

Accounting for pleasure

When it comes to deducting fun, for most Canadians the rules can be confusing and taxing

Among the 10 most frequently asked questions about income taxes, those relating to leisure and recreational activities often top the list. There are specific rules for each activity, e.g., restaurant dining, hockey or baseball games, golfing, boating, fishing or hunting expeditions, season passes for ski resorts, Christmas parties, gifts, trips, frequent-flyer programs, weddings, escort services. As these rules and related terminology can be hard to remember, an overview including practical tips to navigate the regulatory maze and answers to federal tax-related questions of each can be helpful.

Meals, beverages and entertainment This is the easiest category. Costs related to meals, beverages and entertainment, including taxes and tips, are only deductible if they are incurred to earn property or business income. In most cases, only 50% of these expenses may be deducted. The entire tax debate centres on the so-called "business test." Don't be afraid to be creative in this regard. For example, Joshua

Grunbaum put his creativity to good use in 1994 when he convinced Tax Court of Canada Justice Alban Garon that his wedding expenses should be tax deductible as they met the business test. Taxpayers can push the envelope a little, but without going overboard. One never knows.

Restaurant gift certificates and gifts of food, beverages and entertainment to clients are subject to the same rules. If an expense is not considered reasonable, the maximum allowable deduction will obviously be reduced accordingly. Keep records of business expenses specifying where, when, why and for whom they were incurred.

Golf Tax authorities seem to have great difficulty recognizing that golf can serve a legitimate business purpose. Indeed, they remain unconvinced that golf courses sometimes double as meeting rooms — at least after the winter snow has melted. The Income Tax Act expressly states that expenses relating to a "golf course or facility" (e.g., annual dues, green fees, cart rental costs and initiation fees) are not deductible. It has also been determined that 50% of expenses relating to pre- and post-golf meals may be deducted, provided they were for business purposes and detailed bills are available. However, 100% of the cost of promotional items (e.g., golf balls, shirts and caps) offered to clients is deductible.

Club fees This expense category, which includes season passes for ski resorts and memberships in sports or private clubs, is not quite so cut and dried. The relevant provision is set out in the act's subparagraph 18(1)(l)(ii). It states "no deduction shall be made in respect of an outlay or expense made or incurred by the taxpayer ... as membership fees or dues [whether initiation fees or otherwise] in any club the main purpose of which is to provide dining, recreational or sporting facilities for its members." Although the restrictive nature of this provision



may give the impression that tax deductions are not allowed for this expense category, the cost of season passes for ski resorts, lift tickets, private club membership fees, etc. may be deducted in some cases.

A closer reading reveals that subparagraph 18(1)(l)(ii) does not refer to all types of clubs. In fact, the provision only applies to organizations that use more than 50% of their assets to provide members with dining, recreational or sporting facilities. Moreover, the tax act refers specifically to a club. Consequently, this restriction should not apply to facilities such as ski resorts, water parks or equestrian centres. In this regard, Canada Revenue Agency (CRA) has determined that ski-resort season passes or lift tickets provided to clients may be considered promotional expenses and are thus 50% deductible. In addition, if the passes or tickets are used solely for business purposes by an employee or a shareholder, they do not constitute a taxable benefit. Of course, while not going so far as to make recreation decisions exclusively to minimize tax, it should be noted that, from a tax perspective, skiing provides a greater benefit than golfing.

Business executives or their clients who are members of select organizations such as Montreal's St. James Club or Toronto's National Club will be pleased to learn that on Nov. 17, 2006 the CRA confirmed that fees paid by an employer on behalf of an employee for membership in a business social club are 100% deductible by the employer and do not constitute a taxable benefit for the employee if the employer primarily benefits from the arrangement.

No deductions are allowed for memberships in a sports centre or any other sports club; paragraph 18(1)(l) of the tax act is quite clear in this regard. Club fees paid by an employer on behalf of an employee are usually considered a taxable benefit. Certain exceptions do apply, however, particularly in the case of social or athletic club membership fees primarily intended to provide an advantage for the employer or in-house employer-owned facilities. Taxpayers who are shareholders and employees of the same company should therefore ensure that their fees are paid by

the company, even if the expense is subsequently disallowed. In this way, their personal tax bracket will not be affected and the membership will cost 24% to 37% less than it otherwise would, depending on the province of residence.

