corporations); this subsection also applies to alter ego and joint partner trusts.

5 Question 14 of the 2008 APFF Round Table[8] may suggest that a spouse trust should contain a non-assignability clause. The question itself related to a self-benefit trust; however, the requirements (that the individual is entitled to receive all the income that arises before the individual's death and no person except the individual may, before the individual's death receive or otherwise obtain the use of any of the income or capital of the trust) are similar to the requirements of a spouse trust. The CRA indicated that, without a non-assignability clause, "an individual, residing in Quebec, has the possibility of transferring his rights in the income and capital of the trust pursuant to the *Civil Code of Quebec*, without being prevented to doing so by a provision of the trust indenture", so as to contravene the conditions in subparagraph 73(1.01)(*c*)(ii). As can be seen, the question is specifically referenced to Quebec laws, where Article 1285 of the *Civil Code of Quebec* specifically provides for assignability. Based on informal discussions, it appears that, at time of writing at least, the CRA has not considered the applicability of the foregoing views outside of Quebec and to trusts other than self-benefit trusts. However, consideration should nonetheless be given to including a non-assignability clause.

Notes:

[1] In Ontario, subsection 5(2) of the *Family Law Act* provides that when a spouse dies and the net family property of the deceased spouse exceeds the net family property of the surviving spouse, the surviving spouse is entitled to an equalization in lieu of taking under the will or the laws of intestacy. Where shares of a family business are left in a spouse trust, the owner-manager will want to attempt to ensure that the surviving spouse does not opt for this right, thus undermining the succession plan. In the absence of a domestic contract, perhaps this is best done by an open discussion of the terms of the will, including whether the spouse trust will provide for adequate distributions.

[2] However, a trust that retains income at the discretion of the spousal beneficiary does not lose its status as a spouse trust, since the spouse beneficiary nonetheless has a legal right to enforce payment of all of the income while the spouse is alive. See Document No. 2003-001451, June 2, 2003. Further, the CRA does not generally consider that the stipulation in the trust requiring the distribution to be made in the year subsequent to the year the income is earned would prevent the amount of the income from being payable to the beneficiary in the year or would disqualify a trust from being a spousal trust; see Document No. 2003-0008285, September 23, 2003.

[3] In addition, the capital property transferred or distributed to the spouse or spouse trust must vest indefeasibly in the spouse trust within 36 months of the taxpayer's death or, upon written application to the Minister within that period, within such longer period as the Minister considers reasonable in the circumstances.

[4] The trust must be Canadian resident immediately after the time the property vested indefeasibly in the trust.

[5] Subsection 108(4) prevents a spouse trust from being disqualified as such solely because of a provision in the trust instrument for payment of any estate, legacy, succession or inheritance duty or any income or profits tax. Subsection 70(7) and related provisions [discussed elsewhere] allow a tainted spouse trust to be purified, in respect of particular testamentary debts.

[6] Likewise, the bulletin sanctions the renting of real estate for fair market value.

[7] However, paragraph 15 of Interpretation Bulletin IT-305R4 indicates that the doctrine of constructive receipt applies. Consequently, the payment according to the will of, or the provision in the will for the payment of, any income of the trust to a person other than the spouse, on the condition that it be used solely for the benefit of the spouse, does not disqualify an otherwise qualifying spouse trust.

[8] Document No. 2008-0285071C6.

CRA Announces Relief for Taxpayers Not Having Deducted Their RRIF Recontributions

On August 10, 2009, the CRA announced that Canadian taxpayers who took advantage of the measure announced in last year's Economic and Fiscal Statement and recontributed 25% of their 2008 RRIF minimum amount to their plan but did not claim the corresponding deduction on their 2008 income tax return would be permitted to request an adjustment of their tax return. The announcement is reproduced below:

