



Recent CRA Thinking on Topics of Interest

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The Canada Revenue Agency (“CRA”) regularly releases its responses to queries from the general public on varying tax matters. These responses give us insight into the CRA’s approach to the law, including the actual practices and policies of the government on such issues. Some recent queries and responses of interest to business owners are summarized below.

Small Business Deduction

A Canadian-controlled private corporation carried on a professional services business from leased premises. It occupied only a portion of the leased space so it sublet the vacant space to other professional entities. In addition to providing the rented space, the corporation also provided complimentary services, such as reception and billing services, as well as providing office furniture and equipment. The question was about whether the corporation

would be allowed to claim the small business deduction (the “SBD”) on the rental income that it received.

The CRA stated that its decision would depend upon the circumstances in this case. The corporation would be allowed the SBD if the rental income was pertaining to, or incidental to, the professional income it produced. If the rental income was not pertaining to, or incidental to, the professional activities it produced, then the rental income would be considered income from property and not eligible for the SBD. The CRA also noted that if the rental activities were considered to be a separate business of the corporation rather than part of the professional services, the rental income would likely be from a specified investment business and not eligible for the SBD.

Assessment Beyond the Normal Assessment Period

The CRA was asked if it can accept a late-filed return and issue a reassessment beyond the normal reassessment period if a corporation files a tax return for a year that showed higher tax payable than the tax that was payable in an arbitrary assessment the CRA had issued for that year.

Normally, the CRA can reassess a taxpayer beyond the normal reassessment period in instances only where the taxpayer has made a misrepresentation that is attributable to neglect, carelessness, or willful default, or has committed fraud with respect to the return.

The CRA stated that the failure of the company to file the initial return for

that year would be considered misrepresentation attributable to neglect and in such circumstances would issue a reassessment beyond the normal reassessment period. The CRA also noted that in a similar circumstance a corporation had filed a tax return indicating a lesser amount of tax owing than what had been assessed in the arbitrary reassessment. In that case, the reassessment was not issued on the revised tax return because a taxpayer should not have a longer period of time to correct errors on a tax assessment than a taxpayer who files his tax returns on time.

Settlement Payment for Cancellation of a Lease

The CRA was asked how a settlement amount paid to a corporation for the cancellation of a lease should be treated. The situation describes a corporation receiving a settlement amount from its landlord for the cancellation of the lease of the corporation's office facilities, which had several years left to run. The lease cancellation caused significant disruption to the corporation's business. Should the settlement payment be included as business income or should it be considered part of the proceeds of disposition of a capital property?

The CRA responded by stating that it could only give a general interpretation of the provisions relating to the issue and could not make a specific determination, which would depend on the facts of each case.

The CRA stated that the income tax treatment of a settlement payment will depend on what the payment is intended to replace—an income disruption, or the loss of a capital asset. A settlement received by a taxpayer with respect to the loss of business income or business property may fall into one of the following four categories:

1. a non-taxable receipt;
2. an income receipt;
3. a receipt resulting from the disposition of a capital property; or
4. an eligible capital amount.

The CRA stated that, in general, the compensation paid for breach of a trade contract is on income account; however, it could be a capital receipt depending on the circumstances.

Private Health Services Plan (PHSP)—Employee-Shareholder

The CRA was asked if a private company's health services plan would qualify as a PHSP as defined under the *Income tax Act* (the "Act"). The company in question had only one employee/shareholder and the plan worked on the basis whereby the employee would submit his medical expense claims to a third party administrator, who would then bill the company for the full cost of the claim plus an administration fee.

The CRA explained that the rules pertaining to a PHSP state that the plan must be in the nature of insurance, which implies that there be an element of risk that is assumed by the insurer. In the situation described in this case, however, the sole employee/shareholder was essentially paying for his own medical expenses through his corporation. There is no risk assumed by the plan administrator; therefore, the plan is not in the nature of insurance and would not qualify as a PHSP under the legislation. The CRA also stated that the corporation would not be able to deduct the payments made to the plan administrator as they are not expenses incurred to earn income.

Deductibility of Meal Expenses—Meaning of "Long-Haul Truck"

One of the stipulations for a truck driver to be able to claim meal and beverage expenses at the rate of 80% (as opposed to 50%) under the Act is that he or she must drive a "long-haul truck". The CRA was asked to clarify what was meant by a "long-haul truck".

The term "long-haul truck" is defined in the Act as a truck designed for hauling freight and having a gross vehicle weight rating ("GVWR") over 11,788 Kilograms. The GVWR is the value specified by the vehicle manufacturer and relates to the loaded weight of a single vehicle and does not include the weight of a trailer or the weight that the trailer can hold. It is the truck or tractor itself and does not include the trailer attached to it.

Paralegals and Work in Progress Election

Taxpayers who are professional accountants, lawyers, dentists, doctors, chiropractors, and veterinarians are able to elect to exclude from income, in any particular year, the value of work in progress at the end of a year. The CRA was asked if a paralegal who was not a lawyer but was licensed to provide certain legal services in Ontario could make the same election and exclude from income the value of his or her work in progress at the end of a year.

The CRA stated that since the election is limited to the professions listed in the Act and that since the definition of a lawyer as set out in the Act is limited to a barrister or solicitor, a paralegal is excluded from that provision. Lawyers are licensed to practice law, whereas paralegals are licensed to provide certain legal services. The two are quite different and, therefore, paralegals cannot make the election.

Dues Paid to an Employee Association

The question was asked if dues paid to an employee association would qualify as union dues and thus be deductible as such under the Act. The CRA's position is that an association need not be certified as a trade union in order to qualify as a trade union for purposes of the deduction. In the situation described, all non-management employees must be members of the employee association, the dues are collected via payroll deduction, and the association negotiates employment contracts involving compensation and working conditions. The CRA stated that, based on the facts provided in this case, the association would be considered a trade union and the employees' annual dues would be deductible.