Yachts, camps and lodges Expenses relating to the use or maintenance of a yacht, camp or lodge may not be deducted unless such activities represent a company's primary business activity. Hunting and fishing enthusiasts won't be pleased to learn that outfitters are considered lodges for tax purposes.

However, the CRA does allow 50% of food and beverage expenses to be deducted if the yacht, camp or lodge was used in the course of legitimate business and not for leisure purposes. Drawing the line between these two categories can be difficult at times. It should be noted that even if business-related discussions are on the agenda, all expenses will be disallowed if the yacht, camp or lodge is used primarily for leisure purposes.

Christmas parties and other special events Expenses incurred by an employer for food, beverages and entertainment provided to all employees are exempt from the 50% limitation. For example, an office party may qualify for favourable tax treatment if no more than six such events are held a year at each of the company's places of business. Therefore, a company with offices in Montreal, Toronto and Calgary may hold six employee events at each place of business. As for golf tournaments, aside from the exception relating exclusively to meals and beverages, no golf-related expenses are allowed by the CRA. For employees, attendance at such events does not usually constitute a taxable benefit if the cost is less than \$100 per person.

Gifts and awards Employers may give employees a maximum of two noncash gifts and two noncash awards a year to mark achievements or special occasions. Under applicable legislation, the total value of the two gifts or awards is limited to \$500, including taxes. An employer may thus give noncash gifts and noncash

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Expense deductibility				
ACTIVITY	EXPENSE CATEGORY	DEDUCTION ALLOWED		
		0%	50%	100%
GOLF	Food and beverages consumed on site (only if billed separately)		•	
	Promotional items (golf balls, shirts, caps, etc.)			•
	Annual dues/green fees/cart rental/initiation fees	•		
OTHER SPORTS	Recreational club membership	•		
	Tickets to sports events		•	
	In-house company sports equipment (recreational facilities)			•
	Corporate box rental (sports arena)/ski resort season/lift tickets		•	
TRAVEL	Conventions (maximum two per year)/business trips			•
	Business trips (expenses attributable to spouse/children)	•		
LEISURE	Suite rental for clients (e.g., cocktail reception)		•	
	Escort services (illicit)	•		
	Security escort services/tour guide services		•	
ENTERTAINMENT	Movie tickets		•	
	Client gifts (promotional items)			•
	Client gifts (entertainment)		•	
	Activities provided to all employees (excluding golf)			•
FOOD & BEVERAGES	Food and beverages consumed while traveling (bus/plane/train)			•
	Food and beverages consumed while traveling (ferry/boat)		•	
	Food and beverages billed to clients			•
	Food and beverages included in employees' income			•
	Food and beverages provided to all employees			•
	Client gifts (food and beverages)		•	
	Food and beverage reimbursement not included in employees' income		•	
PRIVATE BUSINESS CLUB	Annual dues			•

awards totalling \$1,000 per employee annually on a tax-free basis.

Travel Business travel expenses may also be deductible. If a trip combines business and pleasure, or if a taxpayer is accompanied by his or her spouse, only the taxpayer's business portion of the expenses may be deducted.

Taxpayers thinking of attending a convention should be aware that the CRA also allows a deduction for convention expenses (maximum two conventions a year). Expenses relating to a third or fourth convention in a given year are not deductible. Taxpayers who earn frequent-flyer points when traveling should not automatically assume that they will be able to redeem their points on a tax-free basis; to do so may prove costly. In this regard, the CRA has ruled that employees enrolled in frequent-flyer programs must include the money they save on airline ticket purchases as a taxable benefit in their employment income.

Escort services Security escort or tour guide expenses are deductible, subject to the 50% limitation, if they are incurred for business purposes.

However, Interpretation Bulletin IT-518R states that expenses relating to "illicit services of a personal nature" are never deductible.

This is only a summary of the most important rules; it is not an exhaustive treatment of this subject. Please note that sales taxes may also prove to be a maze in their own right.

We have tried in vain to devise a few tricks to better remember all these rules. Unfortunately, they must be learned by heart. Perhaps that explains why accounting for pleasure has become so "taxing" for so many Canadians.

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