> The Honourable Jean-Pierre Blackburn, Minister of National Revenue and Minister of State (Agriculture and Agri-Food), announced today that the Canada Revenue Agency (CRA) will allow Canadians who took advantage of the new measure announced in the Government's 2008 Economic and Fiscal Statement, to claim a deduction on their 2008 income tax return.
>
> The new economic measure allowed registered retirement income fund (RRIF) annuitants to reduce the minimum amount required to be withdrawn for the 2008 tax year by 25%, or to recontribute an amount equal to that 25% reduction back to their RRIF. The annuitants had until April 14, 2009 to make a recontribution to their RRIF.
>
> "Our government acted rapidly in an economic context in which the market's decline impacted on Canadians' retirement savings. Unfortunately, one of the income tax forms used didn't contain line 232 – the line associated with the RIFF deduction. We are firmly committed to ensuring that Canadians are claiming all deductions to which they are entitled", said Minister Blackburn.
>
> "I encourage Canadians, when in doubt, to contact us if they need some assistance with their tax matters",

states the Minister. "Our taxpayer services enquiries agents in call centres across the country are well equipped to assist taxpayers with their questions and to provide them with instructions on how to request an adjustment to their tax return."

Individuals who did not claim the recontribution amount on line 232 of their 2008 income tax return, can request an adjustment to their tax return. As there are many different income tax return forms, individuals are encouraged to call the CRA call centres for all questions. For example the T1 Special and the T1S-A for seniors does not include line 232 and those who usually use these forms can contact CRA to request an adjustment to their return.

For more information about RRIFs, visit the CRA Web site at cra.gc.ca or call 1-800-959-8281 (in French 1-800-959-7383). The CRA Web site provides instructions on how to request an adjustment to a tax return at www.cra-arc.gc.ca/tx/ndvdls/tpcs/ncm-tx/chngrtrn-eng.html.

List of Registered Investments

The CRA has published the list of registered investments, as at December 31, 2008, in the *Canada Gazette* Part I, dated August 1, 2009. This list is published annually, pursuant to section 204.5 of the *Income Tax Act*. For print subscribers, it will be reproduced in Volume 4 in an upcoming report.

Attachment to Information Circular 84-3R5

The CRA has posted an update to the attachment to Information Circular 84-3R5, "Gifts to Certain Charitable Organizations Outside Canada". The attachment sets out organizations outside Canada to which donations have been made by Her Majesty in right of Canada. Subparagraph 110.1(1)(*a*)(vii) and the definition of "total charitable gifts" in subsection 118.1(1) of the Act set out that a charitable donation for a corporation or an individual includes a gift to a charitable organization outside Canada to which Her Majesty in right of Canada has made a gift in the taxation year or 12 months preceding the taxation year.

Designated Stock Exchanges

Section 262 of the *Income Tax Act*, regarding designated stock exchanges was enacted by Bill C-28 (S.C. 2007, c. 35), pursuant to the replacement of the concept of "prescribed stock exchange". Subsections 262(1) and (2) provide the authority for the Minister of Finance to designate a stock exchange or part of a stock exchange for the purposes of the *Income Tax Act*, and to revoke such a designation. Effective January 1, 2009, the Canadian National Stock Exchange was added to the list of designated stock exchanges, for purposes of the Act. This list is posted on the Department of Finance Web site at http://www.fin.gc.ca/act/fim-imf/dse-bvd-eng.asp and is reproduced following section 262 in CCH's *Income Tax Act*.

CRA's Advisory to eBay Sellers

On July 30, 2009, the Minister of Revenue advised individuals and businesses who earn income by selling items on eBay that this income is taxable and that the CRA would be conducting audits. In 2008, the Federal Court of Appeal dismissed eBay's appeal (2008 DTC 6728, affirming 2007 DTC 5573 (FC)) and allowed the Minister to impose a requirement for information on eBay Canada under subsection 231.2(1) of the Act, ordering the production of information relating to a segment of its Canadian consumer base known as "PowerSellers", in order to verify the group's compliance with their obligations to report income under the Act. The information identifying the group was stored electronically on servers in the United States, owned by the taxpayer's parent corporation.

The Minister of Revenue stated that "[a]s a result of [the] Federal Court of Canada decision, eBay Canada has provided the Canada Revenue Agency with the names of eBay sellers as well as their contact information and sales records". The Minister noted that the CRA will begin audits by the end of the summer based on the information provided by eBay and will contact eBay sellers to determine compliance. The Minister noted that taxpayers can avoid fines and penalties on income that has not been reported by coming forward voluntarily before audit or other compliance action is taken by the CRA.

