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**Recent CRA Thinking on Topics of Interest**

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

**Deductibility of Legal Fees**

The CRA was asked if a taxpayer could deduct the cost of legal fees he incurred to appeal an assessment of tax as well as the legal fees of the respondent that the court ordered him to pay. The CRA stated that, under the Income Tax Act, legal fees paid in a year relating to the "preparing, instituting, or prosecuting an objection to, or an appeal in relation to, an assessment of tax, interest or penalties" could be deducted. This would include the fees that he was ordered to pay on behalf of the respondent. The CRA also noted that the fees deductible need not necessarily be paid to a lawyer.

**Donated vacations**

The CRA was asked about the tax treatment of donated vacations in instances where employees donate their vacations to their co-workers. This would include situations where such vacations were donated at the direction of or with the concurrence of the donating taxpayer. The CRA stated that the amount representing the vacation time is included in the donor's income as part of his or her employment income and that no deduction as a donation would be allowed for the donated vacation time. As well, the recipient co-worker would have received the donated vacation time as a gift and as a result would not have to include in income the value of the vacation time received.

**Filing a Nil Return to Avoid Late Filing Penalties**

The CRA was asked if it can refuse to accept a tax return that is basically incomplete and that was filed simply for the purpose of avoiding the late filing penalties associated with the failure to file a return by the due date. The CRA stated that if a taxpayer files a Nil return or a return that does not reflect a reasonable estimate of the taxpayers income and expenses for the year, it does not have to accept it and depending upon the degree of deception or negligence involved, the CRA may still assess late filing penalties. Even in instances where the initial return is assessed and a notice is issued that no tax is payable, the amended return may be reassessed to invoke late filing penalties in instances where the CRA determines that the initial return was not valid. As well the normal reassessment period would be extended in instances where the taxpayer is found to have misrepresented the facts and filed an incomplete return due to neglect, willful default or carelessness.

**Heartbleed Extension and Appeal Deadline**

As a result of the vulnerability exposed by the "Heartbleed bug", the CRA extended the deadline for the filing of the 2013 tax returns for individuals from April 30, 2014 to May 5, 2014. The question was asked if as a result of the extension to file the 2013 returns, there would be a corresponding extension to the date by which a Notice of Objection could be filed. The CRA responded that the extension to file the 2013 returns was granted so that late filing interest and penalties would not apply, but that it did not alter the April 30 filing due date. Thus the period for filing a Notice of Objection did not change and would still be the later of April 30, 2015 or 90 days after the relevant Notice of Assessment is issued.

### Electronic Records

Under the *Income Tax Act*, a taxpayer who is required to pay tax must keep records in a form that allows the taxpayer to support the income and expenses claimed. The CRA was asked if an individual could keep their records in electronic form as opposed to paper. The CRA responded by saying that the *Income Tax Act* does not specify the form in which records must be kept. Records could thus be kept in electronic form provided they are readable and ascertainable. The CRA will accept documents that are electronic, paper, or a combination of both.

### Rental of Government-Owned Housing

The CRA was asked if in a situation where a government department rents government-owned housing to employees or employees of other government departments, retirees, and on occasion to the general public at a rate that is less than fair market value, would the difference in rent between what the employee pays and fair market value rent be a taxable benefit. The CRA responded that in instances where an employee or ex-employee rents government owned housing at less than fair market value, by virtue of their employment they are deemed to be receiving a benefit equal to the difference between the rent they pay and the fair market rent. However where the tenant is a member of the public and not an employee of the government, there will not be a taxable benefit.

### Disability Tax Credit

The CRA was asked if a Disability Tax Credit Certificate (Form T2201) signed by a nurse practitioner would qualify the individual for the disability tax credit. The CRA responded that the occupations that would qualify a medical practitioner to certify a disability certificate are outlined in the *Income Tax Act* and a nurse practitioner is not qualified to issue such certificates for that purpose.

### Lump-Sum Payments of Support

The CRA was asked about the deductibility of support payments paid to a former spouse where the taxpayer made unscheduled catch-up payments. The taxpayer was making monthly support payments under the terms of an agreement, but each monthly payment was for less than what was required under the agreement. Throughout the year the taxpayer would make more than one unscheduled lump-sum payment so that by the end of the year he would have met the requirements of the agreement. Since the payments were lump-sum catch-up payments, it was unclear if they met the deductibility test.

The CRA noted that the term "support amount" is defined in the *Income Tax Act* and must meet the following conditions.

- The amount is payable or receivable as an allowance on a periodic basis.
- The amount is for the maintenance of the recipient, the children of the recipient, or both.
- The recipient has discretion as to how the amount is used.
- If the recipient is the payer's current or former spouse or common-law partner, the recipient and the payer are living separate and apart because of a breakdown of their relationship, and the

amount is receivable under an order of a competent tribunal or under a written agreement, or if the recipient is the parent of a child of whom the payer is also the parent, the amount is receivable under an order of a competent tribunal within the laws of a province or territory.

The CRA also stated that in this case the lump-sum payments were not periodic payments paid under an agreement, but were lump-sum payments representing periodic payments that had fallen into arrears. As such, the lump-sum payments would qualify as support payments and, if other conditions were met, would qualify for the support payment deduction.

### Compensation for Damages to Crops and Lost Profits

The question was asked about how insurance proceeds received by a farmer as compensation for damages to crops should be treated for tax purposes. The CRA stated that the compensation is treated the same way as what it is intended to replace. In other words, compensation received from an insurance company to replace lost revenue on a crop would be treated as income, whereas compensation received from an insurance company as payment for damages to a capital asset would be considered a capital receipt.

### Characterization of Online Poker Winnings

The CRA was asked to consider a situation where an individual taxpayer started watching videos to learn the basic rules of poker and then began playing the game online. Initially his gains were modest but then started to increase significantly. At some point he began to spend almost all his time playing poker online. Would the taxpayer's income from playing poker be considered a windfall, or be taxed as business income.

The CRA stated that unless gambling became a business and constituted the taxpayer's main source of income and activity, then occasional winnings would be considered a windfall and would not be taxable. However, in this instance the taxpayer indicated that online gambling became his primary activity and at that point his online gambling activity would be considered a business and his winnings from that point on would be taxed as business income.

A payment would normally be considered a windfall if the taxpayer:

- made no sustained effort to receive it;
- did not seek or solicit it;
- did not receive it from one of his or her customary sources of income; and
- did not earn it from an activity or pursuit of gain carried on by him/her or otherwise.

The factors that can be used to help determine if winnings from gambling are of a casual or business nature are:

- the degree of organization present in the pursuit of the gambling activity by a taxpayer;
- whether there is the existence of special knowledge or inside information that would enable a taxpayer to reduce the element of chance in earning poker winnings;
- whether the taxpayer has the intention to play poker only for pleasure, not for profit or as a means to earn a living; and
- the extent of the taxpayer's gambling activities (e.g., time and frequency of playing).