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What the CRA is Saying

The Canada Revenue Agency (the "CRA") releases its response to queries from the general public on a regular basis. These responses give us insight into the CRA's approach to the law, including actual practices and policies of the government on tax matters. We have summarized some of the responses below.

Can two merged condo units be considered one principal residence?

A taxpayer purchased a condominium (condo #1) next to her mother's unit (condo #2) and, in order to make it easier for her to take care of her ailing mother, made the following renovations to the two units:

- Created a door-sized entrance in the common wall between the units
- Made minor adjustments to the kitchen in condo #1 to turn it into an office space but such that it could be turned back into a kitchen very easily
- Expanded the kitchen area in condo #2
- Enlarged the master bedroom suite in condo #1

The two units continued to have two separate addresses and two entrance doors and two legal descriptions, which, according to the taxpayer, would allow a future purchaser of the condominiums the flexibility of re-configuring the two living spaces into two separate housing units. Following the mother's

death, condo #2 was transferred to the taxpayer and the taxpayer inquired whether the condos could be considered one principal residence.

In order to be a principal residence a residence must be among other things, a "housing unit". The CRA stated that in its view, a "housing unit" normally refers to "a room, or a group of rooms, occupied by a person or group of persons, and includes kitchen, bathrooms, etc."

Although a question of fact, the CRA stated that two units will generally be considered one housing unit if they are "sufficiently integrated such that one cannot enjoy the living accommodation of one unit without the use and access to the other unit". If each could be inhabited individually without significant renovations and without having to access the other unit, the CRA stated that it would be unlikely that the two units could be considered one housing unit for purposes of the definition of principal residence.

Factors to consider include the extent of integration of the two units, whether the units have separate legal titles, municipal addresses, entrance doors, and accounts for utilities and other public service providers. In this case, the CRA concluded that condo #1 and condo #2 did not constitute one housing unit for purposes of the principal residence exemption since the renovations did not integrate the units into a single functioning unit.

Can an in-law apartment rented by third party or by taxpayer's stepson be considered part of a principal residence?

The CRA was asked whether a taxpayer could claim the principal residence exemption in a situation where a portion of his residence (i.e., in-law apartment located in the basement) was rented by a third party or by his stepson. The apartment had its own exit and civic address, and separate kitchenette and laundry facilities. It was also assumed that the taxpayer had not designated another property as his principal residence and had not claimed the capital cost allowance.

Although the question of whether there is one or two units in a residence is a question of fact, the CRA relied on the above information to conclude that there were two separate units in the taxpayer's residence. The CRA would consider the following factors to make such a determination:

- number of distinct civic addresses;
- presence of separate entrances, heating systems, and water tanks;
- property tax statements indicating more than one civic address; and
- municipal by-laws preserving the one-family dwelling status of a residence even in the presence of an in-law apartment in the basement.

Since there were two units in the residence, the taxpayer could claim the principal residence exemption for the portion inhabited by him, but not for the one rented to and inhabited by a third party or by his stepson, and not inhabited by him at any time.

Since his stepson would be considered his child under the section of the Income Tax Act (the "Act") dealing with the extended meaning of "child", the in-law apartment would be considered inhabited by his stepson for the period during which it was rented by his stepson. It could thus be designated as his principal residence for the taxation years during which it was normally inhabited by his stepson, but only if the remaining portion of his residence was not also designated as his principal residence.

In other words, the principal residence exemption could be claimed by the taxpayer in respect of the portion of the residence inhabited by him or the portion

inhabited by his stepson, but not in respect of both. For more details on this topic, refer to section 3 of IT-120R6 and CRA Guide T4037 "Capital Gains".

Amount paid to employee's estate—death benefit or retiring allowance

The CRA was asked whether an amount paid to a former employee's estate after his death was a death benefit or a retiring allowance. The employee had been on long-term disability and was receiving health benefits when he died. In addition, the employee had the right to receive a lump sum as a retiring allowance upon retirement at age 65 in 2013, but such retiring allowance had crystallized since the specific operation where he was employed was permanently closed in 2005. The lump sum was now payable to the employee's estate.

The CRA was of the view that because the employee was on long-term disability and was receiving benefits from the employer-funded health plan, he may still have been considered an employee of the employer. Interpretation Bulletin IT-508R, "Death Benefits", states that "if an employee ceased employment and was entitled to receive a retiring allowance but dies before the payment is made, the subsequent payment of the amount to a beneficiary of the deceased is included in the recipient's income ... as a retiring allowance". However, Interpretation Bulletin IT-337R4, "Retiring Allowances (Consolidated)", provides that if an employee dies while still employed, and the employee was entitled to a retiring allowance upon retirement, the severance pay received by a beneficiary after the death qualifies as the gross amount of a death benefit.

In this case, because the employee remained on long-term disability and had the right to receive a retiring allowance at age 65 but died before reaching that age, the CRA is of the view that the amount received by the estate would be a death benefit. As a consequence, the amount could not be transferred into the beneficiary's RRSP (this would only be a possibility if the amount were considered a retiring allowance).

Deductibility of legal fees

The CRA was asked about the deductibility of legal fees incurred by an individual to take action against a potential loss of salary and/or employment.

The taxpayer was an employee. Certain complaints were made against him, and he retained counsel for advice on how to respond to the allegations made by the employer. The employer proceeded with a disciplinary action, the result of which was that the taxpayer's salary was reduced.

The CRA stated that the tax treatment of legal fees is a question of fact and depends on the facts and circumstances of each situation. The Act states that no deduction may be made in computing a taxpayer's income from an office or employment. However, the Act allows a taxpayer to deduct legal fees incurred to collect or establish a right to an amount owed to the taxpayer that, if received by the taxpayer, would be income from an office or employment.

The CRA stated that, in the present case, the taxpayer's legal fees were not incurred to collect an amount owed to the taxpayer nor to establish a right to salary. It was only after the disciplinary action that the taxpayer lost income. In the CRA's view, the taxpayer had retained counsel to protect his means of livelihood.

Repayment of annual bonus and relocation amount

The CRA was asked whether a taxpayer may deduct an amount where the taxpayer has repaid a relocation payment and/or annual bonus that was previously included in his income.

The taxpayer received a relocation payment and/or annual bonus, and such amount was included in his income in the year received. The taxpayer signed a contract stipulating that he would remain with the employer for a specified period or the relocation/annual bonus must be repaid to the employer. Depending on the amount of time worked, the repayment could be prorated for the number of days worked in the specified period.

The Act states that a taxpayer may deduct from employment income an amount paid by the taxpayer in the year pursuant to an arrangement under which the taxpayer is required to repay an amount if the taxpayer does not perform the employment duties throughout a particular period (i.e., repayment upon early termination). The deduction is available to the extent that:

1. the amount so paid was previously included in the taxpayer's income, and
2. the amount repaid does not exceed the amount received by the taxpayer (i.e., the repayment may be prorated).

The CRA stated that the phrase "the period throughout which the taxpayer did not perform the duties of the office or employment" refers to the critical day or days under a contract or specified time period that the employee must have worked to retain a relocation/bonus payment. Where the taxpayer is required to repay the entire payment because he/she does not work through to the very last day of the contract, then that final day is the critical "period throughout which" he/she did not perform the duties of employment. Where the repayment would be prorated, then the period of the contract not worked is the critical period referred to in the Act.

The CRA stated that, in the present case, the taxpayer did not perform the employment duties on the last day of the contract, and thus the repayment would relate to a period "throughout which" he did not perform the employment duties (i.e., the entire specified period). In this case, the requirements of the Act would be met and the taxpayer would be able to claim a deduction for the relocation/bonus payment.