Tuition Fees, Scholarships, and Bursaries

On its Payroll Web site, the CRA recently announced changes for the reporting of taxable benefits by a post-secondary educational institution that offers free tuition to an employee's dependant and by other employers that offer a scholarship program for employees' dependants. These changes start with the 2007 taxation year and presumably are pursuant to the decisions in *The Queen v. DiMaria* (2009 DTC 5019 (FCA), affirming 2008 DTC 3027 (TCC)) and *Okonski v. The Queen* (2008 DTC 2992 (TCC)). In the *DiMaria* case, the Court decided that a scholarship award received by the child of an employee from Dow Chemical Canada Inc. – the parent's employer, was not a benefit of the employee and should not be included in the employee's income. In the *Okonski* case, the taxpayer (parent) worked for the University of Western Ontario and the taxpayer's child received an award for tuition. Again, the Court decided that the award was not a

benefit in the hands of the parent employee. The CRA states the following:

> Starting with the 2007 tax year, if, as a post-secondary educational institution, you provide free tuition to an employee's **family members, do not** include the benefit's FMV in the employee's income. Instead, report the amount as a scholarship on a T4A slip for the family member.
>
> Starting with the 2007 tax year, if you operate a scholarship program for the family members of your employees, **do not** include scholarship amounts awarded in the income of the employee. Instead, report the amount on a T4A slip for the family member.
>
> **Do not** include in your employee's income the FMV of tuition fees, books, and supplies you paid or reimbursed for his or her family member. Instead, report the amount as a scholarship on a T4A slip for the family member.
>
> If the individual meets certain criteria, the income may be exempt, and the person may be able to exclude the amount from income on his or her individual return. If you get any questions from your employee about the T4A slip issued to the family member, you can refer them to Scholarships, fellowships, bursaries, study grants, and artists' project grants, or to their General Income Tax and Benefit Guide.
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> **Notes**
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> If you included the FMV of tuition fees or a scholarship award for a family member in an employee's income for **2007** or **2008**, you have to amend that employee's T4 slip for those years, and issue a T4A slip for the family member.
>
> The change to the employee's income for **2007** or **2008** may mean that you overpaid your share of the CPP contributions and EI premiums. To find out how to recover your share of these amounts, go to CPP overpayment and recovering CPP contributions or EI overpayment and recovering EI premiums for more information.
>
> If you have already deducted and remitted these amounts in **2009**, go to Deduction errors and How to correct remitting errors for more information.

Registered Charities v. Non-Profit Organizations

The CRA's Charities Directorate has updated its Web site at http://www.cra-arc.gc.ca/tx/chrts/pplyng/rgstrtn/rght-eng.html and sets out a chart highlighting the differences between a registered charity and a non-profit organization. The page notes the following: "A charity must apply for charitable registration with the CRA if the charity wants to become exempt from paying income tax and/or to issue official donation receipts. Meeting the definition of a 'charity' (without registration) does not qualify an organization for these advantages". Examples of types of organizations that fall under the four categories of charitable purposes include

- relief of poverty (food banks, soup kitchens, low-cost housing units)
- advancement of education (colleges, universities, research institutes)
- advancement of religion (places of worship, missionary organizations)
- purposes beneficial to the community (animal shelters, libraries, volunteer fire departments).

Examples given of non-profit organizations include:

- social, recreational or hobby groups (bridge clubs, curling clubs, golf clubs)
- certain amateur sports organizations (hockey associations, baseball leagues, soccer leagues)
- certain festival organizations (parades, seasonal celebrations).

The CRA goes on to note the following: "If an organization meets the definition of a 'charity', it cannot be considered a non-profit organization under the *Income Tax Act*, even if the organization is not registered or cannot be registered as a charity. An organization may meet one definition or the other, but not both".

Recent CRA Rulings and Interpretations

Deductibility of Network Marketing Expenses

The CRA was asked to comment on a situation wherein an individual carried on a business that was involved in several sectors. She also worked as a partner and distributor for a network marketing company, and on her own account. As part of her arrangement with the network marketing company and to remain eligible for the commissions paid by the company, she had to buy 200 points per month of products that she could either purchase for her own consumption or sell to her clients. The CRA was asked if she could deduct some expenses related to the 200-point monthly order.

The CRA could not confirm if such expenses were deductible from her income since it did not know their nature and purpose. The CRA noted that she would have to demonstrate the existence of a source of income to be able to deduct certain expenses related to the operation of

her business. A determination had to be made to accertain whether her activities were undertaken to make a profit or were simply personal in nature, and if they were not personal in nature, whether the income source was a business or a property. If the activities included a personal element, they would only be considered a source of income if they were operated in a truly commercial way. If there was a source of income, expenses could be deducted from the income but only if they were incurred for the purpose of earning business or property income by virtue of s. 18(1)(*a*) of the Act and were considered reasonable under s. 67. Any expenses made for human consumption of food and beverages, and entertainment are limited to 50% of the lesser of: (1) the amount actually paid or payable for the expenses; and (2) an amount that would be reasonable to pay in the circumstances.

– Document No. 2009-0319551E5, June 3, 2009,

Disposition of a Life Insurance Policy

The CRA was asked to comment on the tax treatment of a life insurance policy with a return of premium benefit. The particular policy described has two benefits provided in exchange for premiums paid by the policyholder. The first benefit is the right of the beneficiary to the face amount of the policy if the insured dies while the policy is in force. The second benefit is the return of premium benefit, which is the right of the policyholder to receive a payment from the insurer if the insured is still living at the time the policy matures.

A policy is deemed to be disposed of when it matures and any gain realized on such disposition is included in income pursuant to s. 56(1)(*j*). The gain included in income would be the amount by which the proceeds of disposition exceed the adjusted cost base of the policy. Pursuant to s. 148(9), the payment received as a refund of premium would be considered to be proceeds of disposition of the policy. The adjusted cost base would be the amount by which cash premiums paid by the policyholder, and any income in respect of the policy that has previously been reported for tax purposes, exceeds an amount referred to as the "net cost of pure insurance" under the policy.

The net cost of pure insurance, defined in Regulation 308, is the cost to have the death benefit coverage during the years the policy was in force, and reduces the amount that can be returned to the policyholder on a tax-free basis when the policy matures. The CRA acknowledged that the taxpayer considered this to be an unfair result, and suggested the taxpayer contact the Minister of Finance to propose any changes to the tax legislation in this regard.

– Document No. 2008-0269941M4, April 21, 2008,

Transfer of a Life Insurance Policy to a Wholly-Owned Corporation

The situation considered by the CRA involved an individual who was both holder and insured under a whole life insurance policy with a fair market value of $450,000, a cash surrender value or "value" (as this term is defined in s. 148(9) of the Act) of the individual's interest in the policy of $140,000, and an "adjusted cost basis" (as this term is defined in s. 148(9)) of the individual's interest in the policy of $45,000. The individual planned to transfer his policy to a holding company of which he would have all the issued and outstanding shares, and have *de facto* control. As a consideration for the transfer of his policy, he would receive two demand notes payable by the corporation: one of $140,000 for the cash surrender value of the policy; and one of $310,000 for the difference between the fair market value and the cash surrender value of the policy. The CRA was asked to comment on the tax implications of this transaction.

The CRA confirmed that the individual would be considered to have received proceeds of disposition of $140,000 from his corporation for the policy and that the corporation would be considered to have acquired it for the same amount. Because the individual and the corporation would not be considered as dealing at arm's length with each other under ss. 251(1)(*a*) and 251(2)(*b*)(i) of the Act, the rules described in s. 148(7) would be applicable to the transfer of the policy. As a result, the policyholder would be deemed to have received proceeds of the disposition equal to the value of his interest in the policy at the time of its disposition and the corporation would be considered to have acquired it at a cost equal to that value. Based on the definition of "value" in s. 148(9) of the Act, the value of the policy at the time of disposition would be equal to the cash surrender value that the policyholder would be entitled to receive at the time.

As the individual would receive proceeds of disposition in respect of the transfer of his policy to his corporation, he would be required under s. 148(1) of the Act to include in his income for the year of disposition an amount of $95,000 representing the excess of the proceeds of disposition of $140,000 over the adjusted cost basis of $45,000. The CRA did not have enough information to determine if the individual would have to include a shareholder benefit in his income under s. 15(1) of the Act or if the general anti-avoidance rule may be applicable in this situation.

– Document No. 2008-0303971E5, May 27, 2009

Eligibility of Small Business Corporation Shares for the Capital Gains Exemption

The issue the CRA was asked to comment on involved two individuals, X and Y, each of whom held an equal interest in the partnership P. The partnership owned all the

shares of the Canadian-controlled private corporation ACO which carried on an active business. X and Y held their interest in P for a period of 24 months and P held its shares in ACO for the same period. P was dissolved and the ACO shares held by the partnership were transferred to X and Y (in proportion to their interest in P) under the rollover provisions outlined in s. 98(3) of the Act. Less than 24 months following P's dissolution, X and Y sold their shares to non-related third parties. During the intervening period, more than 90% of the fair market value of the assets of ACO was used in an active business. The CRA was asked if the ACO shares sold by X and Y to the third parties would be considered as qualified small business corporation shares eligible for a capital gains exemption under s. 110.6(2.1) of the Act.

The CRA assumed that the conditions described in paragraphs (*a*) and (*c*) of the definition of "qualified small business corporation share" in s. 110.6(1) of the Act were met by the taxpayers. The only question to be resolved was whether the condition described in paragraph (*b*) was also met. To meet that condition, the shares could not be owned by anyone other than the taxpayer or a person or partnership related to the taxpayer throughout the 24-month period immediately preceding the disposition of the shares. The ACO shares were held by X and Y for a period of less than 24 months before their disposition but as they were held before that time by the partnership P (of which X and Y were the sole members), the CRA considered that throughout the 24-month period immediately preceding their disposition, the shares were not owned by anyone other than a person or partnership related to X or Y. The two taxpayers should therefore be allowed to claim the capital gains exemption in respect of the disposition of the ACO shares.

– Document No. 2009-0310231E5, June 3, 2009

Prescribed Prize

The value of a prize for achievement in a field of endeavour ordinarily carried on by the taxpayer in the year, other than a prescribed prize, will be included in the taxpayer's income pursuant to s. 56(1)(*n*), unless the prize is received in the course of or by virtue of employment, in which case the value of the prize will be included in income pursuant to s. 5 or s. 6 (or under s. 9 if the recipient is self-employed).

A prescribed prize is defined in Regulation 7700 as one that is "recognized by the general public and that is awarded for meritorious achievement in the arts, the sciences or service to the public but does not include any amount that can reasonably be regarded as having been received as compensation for services rendered or services to be rendered".

The CRA cited the Supreme Court of Canada's decision in *The Queen v. Savage*, 83 DTC 5409, wherein it was determined that where an amount may be included in income as either a prize pursuant to s. 56(1)(*n*) or as income from employment, s. 56(1)(*n*) will prevail since it is the more specific provision. Subsequent to that decision, s. 56(1)(*n*) was amended, with the result that where a prize could also be considered to be received in the course of business or employment, it will be excluded from s. 56(1)(*n*). The CRA concluded that if the award is sufficiently connected to the services performed by the recipient, then it will not be considered a prize pursuant to s. 56(1)(*n*) or a prescribed prize.

– Document No. 2009-0313051E5, June 19, 2009

Post-Retirement Benefit Assistance Plan

The CRA was asked to comment on a proposal by an employer to offer an early retirement plan (the "Plan") that would provide that once retired, individuals would continue to have all health benefits paid up to a limit of $20,000 of expenses incurred. This would include a medical and dental plan, and also a group term life insurance plan.

Assuming the medical and dental benefits to be offered through the Plan are offered through a private health services plan ("PHSP"), the exception provided under s. 6(1)(*a*)(i) would generally apply. It states that contributions paid by an employer in respect of a PHSP or a group term life insurance policy on behalf of an employee are excluded from the employee's income from an office or employment. The CRA stated that its general position is that where an employer extends benefits to former employees that would be non-taxable to current employees pursuant to s. 6(1)(*a*(i), the benefits will also be non-taxable to the former employees.

With respect to the portion that relates to a group term life insurance policy, s. 6(4) could apply to include a prescribed benefit in computing the employee's or former employee's income. In addition, any other payments made by the employer to a former employee could qualify as a retiring allowance (included in income pursuant to s. 56(1)(*a*)(ii)).

– Document No. 2008-0299611E5, June 29, 2009

Charitable Donation Receipts – Split-Receipting

The CRA was asked to comment on the draft version of the new gifting legislation. Specifically, the CRA was asked whether, under the proposed rules, a registered charity that provides housing for people with intellectual disabilities could issue a charitable donation receipt where parents have made a donation to the charity to ensure accommodation for their child.

The CRA stated that the proposed split-receipting amendments to the Act will allow a transfer of property to qualify as a gift for tax purposes in certain circumstances where a donor has received consideration for the property transferred.

In such cases, the eligible amount of the gift (under proposed s. 248(31)) would be the amount by which the fair market value of the property exceeds the amount of the advantage received by the donor. Proposed s. 248(35) deems the fair market value of the gifted property to be the lesser of the fair market value of the property and the cost of the property to the donor (in the case of capital property, the adjusted cost base). This is subject to certain exceptions in proposed s. 248(37).

Under proposed s. 248(32), the amount of the advantage received by the donor is generally the fair market value of any property, service, compensation, or other benefit received or expected to be received in the future by the donor or a person with whom the donor does not deal at arm's length. Generally, if the value of the advantage exceeds 80% of the fair market value of the transferred property, there will not be an eligible amount of a gift unless the donor can establish to the Minister's satisfaction that the transfer was made with donative intent. It is the responsibility of the charity to determine the value of the advantage provided.

– Document No. 2008-0271951E5, June 10, 2009

Surrender of Property

The CRA was asked whether s. 79 (surrender of property) would apply to a series of transactions in which a debtor had borrowed an amount to construct and operate a hotel property, had failed to repay the interest and principal of the loan, and the creditor had subsequently foreclosed on the property.

In year one, Canco, a Canadian-controlled private corporation, borrowed an amount from an arm's length third party (the "Creditor") at 10% interest *per annum*. Canco used the funds to construct and operate a hotel. In years one and two, Canco failed to repay any portion of the interest and principal of the loan. In each year, Canco claimed an interest expense deduction pursuant to s. 20(1)(*c*). During the two years, Canco had no revenue and therefore reported a non-capital loss to the extent of the interest expense. At the start of year three, the Creditor foreclosed on the hotel. Under the foreclosure agreement, Canco voluntarily surrendered the hotel, and all amounts owing to the Creditor were extinguished.

The CRA stated that s. 79 applies where a debtor has surrendered property to a creditor. Specifically, s. 79(2) sets out the circumstances where a property will be considered to be "surrendered". Subsection 79(3) establishes the rules to determine the deemed proceeds of disposition to the debtor. Accordingly, where a debtor has defaulted on a loan and interest payments to a creditor and the creditor has foreclosed on the property, the provisions of ss. 79(2) and (3) would apply.

The proceeds of disposition under s. 79(3) would be the amount used to determine the debtor's capital gain, if any, on the surrender. Such capital gain would result in the creation of a capital dividend account balance under the definition in s. 89(1). Where the debtor had a non-capital loss carry-forward from the interest expense claims, this non-capital loss could be used to offset the gain that arose on the surrender and the application of s. 79.

However, the CRA noted that if the foreclosure agreement was part of an agreement or was in anticipation of, rather than a consequence of, the debtor's failure to pay, then s. 79 may not apply and instead s. 80 (debt forgiveness) may be engaged.

– Document No. 2009-0305751E5, May 27, 2009

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